



TURUN KAUPPAKORKEAKOULU
Turku School of Economics

PAN-EUROPEAN INSTITUTE

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Baltic Rim Economies Expert Articles 2009

Electronic Publications of Pan-European Institute 24/2009

Baltic Rim Economies (BRE) review continues as an up-to-date discussion forum

In 2004, the Pan European Institute (PEI) started to carry out economic monitoring related to the Baltic States and Poland. A few years later, the monitoring was extended to also cover Baltic Russia, namely St. Petersburg, the Leningrad region and the Kaliningrad region.

In addition to the economic analysis, the Baltic Rim Economies (BRE) review includes expert articles, written by leading European politicians, businessmen, academics and other high profile experts. So far, nearly 500 expert columns have been published in the review, in which various high-level experts have expressed their views on the current issues related to the Baltic rim. During the past few years we have had the privilege to receive especially many articles from the members of the European Commission. In the recent issues of the BRE there have been columns of several prime ministers – the trend that will continue also during the year 2010.

Last year, when the Pan European Institute celebrated its 20 year anniversary, all the expert articles published during 2004–2008 were compiled inside one cover. This publication is a continuation of the last year's collection and includes all the expert articles published during the year 2009.

The popularity of the Baltic Rim Economies indicates that there is a real demand for such an up-to-date, virtual discussion forum for people interested in the development of the Baltic Sea Region and its surroundings. In the future, the BRE review aims to broaden its view both geographically and thematically. Belarus will play an increasingly important role in the issues to come. It is fairly appropriate to consider Belarus as a part of the Baltic Sea area since Belarusian rivers flow into the Baltic Sea. With regard to the central themes of the BRE, economy and ecology have always been very important. However, energy has emerged as one of the key issues related to the Baltic Sea area and will maintain its significance in the future issues as well. In addition, innovations will be in focus in 2010.

The Baltic Sea has a long history of connecting people around its shores. Today, not least because the region is facing serious challenges demanding a common approach, the Baltic Sea Region can still unite countries and people throughout the region. I wish this publication will do its share in addressing central issues and enhancing cooperation in the region.

Kari Liuhto

Editor-in-Chief, responsible for expert articles

Baltic Rim Economies (BRE) review

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Belarus is open for co-operation

By Sergei Sidorski

The Republic of Belarus is a country populated by 9.8 million, occupying a territory of 207.6 thousand, which places it at No. 13 in Europe, and located in central Europe, geographically.

The first decade of the 21st century became a period of transition to a market-oriented economy for the Republic of Belarus. This is now a multisectoral economy, with necessary legislation put in place to help it develop and market infrastructure being currently finalized. There have been improvements made to the structure of production and consumption, large-scale projects launched both in industry, agriculture and in health care, education, housing construction and landscaping.

Over the period, Belarus economy would post an invariably robust rate of development which allowed it, as estimated by the UN (Report of 2009), to qualify into the group of countries with high level of development and run under No. 68 in the Human Development Index, ahead of all CIS countries (Russia – 71, Kazakhstan – 82, Ukraine – 85). The Gross Domestic Product per capita in 2008 was \$ 5.9 thousand.

Pivotal to Belarusian economy are large industrial enterprises accounting for 27-28 per cent of the national GDP. Belarus specializes in the production of machinery, chemical and petrochemical industries, wood processing. The light industry and production of building materials are actively developing. Currently, 90 per cent of the goods exported by Belarus come from the industrial production.

Traditionally, there is a **special focus** in the country on the **agricultural complex**. The agriculture of Belarus encompasses 8.8 million hectares of cultivated lands, of which 5.5 million hectares arable. The country produces largely more major types of agricultural produce per capita (other than grain) than CIS countries and twice as much milk as the US and countries of Western Europe.

The significant potential of the country, exceeding its domestic needs, makes **foreign trade** an overarching priority. Today, we trade with over 170 countries, the world over. Since 2000, our exports of commodities and services have been 4.5 times up to reach \$ 32.9 bn. in 2008.

Key foreign trade partners of the country include Russia and the European Union member states. In 2008, the EU secured No. 1 position in terms of imports from Belarus (43.9 per cent of the total volume). There is successful co-operation with the Baltic countries under way, posting an aggregate turnover close to \$ 11 bn. (excl. trade with the Russian Federation) which is 15 per cent of the total Belarusian foreign trade. Among major trade partners of Belarus in the region are Germany, Poland, Latvia and Lithuania.

The country steps up consistent measures to diversify its export supplies, with new markets and areas explored and tapped in a most active manner. Even though the Russian Federation and the EU remain to be the largest consumers of Belarus commodities, supplies to Asia and South America have recorded a dramatic increase.

In 2009, the country was faced up with the effects of the global financial and economic crunch. Its negative repercussions for Belarusian economy implied, in the first place, shrinking foreign demand leading to the falling volume of exports and production in the exporting enterprises.

However, thanks to the timely crises management measures that were worked out and have been implementing by the Government of Belarus the macroeconomic stability in

the country has been preserved, the landslide of production in the key spheres of economy has been evaded. The crises management program of the Government of Belarus includes several aspects. Among them are economic environment liberalization; support of real sector enterprises, exporters in the first place; budgetary expenditures optimization; promotion of domestic demand; improvement of the financial system stability, narrowing of the external trade deficit.

As a result in January-October 2009 the national GDP amounted to 99 per cent (against the same period of 2008), industrial production output – 95.5 per cent, whereas in all Belarus' neighboring states, except Poland, considerable GDP falldown is in evidence. Thus, in six month of 2009 such downfall made up 10.5 percent in Russia (against the same period of 2008), in Ukraine – 19 per cent, Lithuania – 16 per cent, Latvia – 18 per cent, in the EU as a whole – 4.8 per cent.

The social stability is being preserved in Belarus. In January-September 2009 the population's real income level rose by 2.8 per cent. Full-scale financing of all social programs is carried out; pensions and social allowances are being paid in time. The rate of unemployment in the country does not exceed the pre-crises figures, and at the year-end will not surpass 1-1.5 per cent.

One of the main interests of the state is to create favorable investment climate and ensure protection of investors' interests. To reach this goal a lot has been done on reduction of administrative barriers, liberalization of price formation, customs regulation, reform of property relations. During the last five years the flows of foreign investments to the country have increased 7.5 times, direct ones – 4.4 times. More than 4.2 thousands of organizations with foreign capital from almost 100 countries work in Belarus. Among our main partners are Russia, China, Germany, Austria, the Middle East and Latin America countries.

International organizations (World Bank, Heritage Foundation, IFC and UNCTAD) have registered the improvement of business environment in our country. According to "Doing Business" in 2009 we moved to 58th place (27 positions in one year).

A "B+" sovereign credit rate given to Belarus in 2007 and confirmed this year proves the advantages of cooperation with our country.

Due to our favorable geographical location one of the perspective directions for attraction of foreign investments is the development of transport infrastructure and logistics. A strategic interest for the Baltic region countries represent creation of transit system and logistical services for dynamically developing flow of goods going through the territory of Belarus.

Interaction in the field of energy is also an important direction of development in the region. Belarus actively cooperates there with Lithuania, Latvia and Poland.

Even in the context of global economic crisis Belarus has always been a reliable and stable partner, open for mutually beneficial cooperation.

Sergei Sidorski

Prime Minister

Republic of Belarus

A Latvian view on regional security challenges

By Imants Lieģis

The Baltic Sea regional security challenges need to be viewed in general through the prism of differing security actors. For the purpose of this article I would define them as being three – NATO, the EU and Russia. The latter actor is a member of neither NATO or the EU, but in considering regional security, both these organisations' relations with Latvia's important neighbour have a crucial impact on regional security.

Latvia sees security and defence being provided primarily through NATO. The 1949 Washington Treaty security and defence guarantees from which we have benefited during the last five and a half years of membership are fundamental. Never in the history of the nation has Latvia been so secure since joining NATO. The Atlantic Alliance, which ensures the presence of the USA in Europe, has celebrated 60 years of being the most successful military Alliance ever. The best description of NATO was given by its first Secretary General, Lord Ismay, who stated that NATO was there to keep the Americans in, the Russians out and the Germans down.

Although in many ways this was a Cold War description, I cannot agree with another version of the same quote that was doing the rounds of the conference circuits. Namely today, NATO is kicking the Americans out, bringing the Russians in and the lifting the Germans up. At a time when the primary attention of the new US administration is being directed towards other parts of the globe (China and India) and Europe appears to be slipping off the main agenda, the regional challenge in the Baltic area and beyond still relates to "keeping the Americans in". NATO is the main player which must continue to ensure this US presence.

The European Union remains an important actor in the field of defence and security, but cannot replace NATO as our security provider. The recent ratification of the Lisbon Treaty is welcome in the context of defence and security. But it needs to be acknowledged that the defence commitments in the Treaty are more of a political nature and cannot be viewed as a substitute to the military commitments of NATO.

Even after over 5 years within NATO, we still see the need for reassurances. This is one of the main challenges for us as NATO prepares its new Strategic Concept. For the first time we are able to give a direct input to the process of preparing the new strategy. A former Latvian Ambassador to Washington and NATO, Aivis Ronis, has been appointed as Estonia's Lithuania's and Latvia's joint representative on the panel headed by Madeleine Albright to prepare recommendations for the new Strategic Concept.

Why do we see the need for reassurances? The regional security situation has changed since we joined NATO. Cyber attacks have appeared on the agenda. Our neighbour,

Russia, militarily attacked another of its neighbours, Georgia in August 2008. This changed the security situation in Europe given that this was the first invasion of a sovereign country since the downfall of the Soviet Union. One of the reasons Russia for this action was that it was necessary to defend Russian nationals in Georgia. Since then, Russia has approved in law the right to take such military actions abroad to defend its nationals. In addition, most of the Baltic regional countries were aware of the large scale exercises ("Ladoga" and "Zapad") conducted by Russia and Belarus, together and separately, during August and September 2009. One of the scenarios used was an attack on NATO member states so as to isolate Estonia, Latvia and Lithuania from the Alliance. There was even talk of a nuclear weapon being used against Poland. Regrettably, Russia still seems to regard NATO as an enemy despite the fact that enlargement of the Alliance has provided greater stability to this part of Russia's border.

In awaiting reassurances from NATO's new strategic concept, we in turn will continue to show that we are responsible members. Despite considerable financial restraints on Latvia's defence budget (in 2010 we will have just less than 50% funding than in 2008), I have ensured that our ongoing engagement in the NATO operation in Afghanistan remains our top priority. We will retain our current troop level – 175 soldiers – which has indeed been increased by some 10 soldiers during the course of the year. We are privileged to be part of the Norwegian led PRT in the North of Afghanistan, whilst engaging in the OMLT with our US partners in the more dangerous Eastern border region with Pakistan. Even as the new approach towards this operation (in which all the Baltic regional EU and NATO members are engaged) emerges following President Obama's announcement, we are grateful to our partners for their understanding about the limits of our future participation.

I feel confident that after five years of membership in NATO and the EU for Latvia and our two Baltic neighbours, regional security and stability has improved beyond what we imagined in 1991, when we regained our freedom.

Imants Lieģis

Minister of Defence

Latvia



Us and them

By Päivi Lipponen

Russian democracy is built around a very centralised state combine with a strong sense of national identity

Nikolai Gogol neatly depicts the scene of the 19th century tsarist Russia in his play "The Inspector". Moscow sends an official on inspection duty to a small town. So the local mayor frantically tries to put things in order. Before the arrival of the Inspector hospital patients are sent home, so that the quality of care can not be doubted. Graft is prohibited. The judge reassures the mayor that no one will be able to make any sense of legal decisions handed down by the court. And the mayor suggests that when explaining why the church has not been built to blame it on the fire, even though the money was awarded five years ago for that purpose. Furthermore, the mayor instructs the postmaster to open all outgoing letters so as to stifle any complaints to Moscow. The postmaster gleefully replies that he does just that all the time, being of a naturally curious disposition."

When the satire first appeared it aroused the ire of Russian officialdom. It was not permitted to blaspheme Holy Russia. Gogol had to go into voluntary exile. Back in the 19th century, there was no political opposition to the tsar and his government officials. At that time, writers were very much the conscience of the nation. Only they as members of the intelligentsia, had the courage to speak out and lament the lack of political rights under the regime.

How much has changed in Russia from those days?

Russia has never been a democracy as we understand it in the West. Russian power structures have evolved and been developed down through the centuries. The Chronicle of Nestor records that in 862 Rurik was called on to rule over the Slavs. At the same time in Europe the Frankish Empire was being divided up and the Vikings were trading in the Gulf coast.

Not everything has to be accepted, but we Europeans must learn not to focus on deficiencies in Russia. The debate on Russia is dominated by a one-sided perspective - how we wish Russia to develop. Nord Stream's pipeline project is a case in point. There are similar tubes passing through the seabed, but this pipeline is said to increase insecurity and environmental risks. Some seemed to have invented a tube, which has only one end.

Europeans should have a keener desire and ability to understand Russia. Only then can we build equal interaction.

The Russian saying that "the sun is in the high sky and the Czar is far away" means that central power has always been strong. By extension local administration has always been underdeveloped. The central power has been autocratic and the relationship to the citizen has been very authoritarian. When political decision-making, tax levies and revenues and the economy are concentrated in Moscow, people's everyday survival has been built around local networks and community-based resources. When there is no civil society,

there can be no political party system. Anna-Leena Lauren asks why the Russians would want to experience solidarity with the community when there is no solidarity with them. Modernization becomes possible when citizens feel that compliance with laws benefits them.

Russia is a very multinational state. It combines the strong national identity, which is based on the belief that Russia is a great power and it has developed its distinctiveness through historical and cultural development. Greater Russia is unique, that is the message taught to schoolchildren.

This deep sense of patriotism is to a large extent born out of a feeling of being threatened. Russia feels that the country has been under attack throughout its history, from the East and West. Russia perceives itself as a peacemaker. Its expansions have been assistance to neighbours and civilization exports. From this point of view: Russia has sacrificed a lot for Europe, when they rescued it from fascism. How has this achievement been rewarded, the Russians ask.

Admittedly, the Soviet Union broke up without a military conflict. Russia has allowed the old enemy to expand into its former sphere of dominance.

The Kremlin views the West's concerns over the degree of democracy in Russia as something a kin to crocodile tears. It feels that export of democracy is just an excuse for Western powers to interfere in other countries' internal affairs and undermine the state. Russia has created its own version of democracy. To the Russians, Europe does not seem to have much to offer to them.

The political elite want to make Russia a superpower again, they want a Russia that is to be ready to do great things again. This status can be achieved only if the state is centralized and strong enough. All that threatens this goal must be removed. Citizens on the other hand value stability. They want to get their pensions and salaries on time. Above all, they want to be proud of their country and be able to have trust in the future. President Dmitry Medvedev has a vision for the future: Russia must diversify its natural resource based economy, develop its political decision making and reform the judiciary. These changes are necessary for modernization.

Europe should seek partnership with Russia. It may not be wishful thinking that through closer cooperation Europe can influence Russia. Russia must in any case adapt to the international community rules, but Russia can not be changed by Western orders.

Päivi Lipponen

Ph.D., Member of Parliament

Finland



Place and role of the Russian-Finnish economic cooperation in the Baltic Sea Region

By Valery Shlyamin

The Global financial-economic crisis which has only started to diminish particularly vividly depicted the new role of Governments, revealed the importance and significance of strategic approach and elaboration of economic development strategies on the state level. The crisis painfully affected national economies of all the Baltic Sea region states including Russia and Finland and displayed high level of economic integration.

It's known that Finland is one of the major trade partners of the Russian Federation. In 2009 the crisis has quite adversely affected the volume of bilateral trade (diagram 1). Trade turnover dropped to almost 50%. The crisis clearly indicated the bottle neck in the structure of trade – predomination of raw material trend in the Russian export (diagram 2).

We estimate the overall loss of jobs as the result of trade downfall in 2008-2009 at the level of 25 thousand jobs in Russia and 16 thousand jobs in Finland. The estimation is based on the prevalent trade patterns and branch labour productivity data in both countries. Supposedly in current conditions in order to reinforce the competitive advantages of Russia and Finland it's important to search for the new common grounds and strategic guides mainly in the business sphere.

Within all the diversity of our interaction fields the most distinct perspective is seen for the joint initiatives in the spheres of energy and environmental technologies, forestry, transport and logistics fields, high-tech branches, productive cooperation in manufacturing high added value goods including electronics, communication facilities, food production for both - domestic markets and joint entry to third countries markets.

The Baltic Sea region located in the periphery of the European economic centre is highly dependant on external goods and services trade which reinforces the significance of transport infrastructure as the factor of economic growth. Forming the eastern border of the European Union and the Baltic Sea region Finland plays a unique role in creating the trade and economic bridge between Europe and Russia and in perspective in between Europe and Asia. In the recent years transition of goods strongly contributed to the development of the countries' transport and logistics and strengthened the Russian-Finnish trade ties.

Start of the Northern Dimension Partnership on transport and logistics will become an efficient tool of infrastructure projects coordination with a purpose of transport connections development in the Baltic Sea region and increasing the region competitiveness in the world trade markets as well as the region potential as the EU gate to Asia.

The first internal EU strategy on the Baltic Sea region forms an important step representing the new approach to cooperation within EU and shall undoubtedly become a significant factor of the Baltic Sea region activities coordination. Within the Baltic strategy the Northern Dimension policy should become a substantial basis for strengthening the cooperation with Russia but at the same

time we find it vital to refer to the existing experience of joining the strategic interests of member-states in particular Russia and Finland. The Finnish action plan on Russia, cross-border cooperation strategy between Finland and Russia as well as the regional programmes on cross-border cooperation are all of special notice. We strongly believe that economic cooperation in the Baltic Sea region should be carried out in particular on the regional level. In this context it's important to learn to see and consider each others interests. That is why cross-border cooperation is assigned its unique role. Implementation of 5 cross-border cooperation (ENPI CBC) programmes between the border regions of the European Union and Russia with the overall financing of 437 mln. Euro including 103 mln. Euro of Russian co-financing will be a substantial implement of the designated initiatives. In this respect it's extremely important to carefully approach the process of mutually beneficial projects selection and propose the most deserving ones reflecting the interests of SME as a whole and particularly innovation-oriented.

The "Euro Russia" Forum revived as the joint project in 2009 with an active support from our Trade Representation fully meets the expectations and modern challenges and may be considered as an example of the successful project-backing of the Russian and Finnish national strategies. The main idea which forms the basis of the "Euro Russia" Forum is the eagerness of the Russian and Finnish executive authorities to support the building of mutually beneficial trans-border entrepreneurship network with a focus on SME, technological processing production of goods and services. This entirely complies with the Russian strategic goal – creation of competitive production and effective integration into the world economy; as well as Finland's goal to use the natural advantages of neighborhood with Russia. We suppose that involvement of business-partners from other Baltic Sea region countries would be quite natural.

Development of the productive cooperation between Russian and Finnish enterprises as well as interested companies from the Baltic Sea region is what we consider to be the most substantial reserve of the foreign trade growth.

The major goal of the external economic links between Russia, Finland and the Baltic Sea region states is setting up the strategic partnership on the basis of scientific, technological, industrial, transport and energy cooperation with a purpose of creating the common economic space. This forms the basic key for increasing the competitiveness of both Russia and the whole Baltic Sea region.

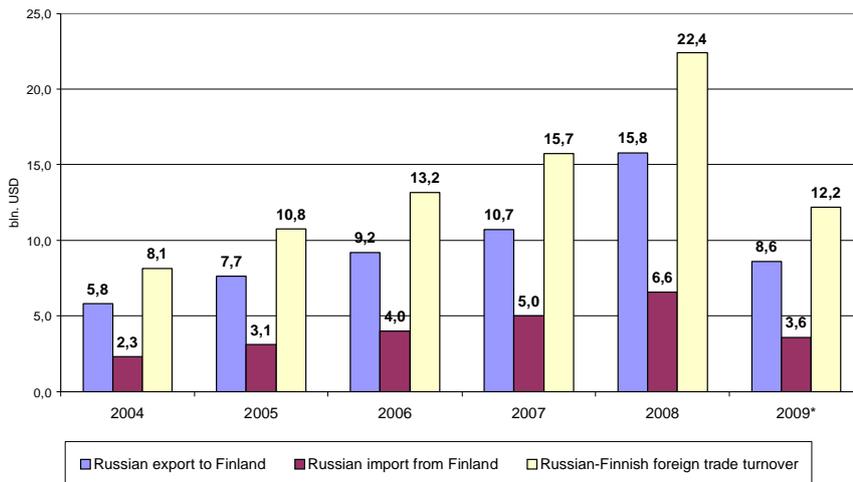
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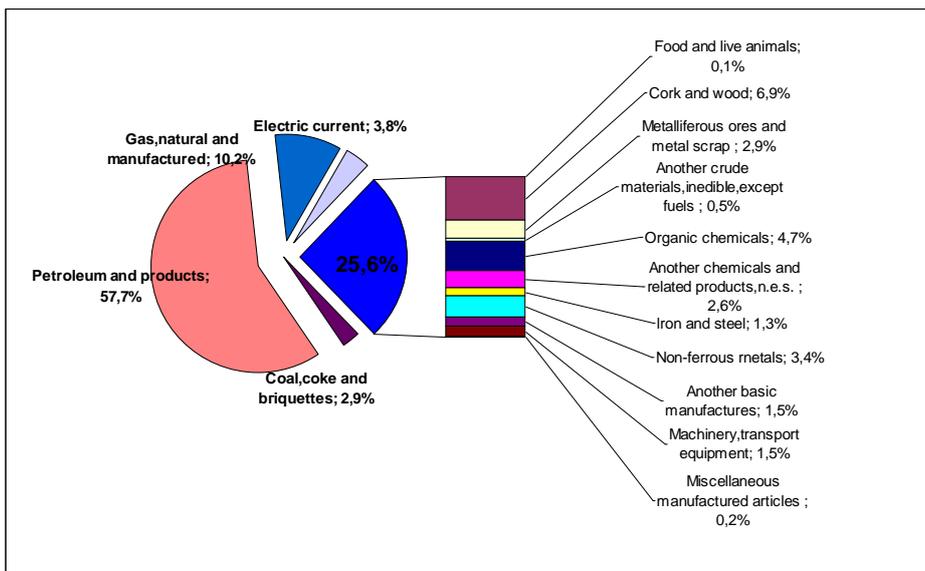
Russia

Russian-Finnish Foreign Trade in 2004-2009



Source: Federal customs service of Russia; * - estimated

Structure of Russian Export to Finland in 2008



Participation of NGOs in the Baltic Sea area cooperation

By Merja Hannus

The Baltic Sea area has favourable possibilities to develop a new kind of unprejudiced multi-faceted interaction and network between citizens and cultures. The high level of economic development of the area, as well as efficient telecommunication and traffic networks further the creation of a good basis for the growing interest of citizens towards cultures of nearby regions. Promotion of a freer mobility of people, so that also Russia would take a close part in this network, would be in the interest of all Baltic Sea area states.

Many non-governmental actors and NGOs have already for a long time been active in the Saint Petersburg area and they would like to cooperate more closely in the Baltic Sea area. They already took part in the establishment of the Baltic Sea network of NGOs in the year 2000 in Copenhagen. From there began the process, which received its form and content in the Baltic Sea NGO Forum established at the Forum of NGOs of the Baltic Sea countries, organized in Turku in 2003. Some 400 NGO actors decided to establish the Baltic Sea NGO Forum. This Forum has convened annually in the chairman country of the Council of Baltic Sea states, the most recent one took place last year in Latvia. Focal points act in each country as contact link between NGOs. The address of this site is www.bsngoforum.org. On these sites there is information about the annual forums and about the documents, pertaining to them.

The agenda of the Forums includes information on the worries of citizens of the area and on the other hand also on the opinions, concerning the development of cooperation. An issue, which has especially been under discussion, concerns the possibilities of NGOs to act, free crossing of borders by citizens, human trafficking and social inequality, as well as elimination of the same. Issues dealing with the condition of the Baltic Sea and protection of the same have been on the agenda of every yearly Forum. Special attention has been paid to environmental education and the means, by which the sense of responsibility of all people for the future of the Baltic Sea can be awakened.

The interest shown by NGOs towards the Baltic Sea area cooperation was in the beginning of the 21st century greater than at the present time. There are probably many reasons, which explain why this is so and the economic factors are not the most insignificant among them. Public support rendered to NGOs is not very well developed in the Baltic states, Poland and Russia. Between the Nordic countries and even with the Baltic states there are many contacts on the level of citizens, but the more extensive contacts with Russia have mostly to rely on Finland. The other Nordic countries do certainly carry on some cooperation with Russia, especially in the Saint Petersburg area, but not to the same extent as the Finnish organizations. The very poor relations as to cooperation between the Baltic states and Russia influence also the cooperation and activities of the NGOs.

The strong side of the Finnish actors in this field is the implementation of many concrete projects. Many NGOs in

the Karelian Republic, Saint Petersburg and the Leningrad area have as to cooperation good relations with Finnish organizations. The appropriation granted by the Finnish Ministry of Foreign Affairs to NGOs for cooperation with nearby regions of Russia has helped to develop joint projects and undertakings. This sum is not so big, but it has made it possible to carry on cooperation on the grass root level, as well as implementation of many development projects between the regions of Finland and Russia bordering with the Baltic Sea area. The Kaliningrad and Pskov areas have aroused less interest in Finland.

The Nordic Council of Ministers has also to some extent supported the development of the networks of NGOs and their project activities. The Baltic Sea NGO Forums have mainly relied on financing by the Council of Ministers and also on that of the Foreign Ministries of the host countries. Each year this financing has however been the result of lengthy discussions and complex project applications. The uncertainty as to financing has without doubt tired many organizations, and this has probably been one of the reasons for the slight decrease in the readiness to carry on cooperation. Finland would now have good possibilities to further the development of the Baltic Sea area cooperation at citizens' level by allocating to this cooperation more permanent resources.

Finland will in 2011 be chairman of the Nordic Council of Ministers and could then especially set as its goal to create closer contacts between the civil societies of the Nordic countries and Russia by way of encouraging and supporting networking between NGOs. The Finland-Russia-Society has a vast experience in the development of cooperation with Russian NGOs and this experience could now be made use of. Interest towards this issue is for sure to be found among the NGOs and actors of Northwest Russia. It would be great, if this kind of a meeting could be held in the only real metropolis of the Baltic Sea area i.e. Saint Petersburg.

The Baltic Sea, its future and strengthening of contacts between cultures and citizens would be natural issues for discussion at an NGO meeting. The special issues, concerning cooperation in the North, could also be brought up. The most important issue for consideration is however, how to promote the operating possibilities of NGOs and in what way these organizations could contribute in the best possible way to the materialization of well-being and a closer interaction between people in the area.

Merja Hannus

Secretary-general

Finland-Russia-Society

Finland



Riga nowadays

By Nils Ušakovs

Riga has always been the city with strong development potential and today it still remains the engine for the national economic growth, being also one of the most significant players in the Baltic Sea Region that has been recognised as one of the most attractive areas of the world for business. Nowadays development of the transport sector and large public infrastructure projects, as well as attraction of investment and strengthening the relationship between the West-East and the North - South have been set forward as the key priorities of the Riga City.

Riga is the centre of a well-developed transportation and communications infrastructure that includes railways, roads, pipelines, port facility and the airport, all of them having a great capacity for further growth and development.

Today the city fulfils the function of the transportation hub supporting the link between the Eastern and European markets.

The Baltic Sea has always been the source of prosperity and well-being. Since its foundation Riga has grown and developed together with its port. The advantages of Riga over the neighbouring ports in terms of distance provide the most favourable conditions for the development of economic relations.

Thanks to the developed motor-road and railway network, the Riga Port is directly linked to the main consumption centres and extraction-processing regions of Russia and the Commonwealth of Independent States (CIS). Presently up to 80% of the cargoes handled at the Riga Port are transit cargoes to Russia and the CIS states.

In 2008 the cargo turnover at the Riga Port has reached more than 29 thousand tons and the further increase of cargo turnover at the Riga Port plays enormous importance for the city economic development. Fulfilment of the Riga Northern Transport Corridor project will additionally provide possibility to connect the Riga Port to the road network of European significance and increase the competitiveness of the East-West transport corridor in Latvia.

Riga has the largest international aviation company in the Baltics and the main air traffic centre in the region - the Riga International Airport that renders both- aviation and non-aviation services, attending national, as well as international

airlines. It is one of the few European airports that services full - service and low costs airlines simultaneously. In 2008 RIGA International Airport attended 3.6 million passengers, which is 16.8 percent more than in 2007. In the first six months of 2009 the number of passengers welcomed at Riga International Airport has grown by approximately 10 per cent year on year. This year the Riga International Airport has been awarded the prestigious RoutesandOAG Airport Marketing Award in Europe as the best airport in Scandinavia. This prestigious award serves as a proof for the successful development of the relationship with airline partners.

Accessibility of the city has enhanced its attractiveness for being a place to meet and share viewpoints, to feel the atmosphere of personal freedom and global thinking.

In recent years the city has been the host in a wide range of different significant international events.

In 2006 Riga welcomed two events of a global significance - the NATO summit and the World Ice Hockey Championship 2006, having proved itself as a reliable organiser and excellent provider of facilities.

The city has also a rich cultural life and it is abundant with social events. In 2014 Riga will be nominated the European capital of culture.

In 2010 it is scheduled to host the Mayors` meeting of the European Union, CIS and other partner cities. This event will contribute to raising awareness that cities have the key role in economic development in local, regional, as well as global context, as they are the centres that attract investment and develop partnership among public, private and academic sectors.

Nils Ušakovs

Chairman

Riga City Council

Latvia



Not the western or eastern, but the Baltic Sea

By Edgar Savisaar

Media creates, maintains, represents and strengthens the identity of today's countries in the world. For example, we could take the American CNN, the British BBC World, the Chinese CCTV9, the Russian Russia Today, the French France24, or even the Arabic al-Jazeera. The integration of the Baltic Sea countries will remain a dream written down on a piece of paper, until we promote the region's identity continuously, every day, every hour and every minute, through its very own media channel.

The European Union Baltic Sea Strategy, approved by the European Council, gives a considerable amount of attention to the subject of energy security and the energy isolation of Estonia and some other countries. The importance of creating physical access to the electricity market is emphasised and the environmental protection aspects of the energy sector are also mentioned – in relation to transporting liquefied gas by sea... However, the strategy doesn't even mention the largest Baltic Sea project in process – a gas pipe linking Russia and Germany. Although the strategy does list dozens of other infrastructures, which will be built in the Baltic Sea region, the effect (financially, economically and especially politically) of even the largest of them, the 19-kilometre Fehmarn Belt bridge, connecting Denmark and Germany, is not even comparable to the 1,200 kilometre Nord Stream project.

Today, we find ourselves in a situation where a project that brings together the eastern corner and western edge of the Baltic Sea will at the same time separate its northern and southern shores. This doesn't have to be so, and the establishment of a shared information space would serve as a tool in aiding to resolve this and the many other problems that keep the people of the Baltic Sea region separate.

It's quite obvious that without a common information space we cannot count on the implementation of the other policies that are planned in the strategy, as all of these assume the commitment of politicians to the established goals – both today and in the future. Politicians, however, will need the support of their people for that in democratic societies. The media channels that currently operate are unable, strictly within a national perspective, to create and explain our common agenda to the Baltic Sea nations.

The public of Estonia, Latvia, Lithuania and Poland was and largely still is against the gas pipeline, while the Nordic countries have favoured it. This is attributable to the fact that the media of the opponents emphasised the risks while the enthusiasts focused on the opportunities. The Nord Stream case is a good example of the fact that we do need a common information channel, especially concerning projects that extend to the Baltic Sea region as a whole. The presence of a common information channel would definitely have given a rational overview to the Baltic Sea countries of the rather controversial subject of the gas pipeline. And, of course, politicians would then have been able to discuss the largest Baltic Sea project within the context of the most important political framework documents of the region.

Compared to the so-called hard investment projects (roads, harbours, bridges – the amount earmarked for such undertakings exceeds 20 billion EUR), which are dominant in the strategy among the projects that are being launched to increase the economic growth and attractiveness of the Baltic Sea region, the expenses related to the creation of a common media channel would be negligible, while the influence of such a channel to the real integration and competitiveness of the whole region would be incomparably bigger than any bridge, tunnel, or railway could ever be. If we

were to add cross-border public and private sector e-services to the central media output, the channel's interconnecting effect on the region could only be comparable to the adoption of the common currency.

Considering the audience number, the Nordic countries clearly have one of the strongest public broadcasting systems in the world and TV channels that receive considerable funding from the state also exist in all the three Baltic states. In the Nordic countries, private multinational media groups control the media market of the whole region. And still one could count on one hand the number of media outlets with newsrooms that regularly share content between countries, them being the BNS news agency (Baltic News Service belongs to Finnish Kauppalehti group of Alma Media) and the Estonian online media portal Delfi, both of which operate in the three Baltic states, and the Baltic Times weekly newspaper; and that's the lot, at least on the eastern shore of the sea. The Nordic countries don't even have that much to their name. Currently, there is no media channel that has a significant number of readers/listeners/audience and which focuses in the Baltic Sea region as a whole.

For such a channel, the working language would be an important issue to be considered. And for more and more people around the sea, the only reasonable answer would be – the English language. Since EU enlargement, the largest multinational companies have given up the *nordiska*, which was only convenient for one party, and have switched over to the English language for running the media groups that cover the whole region – both for practical and strategic purposes. It's time to take the language exchange that has already taken place on the level of the elite to mass media.

However, all the countries that would participate in the project (as much as eleven) would certainly be able to have a voice-over option in their national language, as is the case with the Euronews. For the external promotion of the region there could, aside from French and Spanish, be provision also for other global language options such as Japanese, Chinese and Arabic (subtitles).

Preceding the exchange and sharing of media content and a number of joint media ventures between the countries, in both public and private media, would considerably contribute to the establishment of an international public broadcasting team. Most certainly, the exchange of such programmes should be subsidised by the governments and the European Union. Apart from focusing the audience, this would also bring media teams closer to each other, which is inevitable in launching a channel that covers the whole region.

Estonia is the only country in the world that calls the sea the "Western Sea" (*Läänemeri*) in official documents. Our Finno-Ugrian friends, the Finns, translate it as the "Eastern Sea", (*Itämeri*), translated from *Ostsee*, as the sea is called in the Swedish, Danish and German languages. For Hungarians, it's the Baltic Sea, and this is also how the Latvians, Lithuanians and the Polish, living south of us, call it. For centuries, it has been known to the rest of the world as the Baltic Sea, including the two major working languages of the EU, English and French.

For further real progress with the Baltic Sea region, we need to agree upon a common name for the region. There could be no serious discussion of external marketing if the region is without a single name. To say nothing of the odd situation in which one country would be using the "Western Channel" logo in the upper corner of the screen, another the "Eastern Channel" and the majority – "the Baltic Channel". Estonia could make a short, yet important step for the identity

of the Baltic Sea and start using the name “Baltic Sea” again – as the sea was officially known during the first decade of the existence of the country after 1918. As the Baltic Sea region develops, the Nordic countries, which use the English language for the purposes of international communication, will sooner or later accept the fact that a name that is familiar to the whole world would be used to describe the sea that we all are sharing (maybe getting some inspiration from Estonia, too!).

Finally, I have the pleasure of recognising that the issue of the common identity of the region hasn't been fully ignored in the Baltic Sea Strategy documents. Although it has been stated in the security package that the uniformity and identity of the region comes from the Baltic Sea itself, the chapter on economics, and in particular the section on tourism development, also refers to the need to create such an

identity. The development of regional Baltic Sea identity has been named as the last – hopefully not the least – activity in the list of horizontal actions of the action plan for the implementation of the strategy – and a shared history book and joint hosting of some bigger sports event would contribute considerably to accomplishing this objective.

Yes, this is too little and too late – but better this than nothing. This reference will help to make the Baltic Sea region a green, wealthy and safe place.

Edgar Savisaar

Mayor of Tallinn

Estonia



From Saimaa to continental Europe

By Seppo Miettinen

The City of Lappeenranta in South Karelia, Southeast Finland, is located on the southern shore of Lake Saimaa, the fifth largest lake in Europe. Connection to the Baltic Sea was established in 1856 with the completion of the Saimaa Canal.

Due to its location near the Finno-Russian border, Lappeenranta quite literally serves as a gateway between the EU and Russia. In addition to three border-crossing points (Nuijamaa, Vainikkala, and the Saimaa Canal), the city has an international airport.

The border region has endured several years of war and oppression over the decades. Today, Lappeenranta's location greatly benefits not only the business sector but also education and culture. The fall of the Soviet Union and the subsequent development of Russia have provided the area with completely new opportunities. For instance, nearly 700,000 Russian tourists visited Lappeenranta last year and the total of tax free purchases made in the city is only second to Helsinki.

During Viking times, trade routes extended from Karelia to Novgorod and all the way to Constantinople via the Russian river system. Nowadays Lappeenranta is a hub for road, railway, and water transport between Finland and Russia. Excellent and regular connections ensure quick access to the rest of Finland and the world. Making a day trip to Brussels is just as convenient and easy as travelling more locally.

Good connections have throughout the ages been considered vital to the success of our region. In the Middle Ages, Lappeenranta gained prominence as a centre of the tar trade, and also offered thriving markets for fur and food merchants. Although located far from Vyborg and St. Petersburg, Lappeenranta was never left behind in development in the times before the Second World War.

Maintaining excellent connections to the coastal towns and cities in the Baltic Sea region is vital for Lappeenranta's future. Via Vyborg and St. Petersburg, Lappeenranta has a direct access to Germany and the Netherlands and other centres of commerce in the coastal Europe. In the past, these same channels served to spread cultural influences and knowledge of the newest inventions and world's events to Lappeenranta.

Although the distance between Lappeenranta and Vyborg is only 50 kilometres, land and river connections were considered inadequate. The possibilities for constructing a canal between Lake Saimaa and the Baltic Sea were mulled over as early as the 16th and 17th centuries, mainly to ease transportation of wood and timber. The new waterway, the Saimaa Canal, finally became a reality in 1856.

The Saimaa Canal has from the outset been vital to the travel industry as well as to transportation and trade. With its automated lock gates, the Canal is quite an exotic route in the middle of the unspoiled lake environment, which explains the popularity of visa-free cruises between Lappeenranta and Vyborg.

The Second World War brought radical changes to Lappeenranta. Before the war, Vyborg was the second largest city in Finland. As a highly significant centre of international trade, the city was a multicultural and multilingual community.

The City of Lappeenranta continues to cherish the heritage of Vyborg. In the modern, constantly changing world that values networking above all else, Karelians' famed social skills and innovativeness are precious assets.

In the years preceding the war, Vyborg had no university. In Lappeenranta, the Institute of Technology (now the Lappeenranta University of Technology) was founded in 1969. The strengths of our university include a focus on internationality in general and knowledge of Russian trade and culture in particular, innovation cooperation, and active participation in national university networks.

Today, Lappeenranta is an international university city and the most significant centre of Russian operations that works actively towards creating connections between the European Union and Russia. We have great hopes for the Finnish-Russian Innovation University, which is being developed by the Lappeenranta University of Technology together with other Finnish and Russian universities. The objective is to establish a top-level educational and research cooperation network in the fields of economics, technology, and design.

Lappeenranta is equally close to Helsinki and to St. Petersburg. This means that a total of eight million people live within a two hundred-kilometre radius of our city. If we can find new ways to encourage travel to Lappeenranta, tourism could become an extremely successful trade in the region.

Every year, more foreign tourists visit Lappeenranta than any other city in Finland except Helsinki. Opened in autumn 2009, the new flight connection from Lappeenranta to Europe via Riga attracts not only business travellers but also researchers and adventurous tourists to our city.

The Saimaa region is an exotic destination for people living in continental Europe. The lake is not enough on its own, however, which is why we are constantly adding to the range of services on offer.

Our objective is to enhance the attractiveness of the Saimaa region by introducing new amenities such as spa resorts. We are also developing Energiamaa, a new energy production-themed adventure and science centre. The centre is being developed in cooperation with the Lappeenranta University of Technology and will be an ideal destination for the families and people of all ages.

Connections with Vyborg and St. Petersburg, which were severed during the Second World War, have been revived in recent decades. Together with its old partners, Lappeenranta is still part of the network of towns and cities in the Baltic region. This is reflected in the expertise of our university. The Northern Dimension Research Centre, NORDI, for example, which is part of the Lappeenranta University of Technology, specializes in technological and economic questions relating to Russia and the Baltic region. Typical of its home region, the institute's special fields of expertise include economics, business operations, innovations, energy, and logistics.

Seppo Miettinen

Mayor of Lappeenranta

Finland



Gotland – pearl of the Baltic!

By Eva Nypelius

Gotland is the Baltic region's most creative and magical place, characterised by nearness, sustainable growth and love of life.

This is the vision for Gotland, located in the middle of the Baltic Sea and Sweden's largest island, with over 57,000 inhabitants. We are just as close to the Baltic coast as we are to the Swedish mainland. 80 million people live within a radius of an hour's flight. Gotland's vision guides and drives our work to achieve the region's objectives for 2025:

- To grow to 65,000 inhabitants on Gotland
- Local prosperity will be among the best in the country
- Gotland will be the natural meeting place in the Baltic region
- The local population will be in good health and be the most contented in the country
- Gotland will be a world-leading island region on environmental and climate issues

These are lofty ambitions, but I have every confidence that we can achieve them by working strategically. Gotland is a dynamic place to live and work – all year round! All sorts of positive things are happening on Gotland right now: the population is growing, we are riding out the recession well with low unemployment, the island's business community is confident about the future, house building remains strong and many people are showing an interest in Gotland and the opportunities it offers.

As I mentioned, Gotland has come through the recession extremely well. This is due in large part to the fact that we have many small businesses with just a few employees. Small businesses are often more flexible and able, for a period, to adapt production to survive temporary dips. Gotland has a greater density of companies than any other county in Sweden, and also boasts the largest proportion of female entrepreneurs. Agriculture and tourism are the two largest industries on the island. Manufacturing is a small but important labour market that includes production of timber products, cement, lime and boats. Gotland is also known for its talented designers, who are making a name for themselves far beyond Sweden's borders.

There is great potential to increase the value of our products by turning more of our exquisite raw materials such as lime, wood, wool and leather into more refined goods, as has been done so successfully in the food sector. We have plenty of skilled and innovative entrepreneurs focusing on locally produced and designed products. After all, food is a source of pleasure and experience and mealtimes are an important way of bringing people together. We have great potential to develop Gotland as a meeting place, in combination with the island's cuisine, high-quality resources and environmental work. Gotland is an island full of delicacies and culinary experiences.

Gotland is a modern meeting place in the middle of the Baltic Sea. We are active participants in many Baltic networks, including the Baltic Islands Network (B7). We also host the secretariat for the Baltic Sea Commission and we are the deputy chair of the modern Hansa network, to name but a few of our activities. Here on Gotland, we have long embraced international relations. We were among the first to start cooperating with our neighbours in the eastern Baltic and before EU membership came about, we issued a white

paper on Gotland and our position in the middle of the Baltic Sea. Since the 1990s, we have had three cultural centres: the Baltic Centre for Writers and Translators, the Baltic Art Centre and Visby International Centre for Composers. We see it as a natural and very welcome development that a whole host of institutions with an international focus have chosen to establish themselves on Gotland, which also strengthens our position as the key meeting place in the Baltic Sea region.

With our strategic location, we also have extensive experience of trade links and international contacts dating back to the Hanseatic League. We are now building further on this, in part through Wisby Strand, the new congress hall which, with its unique location and magnificent views of Almedalen and the sea, will be a new and exciting reason to travel to Gotland. Tourism has seen positive growth, with modern facilities helping to generate more visitors and more guest nights.

Globalisation does not stop at any regional borders. On the contrary, a future-focused region has to realise that we are dependent on the wider world and global developments. The climate issue affects and concerns us all, and may indeed be particularly significant for those of us who live surrounded by water. I believe that the greatest challenge we face in the future is a clean and living Baltic Sea. It is therefore good to see the new Baltic Sea strategy taking up many of these key issues. Back in 1990, the municipality of Gotland became an eco-municipality and now everyone on Gotland is working actively on a broad front to achieve an ecologically sustainable society with sustainable growth on Gotland by 2025. One of our objectives on Gotland is to be the leading island region on environmental and energy issues by 2025.

Environmental and energy issues present major potential for economic development. We have already installed a number of wind turbines and wind power has a key role to play in a sustainable energy system on Gotland. The conditions are in place for investment amounting to SEK 1.5 billion through expansion of wind power on Gotland to 1,000 MW installed capacity with annual production in the order of 2.5 TWh. Expanding wind power will have a positive impact on Gotland society in the form of more jobs and an increased influx of capital. Biogas is another exciting area where, in making use of waste products and so on from agriculture, we're working on a conversion strategy so that we can increase the proportion of biogas used as vehicle fuel.

Gotland is a peaceful and safe place to live, with unique access to nature and culture. Living on the island is a special experience, with the ever-present sea and far-reaching views towards the vast horizon. The climate on Gotland is mild and the air is crystal clear.

Gotland is a region of exciting developments with much to discover, so do accept our open invitation!

Eva Nypelius

Mayor of Gotland

Sweden



St. Petersburg – the centre of innovative development of Russian Federation

By Mikhail Oseevskiy

Saint Petersburg, the second largest city of Russia, often called its "Northern capital city". Located at the crossroads of sea and river routes as well as land thoroughfares Saint Petersburg is the European gate of Russia, its strategic center, the closest to the countries of the European Union.

Saint Petersburg is a young city. It was founded by Emperor Peter the Great in 1703. Today, however, Saint Petersburg is the fourth largest city of Europe after London, Moscow and Paris. Its resident population is over 4.5 mln. people.

For over 200 years our city was the capital of the Russian Empire and we still admire the beauty of its palaces, embankments and parks - Hermitage, Russian Museum, Summer Garden, Petrodvorets - are world known.

Saint Petersburg today is the largest industrial, scientific, educational center of Russia. Starting from 2003 the gross regional product was annually growing by more than 8% and was 91 bln. dollars in 2008. Our strategy is a favourable business climate, economy open to competition, support of innovative projects.

St. Petersburg is the centre of the academic, branch and high school science (more than 11 % of scientifically-educational potential of Russia) which is capable to generate scientific and technical achievements in the diversified areas: hydrogen power, microsystems, nano - and the biotechnologies, new materials and other directions.

The sphere of a science and innovative activity of St. Petersburg is presented by 429 scientific organizations, 327 branch scientific organizations, 78 high school organizations.

In a city work as 85,7 thousand scientific employees, from them about 3 thousand doctors of sciences and over 9 thousand candidates of sciences. At universities and institutes of St. Petersburg 8 % of all Russian students are trained. 70 % of workings out of research-and-production sphere of St. Petersburg were realized in other regions of Russia and foreign countries.

The number of the large and average enterprises of the industry of St. Petersburg which create the advanced industrial technologies, in 2007 has constituted 36 companies. The quantity of the created advanced industrial technologies at these enterprises in St. Petersburg in 2007 has constituted 73 % from total number of the created technologies in Northwest region. The enterprises, using in the activity the advanced industrial technologies more than 230, and applying technologies – it is even more. So, the quantity of the used advanced industrial technologies in 2007 constituted 2985 units – a quarter of all used advanced industrial technologies in Northwest region of Russia.

Comparison of this data shows that the enterprises consuming innovations, much more, than making them. On the one hand, it testifies that in a city the considerable quantity of the enterprises uses innovative technologies; on the other hand – that while is much less than again developed innovative products. It means that already in a near-term outlook the increase in demand at innovations will lead to acceleration of work of the enterprises creating them.

We clearly understand what we want our city to be like in the midterm. The primary goals have been stated in "Programme of Social and Economic Development of Saint Petersburg until 2025". The major objectives are:

1. *Saint Petersburg is a center of science, education and innovation.*

There are 45 universities in Saint Petersburg with over 400 thousand students. We are planning to launch a large-scale programme of innovation promotion on this basis. The

primary areas are precision mechanics, optics, electronics, IT-technologies, pharmaceuticals and biotechnologies.

2. *Saint Petersburg is a trade and transport hub.*

Development of Saint Petersburg as the largest Russian trade and transport center of international significance located at the Baltic Sea provides for measures to stimulate export-import goods traffic via Saint Petersburg or adjacent territories, to simplify the procedure for crossing of the border and customs procedures, to build new customs terminals.

An essential element of development in this direction will be reconstruction and extension of the capacities of the Greater Port Saint Petersburg and construction of new terminals. Construction of the ring motorway round Saint Petersburg is nearing completion. New high speed railway and superhighways for communication with Moscow and a new airport will be built.

3. *Saint Petersburg is a city open to the world, a largest international center of business, political and cultural cooperation.*

Saint Petersburg has become a place of high-level negotiations, including summit talks, conferences, forums, a place where major political and economic decisions are taken. Besides, Saint Petersburg has started assuming a number of nationwide federal functions. In particular, the Constitutional Court of the Russian Federation is already located in Saint Petersburg.

Saint Petersburg is strengthening its role as the cultural capital of Russia, as a venue of festivals, exhibitions and concerts, many of them being internationally significant. We set the task to increase the tourist attractiveness of Saint Petersburg, which will enable us to become a leading European center of international tourism.

Nevertheless, like most cities and regions in the world, in autumn 2008 Saint Petersburg faced with the world financial crisis. We had to prove that city was ready for any difficulties, that the pre-crisis measures turned out to be necessary and timely while the strategic goals for the foreseeable future did not change.

In April 2009 the Government of Saint Petersburg developed and approved the anti-recessionary plan consisting of the following main sections:

- The first section. *Strengthening social protection.*

Over the year since the beginning of the crisis the registered unemployment rate has been still very low: 28 thousand people, although the number has doubled. This is a little more than 1% of the workforce. Such a low unemployment level is ensured both by the dynamic development of the city economy in the recent years and reduction of the population, typical of many European cities.

All the unemployed get unemployment allowances and have a possibility of getting a new profession at the expense of the state. We pay special attention to employment of women, young people and the disabled.

Despite the city budget cut, it fell by 20% compared to 2008, we have decided to raise the salary in the public sector in 2009 – over 280 thousand people. We have raised the allowances and payments at birth of a child to families with children, to disabled people. The total amount of social payments in 2009 will exceed 450 million dollars.

The second direction of the anti-recessionary program is *support of business activity and creation of new jobs.*

It should be noted that this complex of anti-recessionary measures is the most financially intensive one and is implemented, first and foremost, by the federal government. This includes increase of banks' capital, granting credits to largest industrial consumers and enterprises, stimulation of

demand, including demand for motor cars. Saint Petersburg has supplemented the federal program by providing subsidies to compensate some part of the expenditures related to acquisition of modern technological equipment by leasing, improving the employees' qualification, certifying the products.

We pay special attention to support of small and medium enterprises as this is an essential part of the city economy. Saint Petersburg has a leading position in Russia by the number of small enterprises per 1 thousand of residents. We have increased threefold the city budget expenditures for providing grants to first-time entrepreneurs for establishment of their own business, training programs and consultations, participation in exhibitions.

From January 1, 2010 the taxes for small business will be reduced by 30%.

Introduction of the system of contracting via Internet has considerably simplified the possibility for small enterprises to receive a city order.

All these measures have enabled us to create over 15 thousand new enterprises since the beginning of the year.

The third section of the anti-recessionary program is *development of the engineering and transport infrastructure of the city using mechanisms of private-public partnership.*

We have always liked this way of implementing large projects; however, the limited direct budget investments available this year made us boost our efforts and attract private investments in new industries. It should be noted that our strategic consultants in the private-public partnership area are the World Bank and the European Bank of Reconstruction and Development.

This year we have completed the tender for choosing a concessioner for construction of a new city airport: it is an international group headed by Frankfurt airport. Tenders are under way to choose partners for construction of the Western diameter – the first toll superhighway in the city and a tunnel under the Neva River.

In the near future we will announce a tender for construction of a large garbage recycling plant and a highspeed tram line.

The anti-recessionary program - live and dynamical, it is constantly optimized and improved. Analyzing the current situation we can say that the peak point of the crisis passed and we are going up. Unemployment is going down, the bank credit volume is increasing and, apparently, in the 4th quarter we fix the growth of the gross regional product.

I want all interested in development of the business in Russia foreign investors to pay attention to St. Petersburg – its possibilities, prospects and potential are opened for you. I do not doubt that cooperation with our city will be mutually advantageous and interesting to all participating parties!

Mikhail Oseevskiy

Vice Governor

St. Petersburg

Russia



Challenges for Estonian higher education 1991–2020

By Peeter Kross

Similarly to the Estonian society and economy, our higher education system has undergone a rapid transformation after regaining independence in 1991. Estonia, being a small country, has very clearly understood that the quality and successful functioning of the higher education system determines economic competitiveness the sustainability of our nation in the future. Here is a brief overview about the development of Estonian higher education system and remarkable challenges from the last 18 years and for the upcoming decade.

90's – market economy growth period

After the restoration of independence, the utmost challenge Estonia faced was to rapidly reorganize the soviet-socialist education system. A society which was experiencing a series of renewing reforms, had established a real demand to acquire the knowledge and skills needed for in a market economy. It was a time when the popularity of higher education rose at an exceptional rate. During those years the total number of Estonian students doubled, increasing from 25 000 students in 1990 to 50 000 in 1999 and the enrollment rate at universities increased up to 2,5 times. In the beginning of 90's the number was 6000 then in 1999 it was already over 15 000.

As a result, the number of higher education institutions increased accordingly. At the beginning of 90's there were 20 higher education institutions, including 6 universities and 14 applied sciences institutions. By the year 2001 Estonia had 49 higher education institutions, out of which 16 were universities and 33 applied sciences institutions.

The liberal economic policy, which brought rapid success to the Estonian economy, influenced the management of the higher education system as well. In the 90's the number of self-financed places soared and several new private schools were opened, so that in the end of the decade it had risen up to 21 000 places forming 40% of the total study places in higher education. However, it was not these new private schools, but our public universities which became the biggest paid education providers in Estonia.

2001–2010: period for ongoing growth and maintaining levels of quality.

In the year 2001 the total number of students in Estonia had grown to 60 000, which has remained the peak year for private higher education institutions. At this moment, Estonia had 10 private universities and 17 private institutions of applied sciences.

During this period the main questions and challenges are related to the quality of higher education, and in order to ensure this, international accreditation process for curricula have been implemented, and several changes in law have been made to make the rules and regulations stricter. Beside those steps taken by the government, public universities sign the Quality Agreement, which aim is to regulate Estonian universities "rules of the game". Remarkably firm changes are made, for example, to the universities' research criteria, Doctoral studies and the Owners Equity requirements for the private schools. For the weaker institutions the year 2002 proved to be the beginning of a period of closures and mergers, so in 2009 there are 34 higher education

institutions left, including 10 universities (6 public and 4 private universities) and 24 institutions of applied sciences, out of which 11 are private schools. However, at the same time there was still a rapid growth in the total number of students in the higher education field, rising up to 68 000 for the year 2009. The greatest number of admissions was in 2004, when 19 500 students started their studies. Also self-financed studies went through a remarkable increase. In the year 2009 37 000 students (55%) studied in self-financed places, out of which 12 000 (18%) were in private institutions. State financed positions were occupied by 31 000 students (45%) of the total students number.

Up to now, Estonian higher education system has been focused on academic education (Bachelor, Master and Doctoral studies) rather than applied sciences, which is supported by the fact that in the year 2009 72% of students were in academic programs and only 28% in applied science programs. It is interesting to see, that during the last years the total number of students in the applied science studies has declined, which is a relatively different situation compared to several other countries.

However, one of the most outstanding and positive outcome for that period is that the Estonian higher education system transferred to the Bologna 3+2 system without remarkable problems.

2011–2020: period of declining number of students and insuring the quality in the future

One of the major challenges Estonian higher education has to overcome is the rapidly appearing demographic gap. The years following the regaining of independence brought along rapid changes in the society and unfortunately also decrease in the birth rate as well as a noticeable extensive emigration wave. Between the years 1990 – 2009 total population of Estonia has dropped by 15% which is 230 000 persons. However, the generation from the beginning of 90's forms the major part of the students studying at the universities for the next decade. It's a matter of fact, that during the upcoming 10 years time the number of high school graduates will fall for 40% compared to the period 2000 – 2010. For our higher education institutions this will result in a sharp downturn in total student numbers accompanied by the fact that after joining EU in 2004 the number of Estonian students going for studies abroad has multiplied. Therefore, the future for Estonian higher education seems rather dramatic. Yet, the downward trend in students and educational institutions provides an excellent opportunity to contribute to and increased level of quality in education. In 10 years time, it is certain that Estonian higher education will have made a big step forward, being considerably more international and open to the world than it is today.

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The Eastern Partnership and Ukraine – plus or minus?

By Olga Shumylo and Jakub Parusinski

The Eastern Partnership (EaP) was officially launched in March 2009, as an instrument for regional cooperation on a broad set of issues, including democratization, good governance, energy security, bolstering trade and state capacity building, between the EU and countries in East Europe and the South Caucasus. The EaP complements and builds upon the Eastern Dimension of the European Neighborhood Policy (ENP), introduced in 2004. As the EU's new policy towards its eastern neighbors, the EaP provides a valuable opportunity for regulatory approximation and economic integration. However, the EaP suffers from internal weaknesses, notably a lack of balance between its multilateral and bilateral components. Moreover, its success depends on both sides demonstrating the will power to push through measures and reforms.

The EaP is based on two pillars, a bilateral and a multilateral one (see table). The former component is significantly more valuable to Ukraine, and other EaP countries, as it presents greater opportunities to leverage reforms through regulatory convergence with the EU. This can be developed through Association Agreements between the EU and its Eastern partners that will focus on deepening trade and economic relations. The EU plans to exploit a new capacity-building instrument through Comprehensive Institution Building (CIB).

The multilateral component focuses on four thematic platforms: democracy, good governance and stability; economic integration and convergence with EU policies, energy security; people-to-people contacts. At the moment, there are two flagship initiatives within the multilateral pillar: Integrated Border Management and the Southern Energy Corridor. The EaP also provides a framework for regional development, with an emphasis on reducing social and economic distinctions between regions.

The EU's trade with Ukraine has been rapidly growing in recent years, with average import and export growths of 18.24% and 23.48% over the past five years respectively, making it Ukraine's biggest import and export partner. Also the Union possesses the strongest transformative power for the country. The most important issues in EU-Ukraine relations, and of the EaP's bilateral component, is the creation of a Deep and Comprehensive Free Trade Area¹ (DCFTA). Such a DCFTA would require analogical regulatory approximation, in order to remove 'behind the border' obstacles. This would not only improve trade 'fluidity' between the two partners, but first and foremost it could also improve regulation and transparency in Ukraine. In the future this may further enhanced by the development of a visa-free regime, one of the EaP's objectives.

The Polish-Swedish initiative is welcomed by Ukraine. While it is viewed as a possibility to deepen collaboration beyond the limited framework of the ENP, it is nevertheless seen as an imperfect solution. The first concern about the EaP regards its value-added in comparison to previous initiatives. Indeed, the EaP does not bring in many new cooperation dimensions as many of these issues were already covered by the Black Sea Synergy, the ENP or bilateral agreements. The second concern deals with the organization of the EaP, notably the 'basket' of nations that it deals with, as there is a wide disparity between the levels of institutional and economic development between the East European countries and the South Caucasus.

The EaP also suffers from a certain dissonance between its political ambitions and its financial resources. The latter were initially planned to be limited to the ENP budget, but were ultimately increased in the framework of the European Neighborhood and Partnership Instrument by €350 million (to a total of €600 million) for all EaP countries, for the period 2010-2013. The bulk of this increase is destined for the CIB, leaving the multilateral component of the EaP underfinanced, and further weakening its relevancy for the countries in question. It has yet to be decided how these resources will be distributed among the EaP countries. Ukraine is expected to receive an additional €25 million annually.

Ukraine's perseverance in collaboration within the EaP framework may be dampened by the lack of a concrete goal in the form of membership perspective. This, however, is both an advantage and a setback for the EaP. On the one hand, the lack of formal membership perspective can be a disappointment, especially for Ukraine, which is relatively enthusiastic (though not very active) about Europeanization and integration with the EU. On the other, membership perspective is not ruled out, allowing the EU to use it as leverage for reform. This is based on the EaP's principles of condition and diversification. Bilateral relations can be developed to varying degrees. Countries that demonstrate greater initiative and will to integrate with the EU through the EaP can do so.

One of the main advantages of the EaP is its flexibility. This ability to adapt its strategic focus in accordance to national and regional developments may allow it to overcome its organizational and financial weaknesses, and focus on the most important issues. In particular, the bilateral component should be strengthened, due to its dominant position as a tool for Europeanization. However, it will demand significant efforts from both Ukraine and the EU to produce visible results. Without increased resources (both financial and institutional) from the EU, and political determination for reform on behalf of the Ukrainian side, the EaP runs the risk of becoming a lost opportunity, or an empty promise.

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¹ For an in-depth discussion on the economic vector of the EaP see Shumylo & Gazizullin (2009).

Selected Areas of Cooperation of the Bilateral and Multilateral Components of the EaP²

Bilateral Cooperation	Multilateral Cooperation
<ul style="list-style-type: none"> ▪ Financial and institutional support for implementation ▪ Economic and regulatory approximation ▪ Deep Free Trade Area development ▪ State-capacity building ▪ Regional approximation and development programs ▪ Governmental aid system reform (development of aid instruments, work group creation and training) ▪ SME support (financing and consultations) ▪ Boundary investment projects 	<ul style="list-style-type: none"> ▪ Promoting good governance and democracy ▪ Liberalization of aviation space ▪ Initiating boundary investment projects ▪ Financing ecological initiatives ▪ Co-financing of cross border projects ▪ Common policy of labor migration ▪ Approximation of regulation policy and standards ▪ Promoting regional social and economic development

² Shumylo, O. & Gazizullin, I. (2009). Economic Vector in the Eastern Partnership and Additional Opportunities for Ukraine. In „EU's Eastern Partnership: Additional Possibilities for European Integration of Ukraine" ed. Vitalii Martyniuk, Ukrainian Center for Independent Political Research

Russian oil on the Baltic Sea

By Bo Österlund

There are more than 250 tankers plying the waters of the Baltic Sea at every point of time. After his retirement from the Finnish Navy Commodore Bo Österlund has mapped out the extent of this traffic, confirming that the Baltic Sea is one of the most important shipping lanes for crude oil.

The Baltic Sea is one of the busiest shipping lanes in the world, counting for some 15 per cent of total seaborne world trade. Annually some 85,000 vessels enter or leave the Baltic Sea through the Danish Sounds or the Kiel Canal, i.e. 230 ships a day.

On the Baltic Sea a total of 33,000 ship movements were recorded east of Gotland in 2008 and 22,000 west of the same island. More than half of the vessels entering or leaving the Baltic Sea start or end their voyage in the Gulf of Finland. In 2008 some 45,000 eastbound and westbound vessels passed the waters south of Hanko, an average of more than 125 vessels a day. Of these vessels 23,000 were freighters, 4,500 passenger vessels or ferries and 6,000 tankers. These figures do not include the traffic across the Gulf of Finland between Helsinki and Tallinn.

Additionally 18,000 ships sail west of Åland and some 1,500 ships through the Archipelago of Turku. It is estimated that there are 1,500 vessels underway on the Baltic Sea at every point of time, comprising about 260 tankers, 900 dry cargo vessels, and 200 passenger vessels.

On the Gulf of Finland there are, depending on the time of year, always 400 to 500 ships underway, and about 20 of these are tankers.

Annually an amount of approximately 100 million tons of oil is carried by some 1,000 tankers from the ports at the eastern Gulf of Finland. Off Tallinn the annual volume has already increased to 140 million tons, and 3,300 tankers. The westernmost part of the Gulf of Finland is annually passed by 3,400 fully or partially loaded tankers. The total number of oil carriers on the Baltic Sea, either loaded or en route to a loading port, reaches 6,000.

The economic significance of the Baltic Sea has increased after the turmoil in the early 1990's, affecting Russia and the other coastal nations. As the countries of the former Warsaw Pact introduced market economy, their fast economic growth and the change in the direction of trade from east to west, as well as the significant growth of the foreign trade have increased the traffic across the Baltic Sea.

According to the statistics in the Baltic Port List 2007, published by the Centre for Maritime Studies of the Turku University, 820 million tons of cargo were conveyed on the Baltic Sea; of these more than 320 million tons, i.e. almost 40 per cent, are liquid bulk, mainly crude oil and oil products. The Ministry of Transport and Communications in Finland estimates that the shipments within the Baltic Sea will grow by 60 per cent until 2020. Imports from other areas to the Baltic Sea are estimated to grow by 30 per cent, and export from the Baltic Sea to other areas by 60 per cent.

How much the oil shipments will increase depends to a great extent, on the development of Russian oil and gas pipelines as well as the possibilities of the ports' to increase their capacity in the number of shipments.

Oil production of Russia is based upon its production facilities which are a legacy of the Soviet Union. The exploitation of the natural resources fell dramatically by the disintegration of the Soviet Union, from an annual production of more than 500 million tons to 300 million tons. Rearrangements related to the oil and gas pipelines through Europe, as well as the procedures of securing and rerouting have again increased the oil production to some 450 million tons annually.

As a result of the economic crisis in Russia at the beginning of the 1990's, the oil export was increased to ensure the inflow of foreign currencies. This was achieved mainly by using pipelines, railroad and road transports, and shipment through ports in the Baltic States.

After these rearrangements Ventspils in Lithuania became the largest port for Russian oil export after Novorossiysk in the Black

Sea. Russia also boosted its export over Tallinn, Klaipeda and the new Lithuanian oil terminal Butinge. At the same time, the importance of Kaliningrad as an export port decreased. The booming transit shipments brought prosperity to the Baltic States. Russia was not, however pleased with their way to manage their relations to Russia, and the transit fees were regarded too high. Therefore Russia decided to expand its own existing ports and also to build new ones, above all in the easternmost part of Gulf of Finland. In 2001 President Vladimir Putin inaugurated the new oil terminal in Primorsk, which was connected to the Baltic Pipeline System, bringing oil from the East. Ust-Luga was established as a ro-ro and container port, and it is now being expanded with an oil terminal.

When it became possible to increase the export volumes through Primorsk, the oil pipeline to Ventspils was closed down in the following year 2002. The Russian oil company Yukos has after that started oil shipments to the port by rail. After this new alteration of course, the idea of building a gas pipeline on the seabed from Vyborg to Germany came up as soon as in 2003 according to Swedish sources. The idea was based upon an existing plan originating from a Finnish-Russian joint venture North Transgas Oy in the late 1990's. Even then it was realized that Central Europe would need more gas to ensure its future demand of energy.

Today Russia counts for ten per cent of the oil deliveries to the world market and stands second after Saudi Arabia as an oil-exporting country. In 2007 Russia's crude oil export totalled 220 million tons – 4.4 million barrels a day. In addition to that, Russia exported more than 100 million tons of oil products. More than 50 per cent of Russia's crude oil export is shipped on the Baltic Sea or to the countries by the Baltic Sea. The infrastructure of this export is sustained by the Northern arm of the Druzba pipeline, leading to Poland and Germany, as well as the oil terminal in Primorsk by the Gulf of Finland.

Finland, Sweden, Germany, Poland and the Baltic States were in 2006 almost totally – up to 95 per cent – dependent on imported oil. Finland imports more than 75 per cent of its crude oil from Russia, the rest from Denmark, Norway and the UK. Germany imports 35 per cent of the oil it needs from Russia. The strategic role of the Baltic Sea as a shipping lane for Russian oil is indisputable.

The port of Primorsk is the most important for Finland's imports of oil. Today there are four, or five, loading piers for up to 150,000 dwt crude oil carriers as well as 18 oil storage tanks with a capacity of 50,000 tons of crude oil each. The annual capacity of the pipeline is 75 million tons. The volume may be temporarily increased by 25 per cent by adding compounds accelerating the flow and decreasing the friction. In last August an amount of 6.6 million tons of crude oil was handled in the port. Every month an average of 60 to 62 loaded tankers leave the terminal, making a total of 750 ships a year, carrying 75 million tons of crude oil. More than 60 per cent of these shipments go to the Netherlands and 16 per cent to Finland.

The new pipeline which is planned to Ust-Luga will have an annual capacity of 50 million tons when it is completed in 2013. It is estimated that it will not increase the total volumes, as it is believed to end the railway shipments to Tallinn. The Port Director of Ust-Luga Maxim Shirokov predicts that the other exports thru the port will increase to 170 million tons by the year 2015, which is almost twice the volume of total seaborne trade Finland.

Bo Österlund

Commodore (ret)

Finland

The role of the Arctic in Russian energy strategy in Europe

By Jakub M. Godzimirski

Over the past few years, Russia has gone through a period of both high expectations and sobering experience of the global economic crisis, revealing the failure of the strategy of economic development propounded by its ruling elite. This experience is like to force the elite to rethink and partly reformulate goals of the long-term strategy for the country's development and may have impact on the realization of several strategic projects, also in the sphere of energy.

National self-confidence soared to unprecedented heights in summer 2007 when the Russian flag was planted by the Russian expedition at the North Pole. This stunt of Artur Chilingarov was widely seen as a highly symbolic proof that Russia was returning as a great power with not only regional but also global ambitions. This move was combined with the semi-official Russian discourse on the country as an indispensable energy superpower and with a growing focus on building a Russian version of what was labelled 'sovereign democracy' intended to make Russia immune to external pressures.

In fact, there are not only symbolic but also other, more down-to-earth reasons why Russia has been paying increased attention to developments in the Arctic. One of those concerns the energy resources believed to be located in this area. According to the last estimates issued by the USGS, 'the mean undiscovered, conventional, technically recoverable petroleum resources in the Barents Sea Shelf are estimated to be more than 76 billion barrels of oil equivalent, which includes approximately 11 billion barrels of crude oil, 380 trillion cubic feet of natural gas, and 2 billion barrels of natural gas liquids'.¹ Those figures make clear how high the energy stakes are and why Russia has again chosen to face the Arctic challenge. This also explains why Russia will have to 'go Arctic' in order to be able to realize its ambitious strategic energy projects.

Some of these projects are especially vulnerable to what will happen in the Arctic, and the most exposed is definitely the Nord Stream gas pipeline. According to official plans, this pipeline will provide Germany and the rest of Europe with up to 55 bcm of natural gas. Half of this volume is to come from the Yuzhnorusskoye gas field, currently being developed by a consortium of Russian and German companies. The other half is to be shipped, starting from 2013, from the Shtokman gas field, the world's second biggest offshore gas field, with 3 800 bcm of gas reserves, to be developed jointly by Gazprom, Total and Statoil. However, it seems that the development of this field may be in grave peril.

Several factors may make the project non-viable. Until recently, it might have appeared that the main obstacles could be of a geopolitical nature, as there was strong opposition in some EU countries to the construction of the Nord Stream pipeline needed to transport gas from Shtokman to West European markets. The recent decisions of the Danish, Swedish and Finnish governments to allow Nord Stream to go through those three countries' exclusive economic zones seem to have removed this obstacle, as the remaining two governments that have to approve the project are those of Germany and Russia, and this seems to be a mere formality.

However, other, perhaps more serious, dangers now seem to loom. The fact that the companies involved in development of the Shtokman field decided to postpone the final decision to 2010 may mean that the purely technological

challenges may be greater than originally expected.² Another important factor is the uncertainty linked to the future development of oil and gas prices. In 2008, with the oil price hitting first the magic \$100 per barrel mark and then skyrocketing to almost \$150, it could seem that the project that was to send until 70 bcm of gas to European and global gas markets could become an effective money-making machine, and that technological solutions would be found, whatever the cost. Calculations based on the average gas price in 2008 (\$410 per 1000 m³) showed that the project could generate as much as \$30 billion revenue per year – but then came the dramatic drop in oil prices, to \$30 per barrel in December 2008, demonstrating the massive price volatility and the impossibility of making reliable short-, mid- and long-term calculations of the commercial viability of such projects.

The economic crisis has also resulted in a significant drop in demand for Russian gas in Europe, forcing Gazprom to reduce its gas production.³ This lessened Gazprom's revenues, which were already suffering from the lower gas price on the European gas market, and forced the company to announce cuts in its ambitious investment programme.⁴ Due to the lack of infrastructure, the surplus of gas cannot be shipped to other markets – like the Chinese – to compensate for the fall in European demand. As Russia has no LNG facilities near fields that produce gas for the European market, that option could not be used either. The global LNG market also seems affected by two recent developments – the current economic crisis, and – perhaps even more important in the long run – the increasing production of non-conventional shale gas in the USA, which should substantially reduce the US demand for LNG. As part of the gas from Shtokman was to be sent to the USA as LNG, this might also have negative implications for that project.

The last factor involved is the Gazprom's decision to cut its investments programme. True enough, Prime Minister Putin has announced that those cuts will not affect the development of the gas sector in Russia.⁵ All the same, this may lead Gazprom to focus less on the challenging Shtokman field and to concentrate instead on the Yamal Peninsula, from which gas could be transported not only to Europe but also to China, as announced by Putin during his recent visit to Beijing. Such a change of focus could jeopardise the realisation of the Nord Stream: there simply might not be the gas to fill that planned pipeline.

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² The problems faced by Statoil in the Snøhvit field clearly illustrate how challenging technologically similar projects may be. For details on the latest developments there see <http://e24.no/boers-og-finans/article3387391.ece>

³ <http://www.reuters.com/article/rbssEnergyNews/idUSLU3329520090930>

⁴ <http://lenta.ru/news/2009/09/03/gazprom/>

⁵ <http://lenta.ru/news/2009/07/13/cut1/>

¹ <http://pubs.usgs.gov/fs/2009/3037/pdf/FS09-3037.pdf>

Prospects and consequences of START follow-on treaty

By Bartosz Cichocki

Presidents Obama and Medvedev have probably signed a Strategic Arms Reduction Treaty (START) follow-on agreement shortly before this paper was published. At least both leaders have repeatedly confirmed their intention to wrap up negotiations before December 5, 2009 – when the 1991 US-Soviet nuclear agreement was set to expire – since the bilateral meeting on the eve of the London G20 summit on April 1, 2009.

On July 6, 2009, the US and Russia agreed, that the future treaty will cut their nuclear arsenals to 1,500-1,675 operational warheads and 500-1,100 delivery vehicles (heavy bombers, deployed intercontinental ballistic missiles and their launchers, deployed submarine-launched ballistic missiles and their launchers). Currently, the US has about 2,200 operationally deployed warheads and Russia – about 2,800. Both sides are already within the above mentioned boundaries for delivery vehicles – closer to the higher one in case of the US and to the lower one in case of Russia [1].

However, the negotiating parties remained far apart on a number of issues. Experts point out the following controversies as most significant: i) rules for counting warheads and delivery vehicles; ii) downloading provisions to allow the parties to remove warheads from the delivery vehicles and to count downloaded missiles with fewer warheads (and with fewer missiles in case of downloaded submarines); iii) measures to prevent rapid uploading of downloaded systems (so called breakout potential); iv) conversion of some START-accountable ballistic missiles to conventional-only roles and removing them from being accountable under the new treaty; v) monitoring and verification measures; vi) whether to bring limits to missile defenses into the treaty on strategic offensive weapons [2].

How these issues have been solved (and whether they actually have been solved) is critical to evaluation of the consequences of a START follow-on treaty. In such cases Sherlock Holmes used to say: it is a capital mistake to theorise before you have all of the evidence. Some general conclusions seem, however, unquestionable.

Firstly, reaching a compromise on all the controversies in such a limited time frame would make a spectacular diplomatic success. It has taken almost a decade for the US and Soviet Union to agree on some hundreds of pages long START in 1991, more than five years to conclude Intermediate Nuclear Forces Treaty (INF) negotiations in 1987 and six months to sign two pages long Strategic Offensive Reduction Treaty (SORT aka Moscow Treaty) of 2002. And still, a START follow-on treaty remains to be ratified by the parliaments, which may take months and become subject of political dispute in US Senate (depending on the content of agreement) and/or hostage to a wider US-Russian security agenda in Duma. That was the case with START II – signed, but not ratified in Russia and ultimately denounced by Moscow, following the US withdrawal from Anti-Ballistic Missile Treaty (ABM) in 2002.

Secondly, regarding security concerns of Central and East European states, whenever the US and Russia reached a strategic agreement or understanding, it made Moscow less inclined to use confrontational approach in her policy toward the neighbors and thus contributed to regional stability. President Clinton's engagement with president Yeltsin helped the 1999 NATO enlargement to become a relatively conciliatory undertaking with regard to Russia's response. President G.W. Bush's look into president Putin's soul (followed by strategic arms treaty offer, understanding of the Kremlin's Chechnya policy, launch of the Russia-NATO

Council, Russia chairing G8, etc.) resulted in Russia's tolerance to the Baltic States acceptance to NATO in 2004 and Ukraine's, Georgia's approximation with the Alliance. And the other way around. Whenever the US ignored Russia's concerns in security area (ABM abrogation, Iraqi operation, Missile Defense offer for Central Europe, US military presence in Central Asia, etc.), it provoked the Kremlin to use energy blackmail and military threat against its former colonies and satellites [3].

Thirdly, the above does not have to constitute a rule. For Russia does not feel a weak side anymore and defines Central and East European gains as her own failures. Additionally, Russia does not seem to be impressed with President Obama's Global Zero vision and regards a START follow-on treaty purely as an instrument to regain two decades gone parity with the US. As the Soviet style and scale Russian-Belarusian military exercise "West-2009" showed this September, Obama-Medvedev strategic dialogue is yet to be accompanied by the rapprochement in Russia's relations with her neighbors. And the latter should be regarded a necessary element (and not a bargain chip), as far as rebuilding of confidence in US-Russian relations is concerned.

Fourthly and finally, for a START follow-on treaty to produce tangible effects in both transatlantic and Central-East European security, it should be followed by arrangements concerning Russian tactical nuclear arsenals and conventional weapons [4]. Today, importance of both in Russia's security policy is rising to a detriment of the former Soviet and Central European space stability.

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Please, note: the views expressed herein are those of the author and do not necessarily reflect position of the NSB.

Travelling by sea has a bright future

By Andres Hunt

Baltic Sea offers a magnificent and unique sea landscape, which has been discovered by numerous passenger shipping companies operating here.

The passenger shipping market has grown by millions of passengers in past years, from 13 million to over 17 million passengers annually on the northern part of the Baltic Sea. Tallink started with 160 000 passengers in 1990 and reached over 8 million serviced passengers in the fiscal year of 2008/2009. In addition to the picturesque Baltic Sea, what attracts people to travel by sea?

The attitude towards travelling in general has changed much during the past 10-20 years. The same trends are also visible in other transportation sectors. People evaluate the time and especially free time very highly. We could name the new trend with the term "effective travelling". Quick, comfortable and all-inclusive trips are very popular. All inclusive does not mean the usual hotel accommodation in this sense, but the variety of travel experience during one trip.

It starts with booking the trip. Tallink has invested into modern and effective online booking system. It is a win-win situation, since passengers can book their ferry tickets, meals, accommodation and even excursions in one place at once. The company on the other hand has lower costs in personnel and offices.

During the years, also the understanding about passenger ships has changed. The passenger ferries built in 1980-ies are quite different from the modern ones.

Nowadays, by sea travel one of the most important aspects is to have a comfortable and multifunctional vessel. The passengers of cruise lines are especially interested in having a selection of shops, restaurants and entertainment facilities on board. It is again the all-inclusive option, as during a cruise of only one to two days, people can enjoy everything necessary for a great mini-vacation in one place, on one ship. Tallink has invested over 1 billion Euros into building new generation cruise ferries for the routes on the Baltic Sea. The market demand is there and the passenger numbers show a positive correlation with the new buildings set to the routes. Tallink always tries to be one step ahead of the market and tries to discover the new market trends in advance. Therefore it is possible, that in the future there are additional changes to the route's concepts or the fleet as they both are linked to the travel market developments in general.

A good example of effective travelling and passenger shipping innovation is Tallink Shuttle concept. Tallinn-Helsinki shipping route is one of the busiest international shipping routes in the world. Today, Tallink services almost 3, 5 million passengers annually on this specific route. 5 years ago the demand was growing, but the possibilities were different. Tallink had up to 6 vessels on the route, from which the 4 high speed crafts were highly weather sensitive and had a low capacity of passenger vehicles. Cargo capacity of these vessels was almost zero; therefore the larger cruise ferries and special cargo ships had to do this work additionally. When Estonia became the member of EU

and the employment policy enabled Estonians to go to work to Finland quite easily, the demand on the route grew even faster. Demand for short vacations both ways was there, the demand for a vacation with a personal car was also rising. Tallink ordered 2 new generation high speed ferries with the capacity of almost 2000 passengers and 2000 lane meters of car deck (450 passenger vehicles). To enable the travelling between 2 capitals all year round, a high ice class is also necessary. The two vessels operate now under the concept Tallink Shuttle and are appreciated by the passengers by their flexible and frequent time schedule, all year round traffic and large space for cars. They are the most booked ferries of the 19 vessels the group owns. It saves time and money of our passengers, diminishes the environmental impact and fuel costs of the company.

When the concepts of the cruise ferries are similar to the ones with cruise ships, the difference lies within the duration of the trip. As there is a clear trend towards shorter, but more effective vacation trips, the short cruises are especially popular in the region.

Especially during the times of economical recession the short cruises are favoured due to the travel expenses. While the ships enable to experience various cuisines, beautiful nature, spa treatments, shopping etc, the travel costs are lower compared to the flight travel, where you additionally also have to book a hotel for an overnight stay. So sea travel can be also seen as cost effective.

During last 10-20 years, also the possibilities to travel to neighbouring countries have widened a lot. The effectiveness is also seen here – no more border control (Schengen area), no more visas, no more documents to be filled. It is easy and comfortable.

People are more than ever interested in travelling to nearer countries; many of those are brand new travel destinations. The Baltic countries for instance are a popular travel destination for people from Nordic countries. Baltic countries have a rich history, architecture, nature and are suitable also for lower budget travelling.

Also the environmental aspects are not to oversee. The shipping is environmentally friendly way of transportation. It is essential to know and develop this advantage for instance by investing to the fleet. In general, passenger shipping in terms of Tallink is all inclusive – environmentally friendly, cost and time efficient and attractive vacation environment. This is the demand today. But we keep our eyes open about tomorrow as well.

Andres Hunt

*Vice Chairman of the
Management Board*

AS Tallink Grupp

Estonia



Russia takes action towards ecological future

By Pekko Kohonen

I have travelled extensively in Russia, touring towns and cities from east to west and north to south. The very warm welcome I have received everywhere could be attributed to the driver of our company ideology: to convert discarded material into new, valuable raw material, and to ensure a clean environment for everyone. No municipal manager wants to waste these valuable resources; instead, they want their region to be as ecological as possible. The first and most significant element required for change already exists – ‘will’. Without the will of private and corporate citizens and decision-makers, nothing can ever change.

‘Must’ is another effective driver of change, but when combined with will it becomes even more potent. Even today, the Soviet legacy still dominates many of Russia’s infrastructure solutions. But back in the Soviet days, the strain on infrastructure was smaller, and needs were very different, as were consumer habits and consumer behaviour. The amount of waste generated by consumers was much smaller, and industry had a practically endless supply of raw material which meant product life cycle was never really a consideration.

But following the emergence of private ownership, a real pricing system and global economy in Russia, things will inevitably have to change. Companies and municipalities will come face to face with the necessity of change as landfills fill up, and companies will no longer be able to afford to ignore the financial value of their raw materials and industrial by-product flows. Russia still remains a closed economy to some extent, which means the real power of ecologic force has not yet dawned on local players. Meanwhile, in the European markets, companies have long been forced to fulfil certain eco-requirements in their production operations, if they wish to succeed. Russian companies seeking access to the global markets have already felt this kind of a ‘must’.

Municipal directors admit this development, and they have the will to change things. What many towns and cities lack is **faith**. City and town leaders know that they will have to change the way things are done, but they blame everything on the “large soul” of the Russian people. People throw litter on the streets if the waste bin is too far away, or forget the regulations they are expected to comply with. It has been said that the Russian people are not systematic and obedient like the Scandinavians, which is why changes such as sorting-based recycling are impossible to implement. They say this is easy for us Finns, but that for the residents of their home towns and cities it is completely or, at least, almost impossible. What these town fathers forget is that the recycling system currently in place in Central Europe and Scandinavia did not appear overnight; the system took 40 long and sometimes painful years to develop, and is still not ready.

Personally, I would be inclined to give more credit to the “large soul” of the Russians, which is inherently closer to nature and green values than, say, the more technocratic Scandinavian soul. Traditional soft values such as friends and family, enjoying life and enjoying the natural environment are very important to Russian people. The Russian soul simply thrives in clean nature, sitting by the water with friends, enjoying shashlik and hand-picked mushrooms or local vegetables bought at the local store. Russians want to have all of this and are prepared to make sacrifices. Russians should be provided with an opportunity for pro-environmental action.

When we have faith that we can make a difference, the only missing element is **actions** that will enable us to pursue our common goal.

This requires a significant change in the current infrastructure to enable a more ecological approach. People should be encouraged and motivated financially to act in a more eco-conscious way. Sometimes people and companies may lack the will to make things happen, and that’s where the ‘must’ mentioned earlier enters the picture. ‘Must’ was necessary in the EU, too, despite a strong will to do what’s right. It was not until legislation introduced the ‘must’ that people started to act in accordance with their will to change. Supporting this through legislation is what Russia needs as well. In Russia, highly centralised power enables quick legislative changes that could promote an environmentally sound future.

Back in the Soviet era, everything could be ordered from the top down, but the lesson learned from history is that this is not always the best way of organising things. Promoting environmental awareness in Russia is everyone’s concern, and everyone should play their part in achieving this goal. Fortunately, it appears that more and more is happening on this front:

- Cities are showing an interest in municipal environmental management.
- The media is showing an interest in the subject.
- Russian companies are starting to buy environmental services.
- People appreciate clean yards and clean environments.

Even President D.A. Medvedev named environmental awareness one of Russia’s key priorities in his speech in January 2008. In this speech, he also urged organisations to take action to launch the recycling industry in Russia, in response to which environmental enterprises operating in Russia established the Russian Association of Waste Recycling (Ассоциация Рециклинга Отходов, АРО). This association has already initiated talks with the federal and regional ministries on development opportunities in the recycling sector.

Co-operation between various fields, such as government administration, companies and private consumers, is required to build a more ecological Russia. It’s time to roll up our sleeves and get to work. The first step could be to follow the EU’s example and enforce a landfill tax, which would raise the price of landfill waste and encourage people to recycle.

Let’s give our souls a chance.

Pekko Kohonen

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Finland



The Baltic recovery – anything else but a long hard slog?

By Ralf Wiegert

Once Europe's leader, now the laggard – the Baltic region has gone through extremes during the last three years. A region that has benefited enormously from European Union (EU) membership, both in terms of trade as well as investment inflow, has been caught wrong-footed as the global crisis fully struck in the second half of 2008. Already sliding into recession following several years of neck-breaking growth, the global crisis has severely aggravated the looming landing of the Baltic tigers in 2008 and 2009. More than once during the last 12 months, it even looked as though the collapse of Latvia's euro-based exchange-rate peg could trigger a pan-central European financial crisis, with repercussions for western Europe as well.

A region-wide disaster has been averted, not least thanks to financial support from the EU, the IMF, and other international lenders. The economic situation has evidently stabilised both in Central Europe and the Baltic region. With the Baltic countries' budget plans for 2010 being close to final endorsement, the fiscal outlook has become more certain, injecting a crucial amount of stability to the markets. Latvia's multinational loan programme will most likely be maintained after the government has adopted yet another round of harsh fiscal austerity measures. Meanwhile, as was recently remarked by EU Economic and Monetary Affairs Commissioner Joaquin Almunia, Estonia is currently on track to secure euro adoption for January 2011, a step that would further enhance stability in the region and improve chances for a recovery.

Against the backdrop of the abysmal first half of 2009, all of that is clearly good news for the Baltic region. However, being confronted with a weak outlook for the next two years, the fact that the downturn has halted after all is scant consolation: the output gap remains large, unemployment is still rising, and the strength of the euro makes it difficult for the Baltic trio - Estonia, Latvia, and Lithuania - to benefit from the visibly improving European outlook.

Meanwhile, a credit crunch has gripped the Baltic countries. Banks have been adamant to scale down their exposure, while households and companies alike are reducing their debt level and saving more. Although the scale of the debt problem varies from Latvia, to Estonia, and eventually Lithuania, the ramifications for the economy are the same. Domestic demand will remain weak for at least three to four years. All three economies will eventually start to grow again in 2011 at the latest, but it will take until 2015 (in Estonia's and Lithuania's case) and 2018 (in Latvia's case) before the pre-crisis level in private consumption will have been reached again, according to IHS Global Insight's forecast.

Because exports are recovering earlier, GDP in the Baltic countries will climb back to the pre-crisis level around 2014-16. At that point, around eight years will have been lost since the start of the recession, making the current downturn comparable to the savage reduction of output following independence from the Soviet Union and the abolition of central planning. Furthermore, it is hardly realistic that the pre-crisis output level in 2015-16 will be produced with the same job count as in 2007-08. High unemployment - in Latvia's case, extremely high unemployment, with rates close to 20% - is likely to remain a constant feature for the coming several years. It will not only slow down the economic recovery, but also alter the way of policymaking, especially in Latvia, where the populist, social-spending streak could gather strength.

There are still chances that unemployment could be reduced more quickly, but this largely depends on foreign capital and the investment climate in the Baltic region in general. The majority of unemployed are well-skilled and have on-the-job experience; meanwhile, the wage level in the Baltic countries, especially in Latvia and Lithuania, is still very low compared with Western Europe. According to Eurostat, average total personnel costs per employee have varied between 17% (in Lithuania and Latvia) and 25% (in Estonia) of Germany's cost level in 2006. Cheap skilled labour makes the region still attractive, but the advantage may be discounted by a further postponement of euro adoption.

Indeed, if Estonia secures the euro for 2011, it will be a major boon for the smallest economy of the Baltic trio. All depends on whether the government keeps the fiscal deficit below 3% of GDP. The government and the Bank of Estonia are sounding increasingly confident, as apparently does the EU Commission, yet so far the issue remains balanced on a knife's edge.

Latvia and Lithuania are much less lucky, having to pay now for their fiscal sins of the recent past. Although fiscal spending has already been curbed savagely, further belt-tightening will be necessary during 2010-13, in order to balance out public-sector finances and prepare for euro adoption, which is not likely to be possible before 2015, or 2014 at the earliest. That being said, Estonia could eventually emerge from the crisis as weakened but clearly stronger and even more prosperous compared with Latvia and Lithuania.

Moreover, if the European Council invites Estonia to join the Eurozone in 2010 and announces the final conversion rate for the kroon, devaluation talk will finally be put to rest – at least as far as Estonia is concerned. In theory, Estonia could still devalue the kroon by up to 15% against the euro and join nonetheless, but this seems a fairly remote scenario.

Regarding Latvia and Lithuania, a devaluation of the lats and the litas, respectively, is unlikely for the next 12 months, at least if the budget plans and tax amendments for 2010 are eventually passed by the countries' parliaments in December. A one-off devaluation could become an issue again, though, at some later stage. Indeed, as the fiscal situation will defer euro adoption until at least 2014, a devaluation could be pushed through by mid-2011 without harming euro chances.

Central Europe's financial markets will have stabilised further and written down most of the region's losses by then. Indeed, Scandinavian banks operating in the Baltic region have had enough time to brace themselves for an even worse outcome, including a steep devaluation. If Europe's recovery is in full swing by the end of 2010, and Latvia and Lithuania are still lagging, the temptation to devalue the lats or the litas to kick-start the economy might be too strong for Latvia's and Lithuania's authorities, whoever is in office.

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Building innovation economy in Russia – big ambitions are build by small steps

By Peter Zashev

Everybody who follows regularly the political and economic development in Russia is aware how high in the agenda are such topics as innovations and modernization of the economy. Both Russian Prime Minister and President spoke numerous times about the need to diversify the economy and diminish its humiliating dependence on exporting raw materials, chiefly oil and gas.

That very topic was also at the heart of the President Dmitry Medvedev recent address to the Federal assembly. It seems that there are two substantial problems in achieving these fine objectives. One is that, as history teaches is, the grand vision of the Russian federal authorities often does not match the interests of those that must implement it. The other seems to be in the inability of many Russian policy makers to break a grand vision in a list of concrete small tasks that may sound less grand and breathtaking but are more prone on tangible results.

Innovations can not materialize by a top down issued instruction. Down at the bottom in the real economy there must be scientists and companies finding common interests to cooperate and do something together. The present organizational setup is not inductive for the two parts to seek and develop such cooperation. Instead both sides prefer to wait for the government to offer some form of grant or subsidy etc. This is easy to fix. Building joint projects with companies, raising (partial) financing for projects from the companies should be part of the regular evaluation criteria for universities, research institutes and researchers. This is one example for a small step that has large tangible impact. Equally important is to offer companies some incentives for more actively using the knowledge, skills and available capabilities of universities and research institutes. There are many different alternatives from simple tax breaks on money invested in such R&D projects to more elaborated schemes when the each rouble invested in R&D could be supported by another one paid by the government. To fire up the cooperation between industry and academia should be a top priority.

Instead it seems the government prefers to apply centralized schemes in the form of mega-projects, special economic zones, techno parks etc. Naturally they all have their place and importance. However none of them addresses directly the above described central weakness: industry and academia do not cooperate enough. On the top of it such cooperation will not mean much in the absence for a market for the new products being born, which requires skills and knowledge in commercialization of innovations. For all its size and pre-crisis economic growth rate the Russian market alone is often not big enough for gaining critical sales for new products and technologies. Fortunately in modern times markets are global for those being skilled in international entrepreneurship and marketing etc. Unfortunately at present the Russian way of innovating and commercializing seems to be mostly domestically oriented.

Russian policy makers seem to put their faith in grand projects! Take the nanotechnologies where the main operator is little controlled State Corporation with sizeable financial opportunities. Besides number of Russian cities and

regions setting up their own nanotechnologies centres (doing what!?) it is not clear what are the results so far. At a recent strategists forum in Saint Petersburg the regional authorities together with big names as Finance Minister Kudrin were talking as some kind of a mantra the words of “proryv” (breakthrough) and “nanotechnologies”. The logic perhaps is that what is needed is grand concentrated efforts in one given field leading to breakthroughs.

However the experience of many countries will show that modernization and progress in innovations is gradual process that consists of many small steps in which often nothing grand or revolutionary happens. Although innovative activity is often linked with high technology sectors of the economy, companies in low- and medium technology sectors also innovate, and such innovations are important for the general level of national competitiveness. These companies may innovate in the field of production processes but also organisational and marketing innovations. Russia has plenty of wood. Producing nice design sauna accessories and marketing them to the world as an expensive brand is pure innovation even if it does not sound like launching a satellite. In that respect it may be very useful for many Russian regions to concentrate on what they have and what they may develop with some more simple but more needed innovations and improvements instead of spending their little resources on yet another nanotechnologies centre or techno park.

It is the every day small steps and actions of individuals that achieve the great things. For that to happen the government only needs to send the right signals in the form of concrete incentives and evaluation criteria that aim at results that may be described in qualitative and quantitative terms. As far as the central government believes that it may be simultaneously the main initiator, financier and often user of innovations the other players in the innovation system will deliberately chose to stay idle. Regional authorities will produce (or rather fake) grand innovation initiatives of the type they know pleases most central government. Companies will wait to get and use a state order or money instead of investing in new markets, products and innovations. Academia will continue to complain about inadequate funding for projects that are anyway of little interest to companies. That will be a pity end for the President’s sincere wish for modernization!

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Belarus and its economic relations with the countries in the Baltic Sea Region

By Irina Yeremeyeva

Belarus has significant economic ties with the countries of the Baltic Sea region. This country plays an important role in the transfer of traded goods from East to West, from North to South. Among the five major trade partners of Belarus three belong to the Baltic Sea region. They are Russia, Germany and Poland.

Russia plays a significant role in Belarusian economic development and the impact of Russia on Belarusian economy is very high. The best indicator of this is the status of their trade. The structure of export-import of the Republic of Belarus with Russia was 47.2% of the whole trade turnover volume in 2008. Exporting food to Russia has been one of Belarus' most important and reliable trade sectors. In 2008, Russia bought 93% of Belarusian meat and dairy products. And Russia always uses this instrument in its political and economic struggle. This country has a tradition of banning goods from neighboring countries of the first sign of disagreement, like the 2005 ban of Polish meat, the 2006-2007 ban of Georgian and Moldavian wine, the 2009 ban of Belarusian milk. And for a while Russia has got everything it wants. And the second way of impact is a price of Russian oil and gas for Belarus. But since 2007, the economic relationship between Russia and Belarus has been steadily worsening, when Russia raised gas prices and demanded that Belarus give up control of gas transit from Russia to Europe — about 20% of Russian gas exports to Europe go through Belarus, and so Russia wants to take over Beltransgaz, the state-run operator of Belarus' gas-pipeline network. And soon this instrument will not work anymore.

Germany is Belarus' second most important Baltic Sea region trading partner. In 2008, the volume of bilateral trade increased by 24 per cent compared with the previous year, to USD 3.61 billion. Belarus' principal exports to Germany are textiles, wood and wood products, medical equipment, chemical products, tractors and optical products. The main imports are capital goods, machinery and equipment, chemical products and motor vehicles. Despite continuing economic and administrative difficulties, 338 German companies are currently operating in Belarus including 189 joint ventures and 149 foreign companies. Six Belarusian companies have offices in Germany. These are Minsk Tractor Works (Belimpex Handels GmbH in Leipzig), Belarusian Steel Works (Belastahl Aussenhandel GmbH in Berlin), Belmagistralavtotrans (Belmagistralavtotrans Spedition GmbH in Alzey), the national air company Belavia (Frankfurt am Main), the Belarusian Chamber of Commerce and Industry (Leipzig), Belneftekhim Concern, and Belarusbank (Frankfurt am Main).

Credit and investment cooperation plays an important role in the Belarusian-German economic relations. Since 1992 Germany has extended more than USD 550 million in loans to Belarusian companies. In 2008 Belarus attracted USD 116.8 million of German investments, including USD 93.7 million of direct investment.

Poland is the third trade main partner of Belarus in the Baltic Sea region. In 2008 the Belarusian-Polish trade was up by 44.9% to USD 2.96 billion. Export to Poland reached USD 1.8 billion, import USD 1.2 billion. The increase in Belarusian export was due to the growth in the deliveries of oil products, liquefied gas, crude oil, potash fertilizer, electricity, timer, tractors. In 2008 Belarus launched exports of 106 new commodities to Poland.

Speaking about the Belarus-Polish investment cooperation, Polish investors are still too cautious in the questions of investment in Belarus. Since 2002 the Polish investments have summed up to about 200 million USD. 400 enterprises with Polish capital are registered in Belarus. Poland is not on the list of the countries leading investors, it's because Poland doesn't have enough free capital to invest, and this country needs investment itself.

Belarus also has good economic relations with such Baltic Sea region countries, as Lithuania and Latvia. In September 2009 trade turnover between Belarus and Lithuania exceeds USD 1 billion. 500

goods items are exported to Lithuania: from products of petrochemical complex to building materials. One of the most active avenues of cooperation is transportation of goods through Klaipeda port. Also, Lithuanian businessmen plan to invest about EUR 1.5 billion to the Belarusian economy. In 2008 318 enterprises with a share of Lithuanian capital were registered in Belarus, including 177 joint ventures and 141 foreign-owned companies. All in all, the investments amounted to USD 43 million, including USD 10.9 million in direct investments. Investment cooperation between Belarus and Lithuania is especially successful in building trade and entertainment facilities as well as hotels and the development of transport and logistics infrastructure (building a trade centre in Minsk by Lithuanian trade company Senukai, building a transportation and logistics terminal by Vingis Logistic Group company, building a trade and entertainment centre in Zhlobin by Belalait company and many others).

In 2008 Belarus-Latvia trade totaled USD 2.32 billion. Belarus exports to Latvia petroleum products, chemicals, carbon, steel semifinished products and rods, tractors. Import from Latvia was dominated by frozen and tinned fish, animal feed, medications, metalware and textiles. Latvia invested nearly USD 600 million in the Belarusian economy in 2002-2008. In 2008 alone despite the crisis Belarus attracted USD 97.7 million in Latvian investments including USD 36 million direct investments. Latvia is an important transit country for Belarusian cargoes, first of all, oil products and potash fertilisers.

The trade and investment cooperation with other Baltic Sea region countries such as Estonia, Finland and Sweden is not developed well. The trade of these countries with Belarus is only about 3 % of total trade and the investments are not so high. But it's really very important for Belarus to develop cooperation with these countries. Baltic Sea countries can help in transferring the positive experience of the Nordic countries to Belarus, especially in developing relations between research and business. Economic cooperation is the most intensive, pragmatic and, certainly, a mutually advantageous direction of the Belarusian-Baltic Sea region relations.

To intensify economic cooperation between Belarus and the Baltic Sea region, it is necessary to settle as soon as possible problems complicating contacts in trade and economic sphere: simplify visa, customs and border-crossing formalities, to modernise and expand a border infrastructure, to develop in every possible way transit opportunities of neighboring countries.

Thus we can draw the conclusion Belarus should focus on further efforts aimed at promoting productive economic co-operation within the Baltic Sea region. The geographical neighborhood pulls together interests of our countries on many strategic directions, including trade, investments, transit and energy. Recently together with Baltic Sea region countries we have reached a high enough level of mutual understanding on these fields. We should keep and increase this common achievement, transforming it into specific projects useful to our countries.

Irina Yeremeyeva

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Belarus



Kaliningrad – unsustainable economy (was growing better and now is decreasing faster)

By Georgy Dykhanov

Financial situation of enterprises

In the I half of 2009 economic conditions in the region evolved significantly worse than in the corresponding period of 2008. Reduced demand for goods and services, reduction of production volumes, rising late payments have led to a deterioration of the financial situation of enterprises, reducing investment activity and their effectiveness. During January-March 2009 the total capital of regional enterprises decreased by 4.1% (January-March 2008 witnessed its growth by 3,7%). In addition, attracted resources decreased by 6,9%.

In the composition of the attracted resources, long-term liabilities increased by 10,4%, while short-term liabilities decreased by 15,4%. As a result of these changes, the debt burden on equity fell slightly - the ratio of own and attracted capital decreased from 1,8 (at 01.01.2009) till 1,7 (at 31.03.2009). In general, the growth of loans in loan form was typical for large enterprises and was determined by long-term debt on loans by 13,2%.

For small, large and medium-sized enterprises total loans and credits in general declined. However, small enterprises in January-March 2009 increased their short-term loans, derived from non-bank organizations, by 10,7%; large and medium-sized enterprises have attracted long-term bank loans, the aggregate volume of which increased by 4,7%. The greatest tenseness of the payments is still characteristic for small enterprises, where 79,3% of all outstanding loans of banks are short-term, the lowest - for the largest enterprises (23,6%).

It should be noted a marked deterioration of payment discipline - for January-March 2009 **overdue payables of enterprises have increased in 2,6 times, overdue accounts receivable - in 1,5 times**. The investment activity of enterprises in the I quarter of 2009, compared with the corresponding period of the last year, has declined, owing to the reduction of all the elements that make up the non-current assets, except for fixed assets, an increase which amounted to 7,6%

Analysis of the results of the first quarter in the segment of manufacturing industries suggests that the recession over 50% (compared to last year) will not allow companies of the sector to restore old volumes without loss of production, or stop the entire enterprise, such as Techprominvest. The loss of personnel, deteriorating financial situation, leading to the decision to suspend the bank's lending and even a requirement for early repayment, does not allow to hope for a quick exit of enterprises on the pre-crisis level of shipment.

Economic situation

Began in mid-2008 the deteriorating of economic situation in the Kaliningrad Region in January-June 2009 had a tendency to slowing down. This is largely due to the slowing decline in demand for goods and services and to the some improvement in production, as evidenced by a gradual increase in the proportion of enterprises that reporting an increase in output of their goods and services. However, in the 1 half of 2009 compared with the corresponding period last year, under the influence of such negative phenomena as the growth of overdue payables and receivables, the situation has deteriorated significantly with provision of the companies with working capital, has intensified the negative impact of changes in the ruble exchange rate for business activities, essentially increased risks of economic activities.

Against the backdrop of companies' high demand in borrowed funds, credit conditions for the analyzed period have worsened, while their impact on production has increased. Along with this such factors as demanding for products, providing the enterprises with working capital, availability of outstanding receivables increased impact on the main activities of enterprises. In general, most noticeably deteriorated economic situation of such enterprises activities as construction, agriculture, manufacturing of machinery and equipment, production of vehicles and equipment.

Banking sector

The difficulties of the regional economy in crisis affected to the functioning of the banking sector of the Kaliningrad region. Compared with the I half of last year slowed the pace of growth of assets and resource base of credit institutions operating in the region, that resulted in a slowdown in lending. Arrears on loans have significantly increased. The amount of the banks profit reduced as well.

At 01.07.2009 the banking sector of the region consisted of 7 regional banks with 1 branch and 35 branches of nonresident credit organizations, including 4 branches of the Sbergatelniiy Bank of Russia. In comparison with 01.07.2008 the number of regional banks fell by 4. As a result, saturation of the Kaliningrad region by credit institutions amounted to 4.6 per 100 thousand of population, while on 01.07.2008 it was 5,5. At 01.07.2009 the aggregate capital of existing regional banks amounted to 7,4 billion rubles, that on 6,4% more than at the beginning of 2009, but on 10,5% lower than at 01.07.2008.

During the analyzed period, deposits of legal entities in a whole decreased by 0,1% (for the I half of 2008 - growth was in 1,8 times). At the same time, in the departments of Sberbank of Russia and other non-resident subsidiaries of credit institutions funds of legal persons' deposits increased by 10,1% and 2,0% respectively.

Arrears on loans given to the economy of the region (for non-financial organizations and individual entrepreneurs) on 01.07.2009 amounted 70,4 billion rubles (78,3% of total loan debt), increased from early 2009 on 5,8%. In general, the outstanding debt continues to rise, approaching of 10% (in Russia in general - about 6%).

Activity in retail lending in the analyzed period has decreased. At 01.07.2009 arrears on loans given the population in a whole has decreased since the beginning of 2009 to 12,9%, whereas for the same period of the last year saw its growth at 21,9%. The greatest decline (by 19,7%) debts of individuals formed for branch offices of stranger credit institutions.

Against the background of overall decline in lending, arrears grew at a considerable pace. Total arrears on loans given for credit institutions operating in the Kaliningrad region has increased since the beginning of 2009 on 43,3% and its share in total debt has reached 9,1% (on 01.01.2009 - 6,4%). The proportion of arrears on loans to nonfinancial institutions, at 01.07.2009 amounted to 10,3% (at 01.01.2009 it was 7,7%), and for loans to individuals - 6,2% (at 01.01.2009 - 3,4%). It should be noted that the largest proportion of arrears on loans given for the region's economy and individuals at 01.07.2009 was noted in the branches of nonresident banks.

The trend to an increase in accounts payable due to lower shipment lead to deterioration of the situation with supplying of the companies working capital and cash at their

disposal. Provision with contracts also decreased, which further reduced the creditworthiness of the companies, along with falling sales. The negative change in the ruble exchange rate also contributed to a sharp decrease of working capital of most companies, dependent from the supply from abroad, herewith the increase of tariffs of natural monopolies and the growth of rent due to the growth of the cadastral cost of land also contributed to growth in accounts payable.

If we consider the dynamics of the GDP of Russia and the GRP of Kaliningrad region, it is easy to observe that advanced growth of the GRP of the region in previous years are now "compensated" by much more substantial fall in the region's economy on the backdrop of the entire country. Primarily, this paradox is the result of shortsightedness and inconsistent actions of regional authorities in the field of economic policy.

Under such adverse conditions the regional authorities should:

1. Stimulate the demand, reduce the tax burden on households (including cars, real estate), reduce household expenditure (including public utilities, the parent fee and other fees in kindergartens, school levies, sports sections, etc.)

2. Regulate the tariffs of natural monopolies, take antimonopoly actions, where possible - reduce bureaucratic barriers, as the main cause of the growth of transaction costs.
3. Develop a set of measures to attract investment, reduce barriers to new investment and provide support for investment in modernization of production and housing construction.

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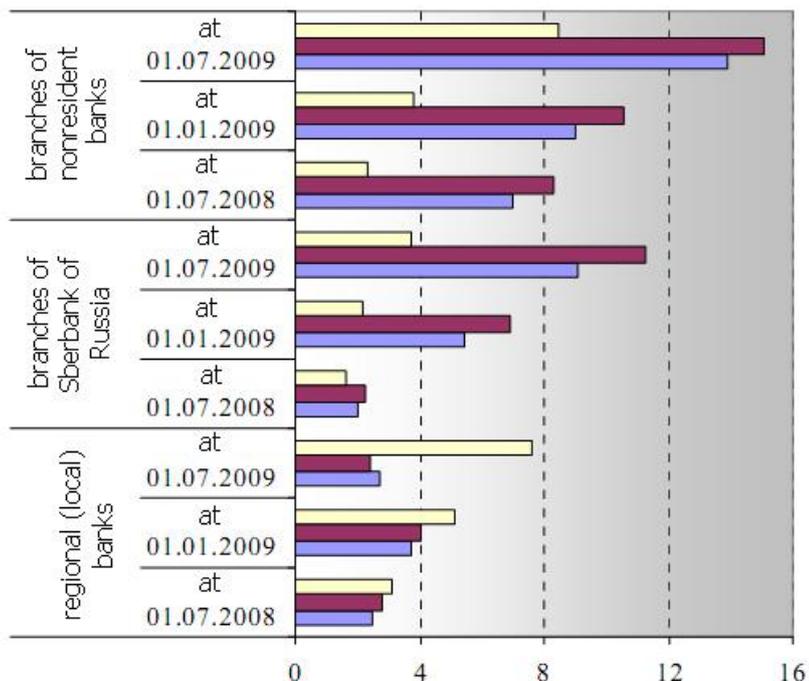
Russia



	2001	2002	2003	2004	2005	2006	2007	2008	2009*
Russia's GDP (% Growth in constant prices)	110,0 %	105,1 %	104,7 %	107,3 %	107,2 %	106,4 %	107,4 %	108,1 %	91,3%
GRP Kaliningrad (% Growth in constant prices)	103,4%	109,5%	109,3%	112,6%	103,6%	111,6%	124,7%	115,9%	86,2%

* Forecast for 2009

Share of overdue credit organizations operating in the Kaliningrad region (% of the total value of debt)



Current economy of Kaliningrad and the situation of energy demand

By Volkmar Wulf

Introduction and current economic situation of Kaliningrad

The present state of impact of the global financial crises reached Kaliningrad a Russian (RF) Exclave within the European Union at the Baltic Sea. The situation of the economy of Kaliningrad became in the first half of the year 2009 apparent more poorly than expected. However the situation differs from branch to branch. Some industry sectors have real problems others are still in relatively good conditions. This might change by the end of 2009 and in 2010 if the devaluation of the Rouble against the EUR raises the cost of goods produced by Kaliningrad's processing companies and reduces the competitiveness on the RF – and / or EU and Global Market. Many companies have reduced their employees or they work only two days or half days a week (but the salary of employees is reduced to their working time). Nevertheless when going through the streets and supermarkets, or look into the restaurants of the city of Kaliningrad or those towns in the vicinity of the region one gets the impression that there exist no crises. But this situation is deceptive as the Kaliningrad economy is quite sensitive to change of scene. However, in the first half of 2009 the index due Kaliningrad Statistical Office of industrial production reached 84,1 % (on the average across the Russian Federation – 85,2 %). On average for June, 2009 the index of industrial production has grown slightly by 32,8 % (across the Russian Federation by – 4,5 %). The volume from processing industry for shipping goods of own manufacture from Kaliningrad reached 74.449 million RUB. The index of processing industry in the time from January till June 2009 reached 74,7 % against 114,5 % in the same period of 2008. It is necessary to note, that in relation to the corresponding months of the year 2008 there was a positive dynamics of growth to be recognised which means that in 2009 one can see a serious recession in production. This has negative consequences to one of the main processing industry sector in Kaliningrad as: of production of electric equipment, electronic and optical equipment. This production line have been reduced due the official index by 55,9 % compared to the level of he year 2008. On the other hand showed the index of manufacturing and distribution of electric power, gas and water in the first half year 2009 only 81,9 % and for June 2009 – 240 % due to repair of the Kaliningrad main power station – TES – 2 which produces approximately 70 % of the electric power for the region. Even in the declining of production in the processing industry and in those time of recession with some slightly growth in the middle of 2009 prices for electric power increases by roughly 25 %. Well, the total building and construction industry went also down and was characterized by a decrease due to the financial and economic crises in the world and which has hid Russia and its Kaliningrad Region at the Baltic Sea, the Russian Exclave within the European Union.

Kaliningrad Region and its Energy Production and Development

a. General and Current Situation

But on the other hand Kaliningrad Region looks and has to look further beyond the financial and economic crises. When economy in Kaliningrad develops in line with the Medium and Long Term Development Strategy the area will be prepared to solve the demand of energy by following sets of points:

- development of the transport infrastructure
- development of the power industry infrastructure
- development of the agro – industrial sector
- development of the tourist and recreation sector

The special geographical position of Kaliningrad at the Baltic Rim defines prospects of development of a fuel and energy complex and an infrastructure as a whole in close interaction with the neighbouring countries. The regional Government sees the following additional main tasks in the area:

- ensuring the power safety of the region and effective social and economic development
- formation of competitive export oriented economy and its integration into the world market

Taking this into account the government of the RF and of the region knows that there is already a huge lack of energy and for meeting this future demand Kaliningrad defines prospects of development of

energy complexes and an infrastructure as a whole and wishes to do this in close interaction with the neighbouring states and so Kaliningrad started a set of special energy actions. The main problem occurs for Kaliningrad Area when the Atomic Power Station Ignalina in Lithuania will be closed by the end of 2009. Lithuania provides Kaliningrad electricity from this Power Station. Another problem concerns the gas and electricity delivery from the RF (i.e. electricity from different Power Station but mainly from the Smolensk Atomic Power Station). This electricity reaches Kaliningrad through Bella Russia, Estonia, Latvia and Lithuania. This long way is a costly distance and loss of energy is pre – programmed. The analysis of current situation in electric power industry of the region shows, that the area has a great deficit of energy. The current energy consumption in Kaliningrad (fig. 2008) area reaches about 4 billion KW/h. Thus the share of export was 30 %. In the long term the energy consumption will increase. The Power Stations in Kaliningrad produce currently only about 2,83 billion KW/h. The different is "import" of energy from neighbour countries or from the RF. Nevertheless the demand of energy in Kaliningrad increases rapidly in future due to the strategy and programme of the Russian government and that of the region for new investments in industry and agricultural industry etc.

b. Kaliningrad and the EU Baltic Energy Ring

Referring to these above views and in this case it will be necessary for Kaliningrad of being a partner of the creation of a *Baltic Energy Ring* as a model for a Common European Energy Space with participation of not just direct neighbours of Kaliningrad but of total Baltic Regions. However, there exists already a network between the Baltic States and from Estonia to Finland and from Lithuania to Sweden. But somehow Kaliningrad Area seems to be excluded. Therefore it will be necessary that this area is linked to a Baltic Energy Ring and the EU Energy Network. In this respect one should not overlook the report from Mrs. Magdalene Hoff MEP and her interview in the Kaliningrad Pravda on July 26th, in the year 2001 when she as the head of the EU – Parliament Delegation in Kaliningrad emphasizing that the European Union will not isolate Kaliningrad. She even referred to the former agreement between the Russian Federation and the European Union, that encourages the process of integration on the regional level and to the Nida Initiative and also the EU Parliament initiative from 2001 and the challenge for Kaliningrad Oblast. Well, an other point is that the Russian – Danish Energy Efficiency Project and the Kaliningrad City Hall, which is a co-operation in energy saving, the Danish energy Agency and the Danish Technological Institute could be the base step to integrate the Kaliningrad Region into Baltic Energy Ring and EU Energy Network.

c. Kaliningrad challenge and problems in climate change and integration of Energy Charter Treaty and energy partnership

Well, Kaliningrad faces a series of challenges too including resources degradation, climate change and other problems. The Kaliningrad Government takes every possibility into account for an integrated energy and climate change policy. This is in line with the conceptual approach of the RF Government to review the Energy Charter Treaty of the signatories from 1990. As it is well known RF's non – ratification as the rejection of the entire process, Russia did not withdraw its signature from that Energy Charter Treaty uses the treaty provisionally accordingly. The President of the RF, D. Medvedev, said in Helsinki in spring 2009 "...global energy cooperation should replace the 1991 Energy Charter Treaty. Actually one should not overlook that the EU's new European Neighbours to the East do not only belong in Europe in a geographic sense, as their citizens also consider themselves European by virtue of common experience and culture, not least because of their Christian roots. However, it must be understandable, that here the RF Exclave in the EU, should be taken into common concern of the EU especially what relates to energy partnership of the Baltic Rim and the EU. A more sustainable longterm development model of the future requires a modern global energy supply system which would be adequate to the current conditions", President Medvedev said. The existing bilateral arrangements and multilateral legally binding norms governing international energy relations have failed to prevent and resolve conflict situations. Therefore it will be necessary to

efficiently improve the legal framework of the world trade in energy resources to avoid further conflicts also for instance at the Baltic Area. To take this into account, that Kaliningrad is somehow excluded from the Baltic Energy Ring the new conflict will be programme in the Baltic Area. The closing of the Ignalina power station in Lithuania and occurrence of deficiency of the electric power in Lithuania (up to 500 MKWh) will lead to essential restriction of transit of the electric power in the Kaliningrad area from the RF for completion of regional deficiency. The question of maintenance of power safety of the Kaliningrad area and effective social and economic development connects the Government of the area with the end construction of the Kaliningrad TES – 2 (Thermal Power Station – 2), designing other generations of capacities with combined development electric and thermal energy in the cities. Kaliningrad having developed systems of the centralized heat supply, development of renewable energy sources, effective Energosperejni. The current TES – 2 Block produce only about 67 % of energy for the Kaliningrad Area. However, on June 6th, 2009 it was agreed with the RF Minister of Energy and Power, Mr. S. I. Shmatko, to establish a new second TES 2 Block for another 450 MWKW. The target is to bring this block on the electric power network in November 2010 for the Kaliningrad area.

d. Renewable Sources for Energy and the Baltic State Interconnection Energy

Well, as mentioned above by President D. Medvedev in spring 2009 and also in line with the views of the Minister of Energy and Power of Kaliningrad the regional Government recognizes that the region should develop a programme of renewable energy sources. In this respect one of the mechanisms of attraction of means for realization of action of the programme will be state – private partnership. The purpose and problem of the state in the field of use of renewed sources are:

- the basic parameters of development of electric power industry with use of renewable energy sources
- list of measures of provisions of economic incentives and support of development of electric power industry on the basis of renewable energy sources
- list of organizational measures of support of development of electric power industry on the basis of renewed energy sources
- target parameter of volume of manufacture of electric energy with use of renewed energy sources for the period till 2020 and beyond. In 2020 renewable energy share should reach more than 4,5 of the total energy consumption of Kaliningrad.

This basic programme could be also one of the parts of the energy and eco – efficient economy provided by Kaliningrad and governing the climate change within Baltic Region States Interconnection Energy Plan.

For Kaliningrad region this new Baltic State Interconnection Energy (see also point b above) Plan is isolating Kaliningrad completely when the action plan of the eight Baltic States signed on June 17th, 2009 together with Denmark, Germany, Poland, Finland and Sweden will come into force. This plan and strategy is to connect Lithuania, Latvia, and Estonia with the EU Energy Network. Part of the action plan is to implement a number of energy infrastructure and market restructuring projects identified in the Baltic Energy Market for a more integrated electricity market in the Baltic Region in accordance with the European Commission's Second Energy Review from November 2008. The target of the plan is to extend the liberalisation of the Nordic Electricity Market. It might be that currently a problem could be the removing of regulated tariffs and cross – border restrictions etc. for the Kaliningrad region as a Russian Exclave within the EU. However, this could be solved in negotiation with the Russian Government so that Kaliningrad could be part and to be connected and integrated into this European plan and finally to the European Electric Network.

e. Existing Electric Power Station and Future Energy Power possibilities

However, one should not lose the sight, that the existing electric power stations in Kaliningrad are very old excluding TES – 2. There are for instance one in Swetley close to Kaliningrad City and one in Gusev not so far from the Lithuanian border. For instance the power station in Gusev was established in 1934 in the German time and has been taken into operation in 1935 for producing electricity. After the end of the war in 1945 this station has been rebuild but what was usable from the previous time, has been integrated into the

construction. 1947 the power station has been nearly ready for producing electricity but it took some more years and at least in March 1955 the first electric power has been produced. End of 1950s the power station has been changed to heavy oil (Masut). The power station currently produces electricity and heat for the city of Gusev and the region. However, the heat power for the city and the area is stopped yearly from April 15th till October 15th. In future the power station will be changed from Masut to Gas, which is delivered from the Gas regions in the Russian Federation. But this does not change the age of the power station.

As mentioned several times above TES – 2 life Power Station of Western Russia is the important and modern facility in Kaliningrad region. TES – 2 is the most modern plant with two modern SIEMENS turbines. The power station with its first Block was established in October 2005. The equipment used here is in a sense unique. It was mainly manufactured in the RF (including the SIEMENS turbine under license). The capacity of the TEC – 2 first Block unit reaches by full power 450 MW. The total capacity of the power plant will reach 900 MW after the second Block will be ready in November 2010. The technology based on the steam and gas cycle will enable to increase the efficiency to 51 % (at ordinary power plants with steam power aggregates the efficiency does not exceed in the Kaliningrad area 40 %), to save up to 20 – 25 % of fuel and reduce pollution air emissions by 1/3. After the second Block of TES – 2 will come into operation the electricity production in the region to develop large scale industrial production with many new workplaces, thus creating a resource basis for attracting investment in Kaliningrad as mentioned above.

f. Renewable Energy Development and Problems

Well, some points mentioned above of the strategies for development of electric power industry mentioned above by President D. Medvedev concern the part of renewables but not mentioning those in detail as for instance Bio Fuels and Bio Gas, Wind Energy, Cogeneration = Combined Heat and Power Generation, and Energy Recovery from Waste by Waste Incineration or electric power station by watercraft. As in the next few years in Kaliningrad five new, but small, electric and heat power stations for the narrow and close regions will be established. The base possibilities for the different power stations are given. As far as information are provided by authorities the various possibilities are discussed in working groups examine which sector of the power station based on renewable "material" will provide the best and efficient power for the region.

Concerning Wind Energy, the established capacity of Wind Energy in Kaliningrad produce about 5,1 MWh and in total RF 14,1 MWh. The total energy in the Kaliningrad territory of Kaliningrad is estimated by 1100 MWh. The use of Wind Energy Stations / Parks can only be recommended in the coastal zone of wind activity. However there are plans that prospects of development of wind parks in water areas of Lithuania, Poland and Kaliningrad area at the coasts of the Baltic Sea particular in water area. Yantarenergo of Kaliningrad plans a project of a Wind Energy Park with 50 MWh in the Baltic Gulf. That park could perhaps cover 25 % of electric power consumption in Kaliningrad. But one has to take into consideration that Kaliningrad Region and the neighbouring countries are part of the bird migration route. Wind energy parks could disturb the bird route in spring and in autumn.

Well, an ambitious renewable energy policy in Kaliningrad is not yet completely seen. Lots of work has to be done. One sector is the clear directive of legislative law and regulation energy power and industry interests on energy out of renewable material. One could be the "copy" of the EU recycling strategy. That strategy is targeting on prevention and recycling waste to pave the way towards a recycling society by decoupling economic growth from resource use. As the living standard in economy rises after the current crises natural resources even in the RF and so especially in Kaliningrad will not be available for use for ever. However, renewable on the other hand could spearhead regional market integration in Kaliningrad together with its Baltic Neighbours, if the Baltic States together take the advantage of the cooperation mechanisms in this area. A binding target to satisfy the energy consumption from renewable energy for instance from waste in the frame of cogeneration is very challenging for the electricity industry, which will have to produce perhaps 35 % of total electricity from renewables. Cogeneration (CHP) would bring Kaliningrad closer to its energy related goals. It is a proven tool to increase energy efficiency and to achieve energy savings' targets. It contributes a high percentage of annual primary energy savings objectives. It reinforces efforts to fight climate change by reducing

CO2 emissions and decreasing electricity network losses. The technology for cogeneration is on the market for decades, the common perception is that cogeneration is in the opinion of the engineers of administration archaic, particular when compared to new technologies, such as solar panels or Nuclear Power Stations as planned in Kaliningrad close to the Lithuanian border. Moreover, the use of fossil fuels for instance in cogeneration is considered unattractive, and knowledge of the efficiency and potential uses of biomass or waste for energy recovery etc. is not widespread. One should keep in mind that especially in Kaliningrad and might be in other RF areas too, waste is mainly land filled in deposits but also thrown into the landscape. (See *ECAT STUDY – Environmental Situation in Kaliningrad from 1999*) Landfill not only takes up more and more and more and more valuable land space, it causes air, water and soil pollution, discharging carbon dioxide (CO2) and methane (CH4) into the atmosphere and chemicals and pesticides into the earth and groundwater. This in turn is harmful to human health, as well as to plants and animals. In waste we have the best recourse for Cogeneration. It depends for small demand one can establish a small cogeneration plant or if necessary a large cogeneration station for heat and electricity. Large CHP facilities have in general lower production costs than small units. Kaliningrad region at the Baltic Rim is a small area and avoiding cost from long distance transport of energy from the Russian main territory cogeneration could be one sector for energy demand in future by incineration of waste in combination with bio gas or bio fuel. By selecting waste for incineration useable raw material will be separated for recycling and also other important resources will be protected for other important purpose.

g. Nuclear Power Station

Last intention for energy development is the plan of Kaliningrad and the Russian Government to establish a Nuclear Power Station in Kaliningrad Region close to the Lithuania border. This power station has among experts no unanimity as to how realistic; environmentally sound of economically viable are the plans to create a nuclear power station together with a French Company. On the other hand Iglanina in Lithuania will be closed under the presser of the European Union and not far away from that power station a new nuclear power station will be established. The Kaliningrad regional authorities at the moment are strongly in favour of that plan and some practical steps are made already in the direction of that plan. The Government of Kaliningrad Region and investors as well of the construction bureau have signed a contract for that Baltic Atomic Power Station. Well, in addition, the Russian Ambassador for Lithuania, Dr. Vladimir Tschchikvadse, in August this year required that Lithuanian investors should or could participate in the creation of the nuclear power station "Baltijskaja". The demand, he said, reaches about six billion EUR (€) by private investors. It is possible, that foreign investors participate but the main shares will be kept in the hands of the Russian Federation. The Russian Federation argues that it is cheaper for Lithuania to participate at the Russian Power Station than to reconstruct an own one. However, Lithuania prefers as mentioned above to establish together with Poland, Sweden, Latvia, Estonia and the other States of the Baltic Sea Area a common EU Energy Ring. The Kaliningrad Atomic Power Station will provide the Kaliningrad Area with electric power especially for use in industrial industry. The station will be build by Russian companies which are part of the holding "Atomenergoprom" in St. Petersburg. It is estimated that the Nuclear Power Station of Kaliningrad will after termination in 2016 or 2018 manufacture electricity by two power units 2.300 MWt. And later there will be the possibility to export electric power of 900 and 1.700 Mwt. to the neighbourhood countries. On June 6th, this year a conference took place in

Kaliningrad with the Russian Minister Sergey Shamtko and nearly all general directors (CEO) of the largest generating and electricity network power station in the Russian Federation. The key issue was the construction of the Nuclear Power Station in the Kaliningrad Region as well as:

- necessary changes to be introduced into legislation taking into account the peculiarities of the Kaliningrad Region situation;
- development of the electricity grid and of the infrastructure of the region with regard to the planned commissioning of new generating capacities;
- Prospects of electrical power import / export organisation, ensuring the full – capacity operation of TES – 2 power Station;
- and finally how shall the radioactive nuclear waste be handled. This important item should be solved before the power station is been build. There are many doubts that it is possible to transport that special waste through Lithuania and Bella Russia or by ship via the Baltic Sea or to keep these waste it in the permanent disposal in the Kaliningrad Region. And on the other hand, nuclear energy is one of the cleanest if handled the condition which is necessary so that no harm will occur for the public.

Energy of all kinds including nuclear energy is on the other hand important to be developed in total because it is necessary in the Kaliningrad Region for the future to guarantee the prosperity and economic situation of the Kaliningrad Region in future and make the region attractive for the people / inhabitants and investors.

Conclusions

The problem for Kaliningrad is although, practically and finally currently the complete absence in the RF of legislative initiatives on development of the market of the renewed energy sources operating in many industrialist countries of the world. Further the laws and regulations as well as the stimulation of the inhabitants are missing. However, it should not be denied that first signs are there in Kaliningrad in this respect. Some schools do teach or instruct pupils about environment etc. and to help collecting waste (perhaps once a year) from landscapes as beaches, forest or environment of housings and living places. But this waste will be collected and thrown into bins and transported to the landfill, which is not the renewable view of the Russian President D. Medvedev or Prime Minister V. Putin. Well, it is necessary, that the Kaliningrad area will be the first region in Kaliningrad taking care of the transformation planed of Prime Minister Putin to change the economy in Kaliningrad away from the raw material delivery towards a real industry and processing industry sector with a large small and medium size companies and job – sharing sectors. Naturally the European Union has to play its strong card too and is responsible for that what has been said in the past: the European Union will not isolate the Kaliningrad Region. Russia and here Kaliningrad is the key to the Baltic Sea Region.

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Baltic Sea cooperation – from strategies to results

By Matti Vanhanen

The Baltic Sea and the surrounding region face severe challenges which require urgent and determined action. I want to emphasise word “action”. We do not save the Baltic Sea or boost its economy alone by giving statements or preparing papers. We need concrete actions.

Policy papers and action plans are important and useful tools for us to define priorities and actions needed. The EU's Baltic Sea Strategy and the accompanying action plan are valuable documents to summarise what needs to be done and to guide our actions. However, without concrete actions the documents will lose their relevance.

We know what should be done, and now is the time to do it. But no government can do it alone. In order to get real results we need cooperation of all coastal states, and in some cases of a wider catchment area which includes e.g. Belarus. We need cooperation in all levels and fora – from international organisations to individual citizens. In addition to policy decisions we can all make difference by our own choices.

With this action-oriented approach in mind we have launched together with President of the Republic Tarja Halonen and the Baltic Sea Action Group, chaired by Ilkka Herlin, a joint initiative: The Baltic Sea Action Summit 2010, held in Helsinki in February 2010. The initiative builds on a strong public-private partnership and concrete commitments.

The Summit will not be just any summit meeting. It will be a meeting of commitments and actions to save the Baltic Sea. Governments, public institutions, private enterprises and non-governmental organisations from the Baltic Sea region are invited to make concrete commitments facilitating the recovery of the sea. Several actors, international corporations among them, have already joined the process by making a commitment to environmentally sound practices and donating their know-how, products and funds.

What kind of commitments can we make? We do not have to invent those actions. The Baltic Sea Action Plan by the Helsinki Commission, adopted in November 2007, includes a number of recommendations and actions needed to restore the good environmental status of the Baltic Sea. There are actions and concrete recommendations in four areas: eutrophication, maritime actions, hazardous waste and biodiversity.

The HELCOM Action Plan introduced a totally new approach to the prevention of eutrophication as it determined a ceiling on the nutrient loads that the sea can take. Based on the ceiling, each country was given a specific reduction target. It is of crucial importance to reach those well-defined targets. There cannot be any excuses to backtrack from the commitments already made.

The state of the Baltic Sea is alarming and we all have to improve our performance. We all have homework to do. In order to enhance actions Finland can and should take, we have prepared a Government report on Baltic Sea policy. In the programme we have over 70 concrete and practical actions to improve the protection of the marine environment and maritime safety, as well as to enhance economic cooperation. Some of these actions we can take nationally, some with our neighbours and some actions require EU-level, regional or international cooperation. What is important is to know what needs to be done and then find the best forum to implement it.

In Finland we have already taken efficient measures to improve industrial processes and the treatment of municipal wastewaters. We have reached the level where we can no longer achieve any major reductions in discharges. Additional measures would not be cost-efficient any longer. However, it has been much more difficult and slower to cut discharges from agriculture, forestry and scattered settlements where you cannot apply technical solutions and add new devices. So, we have basically done the easy things and now we need to scatter additional measures from smaller streams, which is always much more difficult.

No country can save the Baltic Sea alone. We need cooperation and joint efforts. The European Union has many efficient tools at its disposal. The EU's Baltic Sea Strategy will help us to use the EU toolbox more efficiently and coordinate various actions and programmes better. We have a long tradition of good cooperation in the whole Baltic Sea area and we need to build on those foundations.

In addition to public level actions we need cooperation and contribution of other actors, that is, private companies, non-governmental organisations and private citizens. The Baltic Sea Action Summit brings into the picture these private and non-governmental actors. Even if it is not evident from the first sight what these actors could do to the benefit of the Baltic Sea, there is almost always something one can do in their own area of expertise.

The success of our Baltic Sea measures will not be judged by words but by deeds. It is concrete results that count. I invite you all to take part in the work to save the Baltic Sea.

Matti Vanhanen

Prime Minister

Finland



The Baltic Sea region at the crossroads of culture and economy

By Laine Jänes

Cooperation among countries situated by the Baltic Sea is active, and cultural contacts are in most cases so self-evident that we may not always even notice this interaction. But now the Nordic and Baltic countries as well as North-Western Russia have begun to focus on stepping up cooperation in the field of creative industries, which creates completely new opportunities for merging creativity and enterprise when increasing the attractiveness and competitiveness of the entire region.

The Baltic Sea region stands out in the European Union with higher than average indicators of culture consumption, people working and companies operating in creative industries and the proportion of creative industries in the gross national product. Nordic countries are also Europe's frontrunners in innovation and introducing new technologies. The region, with its rich heritage, vibrant cultural life, innovative ideas and modern technology, has all the makings of becoming the leader in creative industries in the whole of Europe.

The role of culture and creativity in increasing economic growth and employment is one of the central subjects in the relevant European Union policies, and cooperation in these matters has been very active in the interaction among Baltic Sea countries. Inventive and innovative business that is based on traditional skills and honours the uniqueness of cultural environments is certainly a great potential for the region.

Europe has been talking about creative industries already for more than 20 years. The Baltic Sea region may have had a slow start, but today's developments are definitely promising. Creative industries networks have already tied the Nordic countries and Baltic countries into a well-functioning network. We are also actively contributing to developments at European Union level. We are currently preparing a cultural and creative industries cooperation platform within the Northern Dimension, which brings together the European Union, Iceland, Norway and Russia in achieving common goals.

On the one hand, cultural cooperation within the Northern Dimension supports direct contacts among cultural actors, organising various festivals and joint events and sharing the region's diverse cultural traditions, and on the other hand, it creates the environment for implementing the ideas and projects born at the crossroads of culture and economy and for finding new sources of financing. Involved in this process are ministries, international organisations, potential investors and, naturally, cultural actors representing various fields.

Cooperation is of key importance in developing creative industries. Viewed separately, practically all the countries of the region are too small to be able to create a significant large-scale effect. When viewed as a region, on the other hand, our market share becomes considerable, which in turn makes us more competitive on the global arena. This message has been understood by the Nordic countries, who do not limit the development of creative industries only to the domestic market, but are directing considerable attention

both to Western-European and Asian markets. Among the areas with potential are design, music, the audiovisual field, but also the gaming industry. In addition, promoting creative industries makes the region more attractive to tourists and contributes to introducing all countries of this region to the world through entirely positive messages.

Of central importance in building up a creative economy is education. This is where the competitive edge of the Baltic Sea region lies. To this end, the merging of different universities, disciplines and curricula should be intensified. A bold example to be followed by all others is the Aalto University, created by merging the Helsinki University of Technology, the Helsinki School of Economics and the University of Art and Design Helsinki. Although we still lack such cooperation results, we can assure that innovation at its best is achieved by bringing together creative ideas, practical solutions and venturesome people. Addressing the younger generation is important for all of us and we should think about working out common education principles and joint methodological grounds.

Estonia finds it very important to develop cooperation between the Baltic region and the Nordic countries. It is important to use the experiences of the Nordic Innovation Centre and the process that led to the Creative Economy Green Paper in the Nordic Countries. There are already a lot of cultural contacts between the Baltic and Nordic countries. Using the already existing experience and finding common solutions is a key factor to our region's competitiveness.

Estonia has put a lot of effort into raising knowledge and awareness of creative industries among the culture sector and entrepreneurs. We have encouraged our professionals to follow the example of the Nordic countries, who have found a good balance between the cultural and social needs of society and business.

We have the opportunity of taking on the role of the intermediary of various good practices both within the region and in the European Union. We have made quite active use of European Union funds aimed at culture; several important projects have been completed and there are others to come. We are also unique in that we have directed funds at promoting creative business through the foundation Enterprise Estonia. We can share with others the experiences of planning this process and incorporating the relevant parties.

It is wise to focus on topics where joint efforts are needed to achieve goals that would be difficult or even impossible to reach alone.

Laine Jänes

Minister of Culture

Estonia

Belarus on the road towards the Council of Europe

By Sinikka Hurskainen

Relations between the Parliamentary Assembly of the Council of Europe (PACE) and Belarus began in the early '90s. A process of democratic transition in Eastern and Central Europe led the countries from the region to look with new interest to the Council of Europe, the oldest democracy and human rights standard-setting organisation on the continent.

In 1989 PACE introduced 'Special Guest Status' as a mechanism to allow parliamentarians from potential candidate countries the involvement in PACE activities, in order to forge closer links and to help their countries meet the conditions for the Council of Europe membership. Parliamentary delegations with Special Guest Status can participate in the activities of the Assembly and its committees, with the right to speak but not to vote.

The Belarusian Parliament was granted Special Guest Status in 1992. In the following years other countries from Eastern and Central Europe, followed by countries from the Caucasus, were granted membership of the Council of Europe. Belarus, however, was left behind due to its lack of progress in the organisation's core areas: democracy, the rule of law, and the protection of human rights. In fact, structured relations between PACE and Belarus came to a halt: Special Guest Status was suspended in 1997 and the suspension was confirmed in January 2004.

In April 2004, the Pourgourides report, on the fate of four political opponents who disappeared in Belarus between 2000-2001, marked a new stage in the deterioration of relations between PACE and Belarus. Pointing at the involvement of a number of high-profile officials in the disappearances, the report asked for an independent inquiry to be carried out, and announced that until such an investigation, even the informal presence of Belarusian parliamentarians in PACE activities would be inappropriate. Between April 2004 and January 2006 there was no contact at all between PACE and the Belarusian authorities.

Since 2006 several representatives of the Council of Europe have visited Belarus. These sporadic, yet significant contacts between PACE and the Belarusian authorities intensified with the appointment of a Rapporteur, Mr Andrea Rigoni, who has always been adamant that dialogue is the only way to bring democratisation forward in Belarus.

Recent developments in Belarus form a complex picture, where, for each key area, progress and problems coexist:

- 1) The liberation of a number of prominent political prisoners before August 2008 was a key improvement, but obstacles to the activities of opposition parties, movements and NGOs remain. The general climate is such that the expression of political views deviating from the official line is stigmatised, repressed and sanctioned, not only through measures taken by the judiciary and law enforcement officials, but also by loss of employment, expulsion from universities or forced conscription into military service.
- 2) In the area of freedom of association, even if the opposition movement *For Freedom!* was finally registered, other organisations continue to face obstacles in obtaining registration by the Ministry of Justice while their members risk prosecution for membership in these non-registered organisations. This article of the Criminal Code has not been repealed.
- 3) In the media field, despite the inclusion of *Narodnaya Volya*, *Nashe Niva* and *Uzgorak* in the state distribution

network, many other independent media outlets cannot benefit from this system nor even be printed in Belarus. In addition, foreign journalists face difficulties in obtaining press accreditation and foreign media, including the satellite channel BELSAT, in obtaining registration. On the other hand, numerous statements coming from the Belarusian leadership indicate their willingness to ensure that the new media law is not implemented in such a way as to restrict freedom of expression.

- 4) In the area of capital punishment, the death penalty is still on the books and there are no concrete signs that a moratorium is in the pipeline, despite the reduction of the categories of crimes for which it can be inflicted and a decrease in the number of death sentences handed down.

Finally, even if the September 2008 parliamentary elections were regrettably below European standards of freedom and fairness, it is to be welcomed that the Belarusian authorities have started to work with the OSCE/ODIHR on the reform of the electoral legal framework and practice, in order to align it with OSCE commitments.

Rigoni's report finds that although Belarus is far from Council of Europe standards in the field of democracy, human rights and the rule of law, in recent months its authorities have taken important steps in the right direction, and that they have shown, as never before, a willingness to engage with European organisations and respond to their demands.

In June 2009 PACE voted in favour of restoring the Special Guest Status of the Belarusian Parliament with a view to engaging in political dialogue with the authorities while supporting the strengthening of democratic forces and civil society. This status, however, could only be granted after a moratorium on the execution of the death penalty is decreed. The parliamentarians also said that a delegation of the Belarusian extra-parliamentary opposition should be invited to participate in the work of the Assembly and its committees.

By stopping further execution of death penalties and by going towards abolishing it altogether from the legislation in the future, Belarus can show concretely that it truly wants to move forward on the road towards Council of Europe. With these two steps the Special Guest Status can come into effect.

Sinikka Hurskainen

*Chair of the Sub-Committee
on Belarus of the Parliamentary
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*Member of the Parliament of
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Finnish delegation*



Russia's challenges in the global crisis

By Mikhail Dmitriev

Unlike many other economies, Russia entered the crisis in a high confidence mood.

Then it seemed to be well grounded: huge FX reserves (\$598 billion - third most largest in the world), fiscal surplus (6.8 % of GDP in 2007), small public debt (5% of GDP, end 2008). Among BRIC countries perhaps only China could be a match in the relative size of fiscal space for anti-crisis policies. Russia's fiscal stimulus package (4% of GDP in 2009 apart from extra 2% of GDP spending on pensions and other social programs) was also one of the largest in the world.

However, the crisis dramatically exposed vulnerabilities of Russian economy including heavy reliance on natural resource exports and on international capital inflows. By comparison to other BRIC countries, Russia suffered the worst deterioration of the terms of trade and the largest capital outflow (mainly due to the run of portfolio investors and inability to refinance medium-term corporate debts).

As a result, by mid winter Russia lost more than a third of hard currency reserves and finally was forced to devalue its currency deeper than India and almost on par with Brazil. Shrinking exports and capital outflow triggered deep recession, second only to Ukraine among large economies. By May 2009 manufacturing output declined by 17.1% yy and investments fell by 24.5% yy. In the Baltic region the magnitude of the recession in Russia was compatible to that of Latvia and Lithuania.

On the positive side, generous social transfers (wages in the public sector were increased by 5-9 percent in real terms, and pensions – by 13.4% in real terms) almost offset the decline of other incomes. Therefore, in stark contrast to economic performance, household incomes in the first half of 2009 were sustained at pre-crisis peak levels. Poverty headcount increased insignificantly and in Q1 still remained below 2007 level. Number of registered unemployed, albeit increased by over 1 million, still remained roughly at 2005 level (quite a favorable year for Russian economy). Since February number of unemployed (ILO definition) was declining roughly by 200 thousand per month. Contrary to great recession of 1990s, when Russia experienced sharp decline in birth rate and life expectancy, during the first 9 months of 2009 these indicators were improving.

But social achievements came at a price. Fiscal deficit for 2009 is projected at 7.4% of GDP, 7.6% for 2010 and 4.5% for 2011. Budget reserve funds which reached 13 percent of GDP by the end of 2008 risk to be depleted by 2012. The most onerous spending program by far is related to pension reform. In 2010 Pension Fund budget will increase by at least 4 % of GDP from pre-crisis level. Rapid population ageing during next decade will make problems only worse. Pension system in its current state becomes the major source of long-term fiscal instability which could undermine the impressive record of fiscal prudence of the last decade. Besides, generous social spending did not translate into consumer demand. Households responded to uncertainty by increasing savings and curbing consumption. By mid 2009 household savings rate increased by 10 percentage points and retail sales plunged by almost 10 percent. They became the second most important contributor to GDP decline in Q2 (10.9% yy).

Improved terms of trade and reopening of access to global financial markets supported output recovery during summer. But 70 percent of output growth was attributed to higher exports and the rest to import substitution. By far anti-crisis stimulus package of the government had almost no effect on output. Recovery in Russia still looks weak and fragile by comparison to other BRIC. Besides, output remains highly sensitive to volatile commodity markets.

Until very recently, government expressed little interest in post-crisis structural adjustment. In fact, many of the policies implemented during the crisis intended to prevent the much needed restructuring at the enterprise level. Authorities tried to prevent mass layoffs, provided protection from foreign competition and tried to keep afloat even hopelessly uncompetitive companies like the largest carmaker AVTOVAZ. But with the end of recession in view, the longer-term disadvantages of such patronizing strategy become obvious.

High economic growth in Russia during the past decade was non capital intensive (due to relatively low initial capacity utilization and fast growth of retail and other non capital intensive services).

Incremental capital-output ratio was roughly twice as low as in other large economies like China and United States. It was also underpinned by steady growth of labor supply (which contributed more than 2% of GDP increase annually). Fiscal stability compensated for slow progress in institutional reforms and allowed impressive gains in international investment and competitiveness ratings.

In the post-crisis economy commodities are unlikely to remain a dominant growth driver and Russian economy will have to diversify. Besides, in the next decade Russia is facing labor supply decline of over 1 percent per annum. It will also need huge investments to modernize outdated manufacturing and infrastructure. Rough assessments indicate that Russia will need to increase investment rate to GDP by at least 6 percentage points to sustain GDP growth rates at 4 % (3 % below pre-crisis average). Given the structural weaknesses of domestic financial sector, most of incremental investments should be drawn from the global markets.

But after the crisis this task does not seem as easy as before. During the crisis, market vector volatility for Russia (an indicator of investment risks developed by Nobel Prize winner Robert Engle) increased much steeper than for majority of emerging markets and is now approximately two times above the average for emerging markets and for BRIC. Even more worrying is that Russia's market vector volatility is considerably higher than the volatility of oil and gas price index. In the recent WEF Global Competitiveness Index Russia' slipped 12 lines down (second worst performance after Latvia). India and China, on the contrary, improved their ranks by one point and Brazil moved 8 ranks up the scale (the best performance in the sample). The survey revealed negative assessment of Russia's medium-term economic perspectives by international business community, again, in stark contrast with the positive assessment for India and China and most favorable – for Brazil. Before the crisis Russia's medium term perspectives seemed to be at least as good as for the BRIC as a group. Since the onset of the crisis, Russia is looking more like an outlier – a dire warning that something goes badly wrong for the Russian economy.

With such expectations in the global markets, business as usual is not possible any more. Relative fiscal stability per se is no longer enough to attract capital. The end of easy growth based on commodity rents, made the markets less tolerable to noncompetitive business practices, rent-seeking, weak rule of law, rampant corruption, cronyism and political interference which became the hallmarks of Russian capitalism. After the crisis "growth without investments and institutions" is no longer conceivable. Unless it demonstrates tangible improvements in business environment, Russia is unlikely to attract investments it needs to sustain growth rates of at least 4 % a year.

One can suggest that current crisis manifests a turning point in Russian history when transition to modern postindustrial society becomes key determinant of future economic success. Such transition presumes bold modernization of public and institutions, more opened society and competitive political system. At the turn of the century similar challenges were faced by Japan and Republic of Korea, and more recently – by Central European and some of the Latin American countries including Mexico and Brazil. From now on, Russia's economic perspectives will be forged first and foremost by the progress of post-industrial social transformation. In this intricate process our country may strive to be a forerunner, like Republic of Korea, or could become a laggard, like Japan.

Mikhail Dmitriev

President

*The Center for Strategic
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Russia



The death of print? The challenges and opportunities facing the print media on the web

By Kimmo Lundén

"Either you go on to the web and you go broke. Or you don't go to the web - and you go broke!"

John Lloyd, Director of Journalism at the Reuters Institute for the Study of Journalism, had the point. The old business model of the news industry is broken and the new ones are still in development.

Why should print media die? Will it die? Is the market for paid news failing? Are the internet and the web's free online news failing to satisfy our hunger for news if the business model for printed newspapers is in trouble? What are the implications for democracies? What are the possible business models for online news?

In a market economy, a profound factor is a (perceived) need and demand for something. The need for information is not going to vanish. Information is the key to the questions and answers to, for example, discussions on globalisation, climate change or business and finance.

And in the digital era there are masses of new information to be reported and sorted. In the next five years, we will produce more information that can be stored and indexed via the web than has existed in the entire preceding history of human civilisation. That digital tsunami is being captured by the growth rates of popular websites like You Tube, Flickr (photos) and Wikipedia.

The news industry faces a dilemma in the era of the web: newspapers are better read than ever before when the number of web-site visitors are included. However, the problem is that advertising on the internet is a lot cheaper than it is in printed editions. In most cases, for the time being, it won't bear the cost of creating the content.

The web is not a problem in itself for the traditional print media. It is the readers and audiences who are to blame - and the publishers themselves. They have been relying on having enough readers to sustain advertising revenues on the web, but, at the moment, this does not generate enough money, even with the millions of monthly unique site visitors.

I participated as a Journalist Fellow to the Reuters Institute's Journalism Fellowship programme at the University of Oxford for the academic year of 2008-2009. During the year I had the pleasure to listen and talk to academics, media professors, prominent newspapers' senior journalists, editors and publishers. None of them believed anymore, that the content published on the websites for free will pay the cost of content with advertising revenue only.

With the global economic recession and plummeting advertising revenue of the media, we may have seen the end of the free lunch. The publishers have enjoyed a time of high profits, which now seem to be over. The number of companies that can be sustained by revenue from internet advertising turns out to be far smaller than many people anticipated. Those publishers, who still obtain revenue from online subscriptions are lucky to report also other revenue besides their plummeting advertising revenue.

The writing is on the paywall again, even though that online business model was already thought to be impossible on the web.

But how have we in the media once thought, that our content should be given free to the online news sites - to gather as much audiences as possible and attract advertisers? Some citizen journalism enthusiasts and bloggers argue, that they are not anymore media consumers but users, who use the content to support their conversation, blog sites and their own media outlets. Consumers pay, users don't.

Well, in that case, I would like to be an electricity user - not a consumer - and I should not have to pay for my electricity! The logic is the same.

To find an economically viable business model for a print newspaper in the era of the web, there is no 'one size fits all' answer. Neither is there a silver bullet for every online news site to alter and become an economically sound business.

The owner of News International, Rupert Murdoch, commented recently: "I think we have to find new ways to monetise our huge audiences". The downturn has shown the value of the Wall Street Journal's subscription model. As the global recession hit the advertising markets in the 4th quarter of 2008 and subsequently, the news publishers, which did not count on advertising revenue only but had a steady and even rising revenue stream from subscriptions,

were satisfied. Pearson, the publisher of the Financial Times, was in that way, more shielded compared with other publishers. The company had also to take steps to cut its costs in anticipation of a worsening economic climate.

The New York Times, which earlier also gathered subscription fees from their website users, is rethinking to return to subscriptions online. The NYT stopped charging for access to parts of its web site in September 2007. What changed, the Times said, was that many more readers started accessing the site via search engines (Google and Yahoo) and links from other sites instead of going directly to NYTimes.com. These indirect readers, unable to get access to articles behind the pay wall and less likely to pay subscription fees than the more loyal direct users, were seen as opportunities for more page views and increased advertising revenue.

In February 2009, the growth of advertising revenue ceased, and so subscriptions again appeared to provide the more attractive and constant type of revenue, compared to the uncertain advertising revenue.

The year 2009 might turn out to be a year when publishers will try to revert to the subscription or partly-paid content models. The freemium philosophy combines free online content with a premium, which is backed up by paid subscriptions.

The problem is that, if one tries to do it and nobody follows, then the one who charges will lose out.

There is a social cost to democracy involved, if the local and regional papers in even the major cities are forced to close due to economic reasons. Clickstream hunting on the web can influence the editorial coverage, and thus leave some of society's important areas without any media coverage.

The death of newspapers has been predicted several times in the past, too, but papers have survived in one format or another every time. In the 1960's, it was television that was supposed to kill newspapers. It never happened. Now, almost 50 years after the technological revolution heralded by TV, it might be that, in the era of the internet, TV is a more endangered market than newspapers - both printed and online.

Going online is supported by not only cost savings but also environmental issues: fewer trees are cut down to provide paper. Sure, there are costs involved when creating and running a digital infrastructure; however, for most publishers in the world, print remains their main source of revenue and profit for the foreseeable future. As long as printing newspapers is a profitable business, it does not make sense for publishers to abandon it. Professor Robert G. Picard predicts that the printing of newspapers will continue for at least 20-30 years: "Over a period of time, you're changing the newspaper to be online. And, at some point, it is most likely that a newspaper is not going to be published in a newspaper format like it is today, but I don't think it is going to happen for 20 or 30 years."

This story is relevant because, for the newspaper industry and its publishers to survive, they have to find ways to keep their product economically viable by publishing quality content, which attracts enough both readers and advertisers.

But this is nothing new; this has always been the case, although the environment has become more challenging for publishers during the era of the web and the current global financial crisis that is hitting both the news industry and its business environment.

Newspapers are not dead, but they will have to alter, finding what they are best at and devising ways to exploit this financially. The web has brought both challenges and opportunities to the media, which it has to discover.

Kimmo Lundén

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Environmental regulations are a challenge for the shipping industry

By Ulla Tapaninen

Maritime traffic has always been considered as an environmentally friendly mode of transport. When thinking of a sailing vessel at sea, who could think of a transport mode friendlier for the nature. Unfortunately, the times of the great sail vessels are gone, and situation today is different.

Nowadays, the negative effects of maritime traffic on the environment can be considerable: ships make noise and harmful gases, waste and wastewater are dumped into the sea, the engines run on fossil fuels, ballast waters may bring unwanted alien species to vulnerable seas, toxic materials, e.g. heavy metals and asbestos have been used in building vessels, poisoning the environment and endangering the health of the workers when vessels are scrapped. In case of ship accidents large sea and shore areas can be destroyed even for decades.

However, compared with other modes of transport, due to its environmentally friendly image, the shipping industry has managed to stay quite a long time out the focus of "green movement" and tightening environmental regulations, while industry and car manufacturers changed their strategies during the last decades. It was not until 1970s before the United Nations based International Maritime Organisation (IMO) made its first regulations concerning the environmental effects of shipping. The first environmental regulations at sea concerned the handling of waste and wastewater. In addition, it was not until 1990s before IMO started to make regulations for emissions to air within the shipping industry. Due to the technological improvements of other transport modes, the share of shipping in emissions to air has increased all the time.

Quality of heavy fuel used in vessels gives a revealing example of environmental issues in maritime transport. In 1970s the vessels burned practically the same fuel as other big machines and vehicles everywhere. While environmental rules were getting tighter on land, the crude oil was purified and the cleaner part was used in land and the rest at sea. Today, the price of ship fuel is even lower than that of crude oil, it is practically considered as waste. In other words, shipping has been taking care of the problem waste of oil distilleries without thinking of its costs. Now it is time to pay these costs.

Cheap fuel and consequently cheap sea transport has been one of the main promoters of globalisation. Since 1995 the worldwide container transport has increased by 150% bringing mainly cheap consumer goods from Asia to consumers in Europe and America.

Presently we are in a situation where instead of shipping in many respects it is more environmentally friendly to travel by other means of transport, in particular by rail, but even on land. Consequently, there are coming various expensive requirements to make sea transport more environmentally friendly. For example, in 2015 in the Baltic and North Sea areas the vessels will switch to use low-sulphur fuel. It has been calculated that this will bring extra costs for Finnish industry in total from 200 million Euros up to even 1,2 billion depending on the oil prices. Similarly, Swedish Maritime

administration calculated that changing into low sulphur fuel will increase transport costs in shipping by an average of 20-28%. They have also calculated scenarios where part of the present transport flows at sea will move on land.

While Finland is so dependent on sea transport (75% of import and 89% of export is transported by sea), these kinds of environmental costs do not have only effect on transport modes of the Finnish industry but also on the location of industrial facilities. It will be questionable whether heavy industrial goods (e.g. paper products, machinery) are economically feasible to be produced in the area of Baltic Sea at all.

Low sulphur fuel is only one of the environmental challenges the shipping industry is facing in few coming years. There will be more and more regulations on waste waters, solid waste handling, noise pollution, nitrogen oxide emissions, ballast water treatment, ship recycling etc. One of the most urgent questions is how the shipping industry will take its share on reducing global greenhouse gas emissions. There are still many options and open questions, but while writing this, IMO is busy making proposal to UN, regarding the actions and measures that the shipping industry will take. In any case, these actions will have a fundamental effect on maritime economics, global shipping and international industry.

However, we must not forget the fundamental basis of shipping. It is a mode of transport that can be utilised far from congested housing areas with low need of energy when compared with the amount of cargo transported. This brings obvious opportunities to engine manufactures, ship designers, shipyards, port machine manufactures and even supply chain managers and ICT systems. To fulfil the tightening environmental regulations in shipping, high technological expertise and logistics knowledge is required. The speed and fluency of transport, as well as any technological developments in vessel design are to be fitted into the requirements of the supply chain. This expertise can be turned into a competitive advantage of Baltic Sea shipping. The path will be long and expensive, but it is worth to take.

Ulla Tapaninen

Professor

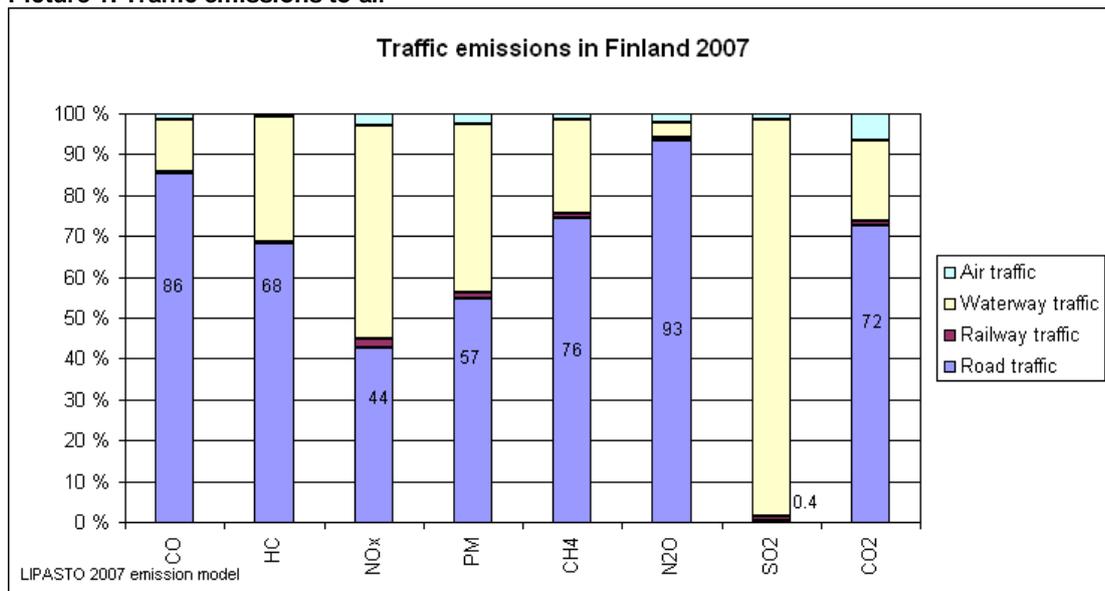
*Centre for Maritime Studies
University of Turku*

*Kotka Maritime Research
Centre*

Finland

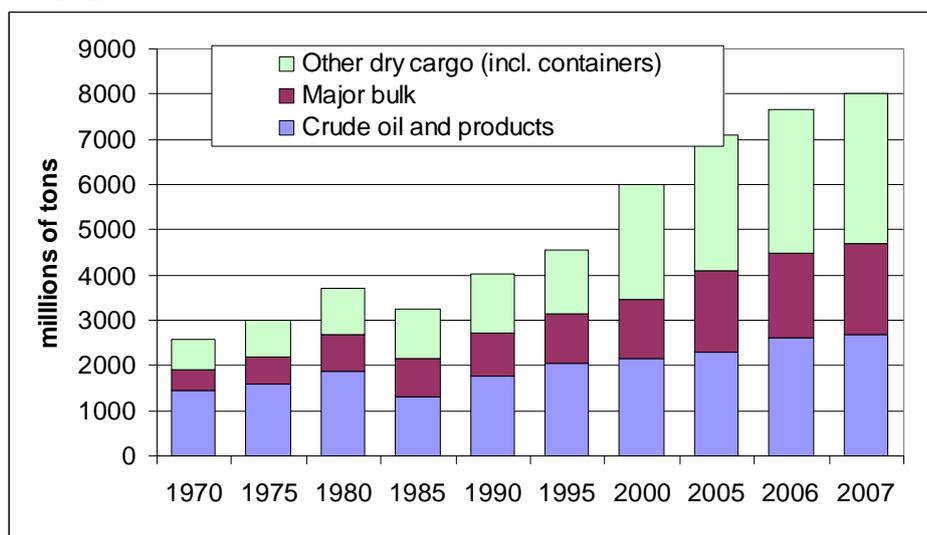


Picture 1. Traffic emissions to air



VTT-Technical Research Centre of Finland, 2008

Picture 2. World seaborne trade



UN Review of Maritime Transport 2008

Table 1. Effects of the estimated price rise in fuel on freight charges (percentage increase on current levels)

Cargo	1,0%	0,5 %	0,1%
Container	4 – 13 %	8 – 18 %	44 – 51 %
Paper reel	3 – 10 %	6 – 14 %	35 – 40 %
Lorry	3 – 10 %	6 – 14 %	35 – 41 %
Passenger car	3 – 10 %	6 – 14 %	35 – 41 %
Oil	3 – 8 %	5 – 11 %	28 – 32 %
Freight tonne on bulk carriers	4 – 11 %	7 – 15 %	39 – 44 %
Timber	3 – 10 %	6 – 14 %	35 – 40 %
Steel products	3 – 10 %	6 – 14 %	35 – 40 %

Finnish ministry of transportation and communications, 2009

A view on the world economic crisis

By Stepan Sulakshin

The present economic crisis was not a bolt from the blue; it broke out following years of huge disequilibria within and among major national economies.

Where can the global crisis be seen? In the abrupt fall of working capital and in the emergence of problems to the actual economy. Where did the working assets disappear? Is shrinking of the working assets beneficial to anybody?

I mean the influence of the politics which can create absolutely wrong estimation of what was going on and which on this basis giving the wrong prescriptions how to deal with these events.

In fact, the issue of the global financial working capital in dollar is uncontrolled (except for the country of issue itself) and arbitrary. Let's pay attention to one fact. Approximate value of global economy counts to be like 60 trillion dollars. As for the mass of moneys and surrogates of moneys, derivatives, nobody can exactly say what is the amount, but the approximate estimation is like 10 times higher — 600 trillions. We also know that dollar-based economy now doesn't link with anything, like gold for example. So, you know the emission centre being placed in the United States of America, is controlled by whom? By FRS. What is FRS? This is a private structure, 20 banks. They conduct everything, they place the rules, and they know when to switch on the printing machine and when to take the money out. So, it is not right to my mind to blame only Americans for the crisis because that was global scale crisis and it was created globally, but of course, the major proportion of responsibility and that is the understanding of the world community should be placed on the administration.

The cause of crisis in dollar economy is the giant structural macroeconomic imbalance. This imbalance appeared as result of uncontrolled growth of borrowings of American economy, starting from the 60ies and uncontrolled emission of derivatives starting from the 90-ies.

Crisis that we witness today has been progressing for a long time in a latent form, but because of privileged position of US currency and US economy, it's earlier aggravations could be shifted onto the developing economies (Asian crisis, Russian default, Argentinean default), provoking local crises. Absence of real policy to overcome this permanent crisis from the part of last three administrations led to the situation when it became impossible to localize another aggravation of

crisis within one economy or one region and it became global, resulting in fact in the default of maternal (American) economy, that stays afloat due to credit emission of the FRS solely, because credit market is paralyzed.

Contrary to this, the nation states of the world are securing their economies with financial working capital (Fig. 1).

It can be seen that the ratio of money supply and GDP of countries of the world does not exceed 200 per cent.

Thus, the ratio of money supply and US GDP is approximately 70%, and the ratio of world's working capital and gross world product not less than 1,000 per cent¹. The volume of this capital is largely a matter of choice of an issuing country. Since 1971, when the Breton Woods' requirement of gold security against the dollar stock for the issuing country was cancelled, the amount of issue is determined by the choice of respective decision only of the issuing country itself.

What happens, when some monetary zones of the world start driving the dollar out of circulation? If the dollar stock returns "home", collapse of American economy is inevitable.

Is there a mechanism of global financial management? Let's see Fig. 2 reflecting the dynamics of demand and prices for oil in the world market.

The mechanism of speculative price dynamics (i.e. without the correlation of demand and supply) is based on someone's will.

What the latter should do in the light of the comprehension of the nature of the current financial and economic crisis? There's need in balancing adjustment of "will", that is responsible for the generation of world crises in the first place.

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¹ Carlos Lessa. The crisis in the USA and its repercussions in Brazil and the World. Oct. 20, 2008// http://www.larouchepub.com/eiw/public/2008/2008_40-49/2008_40-49?2008-44/ibero.html

'To give you an idea: the estimation is that the world's GDP is \$67 trillion, whereas the total paper assets issued is about \$600 trillion, and now that speculative bubble has exploded'

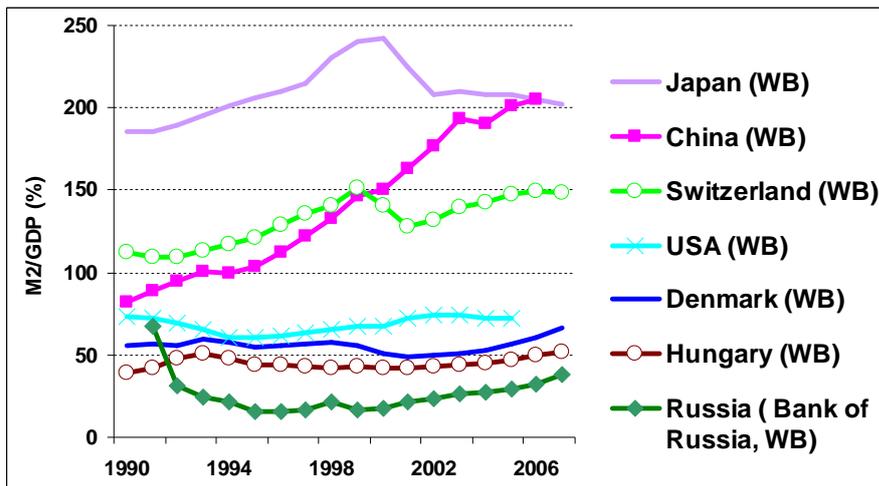


Fig. 1. Ratio of money supply and GDP of countries of the world.

Sources: 1) World Development Indicators Database 2008. World Bank// <http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/>
 2) China Statistical Yearbook 2008. October. China Statistics Press, 2008// <http://www.stats.gov.cn/eNgliSH/statisticaldata/yearlydata/>
 3) About sufficiency of money in economy // Bank of Russia Bulletin No. 64, 1996

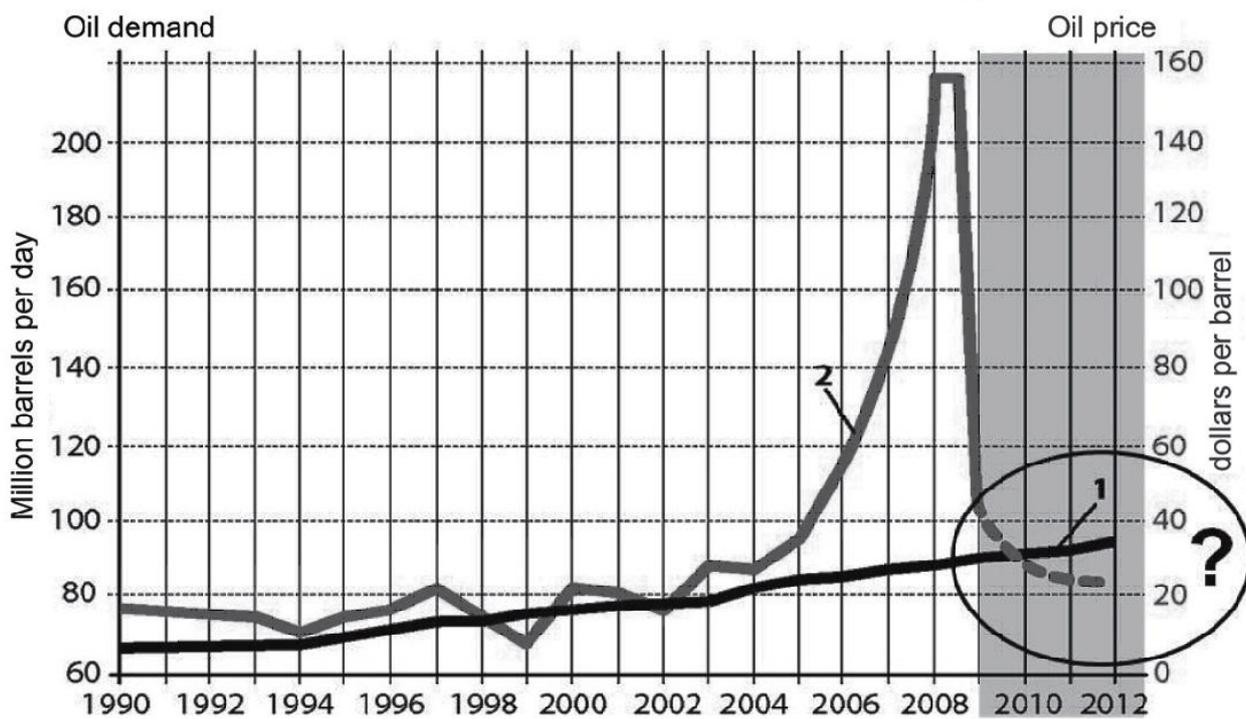


Fig. 2. It's not the demand that dictates price for oil.

(1- world demand for oil, 2 – world price for oil)

Expectations on energy and climate change

By Ionut Purica

In January 2009 the gas supply to EU from Russia, through Ukraine, was stopped and, consequently, Bulgarians and Slovaks were rather shivering at the Winter temperatures of that month, while Romanians, who had their own gas natural reserves, were not. Several thoughts came to my mind that are shared in what follows.

First I should mention that there are four main 'fluids' that are holding the economies together: money, labor, energy and information. EU, that have started as a union of coal and metal, succeeded in unifying their monetary policy first (this resulted in the Euro). Labor is following closely and the blue card will soon be a reality. We are not talking about information since transparency of communication is a fact in the EU.

Remains energy. The energy policy of the EU is only now starting to get a shape. Given the situation of climate change both from a physical and a commercial point of view the energy policy is interconnected with the climate change one, as was made very clear by the EU Commission starting with 2007 on. Obviously the climate change strategy is aimed at fighting the increase in temperature thus, against the greenhouse effect.

Let me say a heresy: if we need the Russian gas to heat during Winter why not accelerate the greenhouse effect toward making Europe a rather tropical region and thus, avoid the need for gas. On a second thought, since nowadays Piazza 'Campo dei fiori' in Rome (where Giordano Bruno was burned for heresy) is now more famous for its restaurants, hence for commercial characteristics, it occurs to me that the resulting costs from making Europe a hot zone are more important than the benefits of the avoided gas supply.

So, on a short to medium term negotiating the gas supply safety is imperative and, on a medium to long term the implementation of non carbon related energy technologies is mandatory. There is also the scenario of a Europe having its energy supply controlled by others, at the periphery of an Eurasian hegemony of China, Russia, India, Japan and so on, holding the poles of high technological development.

Let's see first negotiation. In a conference of the Pan European Institute in Finland at the end of 2008, a Russian representative stated clearly that if EU wants to negotiate it should either speak with one voice i.e. the Commission, or with 27 voices; the present situation when several member states are talking separately and the Commission is coming on top of them is not likely to lead to efficient results.

The old Regan sintagma of consumer side dominated economics worked when consumers and suppliers were two sides; in the case of Europe and Russia one must consider Asia that is following its own development path giving Russia the leverage to negotiate commercial terms with the EU.

Regarding negotiations I have heard various suggestions beside the one above regarding the mutual need of the parties; e.g. 'keep the other party happy'. It seems that the leverage of the EU is definitely not the one in the last century.

The logical conclusion is to accelerate the development and implementation of carbon free energy technologies. The climate change policy of the EU is definitely a good instrument toward achieving this goal. The Kyoto Protocol has come forward with a mechanism to generate and transfer such technologies among governments. The EU

Emission Trading Scheme pushed this mechanism at the level of companies with promising results. Going further, on a purely speculative basis, we are likely to see regulated a system of personal or family carbon accounts, as a measure of the Carbon print, in some not very distant future.

I should stress though the risk that such mechanisms are liable to become purely commercial i.e. selling carbon emission certificates and lose the main objective: decouple from the carbon based technologies of today.

The recent outburst of nuclear power plant construction and new smaller nuclear power systems being proposed by manufacturers, is just one symptom of the scenario above. Let's not forget that Hydrogen systems are over the hill and the 3 x 20% policy of the EU till 2020 is just the beginning. All these technologies are going to change not only the environment we live in (to the better, I hope) but, also the values of life.

Let me give another farfetched example: in 1999 a 100 million Dollars World Bank project was developed in Albania to improve the public lighting. I was thinking that with the same amount of money one could have bought each Albanian (there are about 2 million of them) at 50 USD a piece, infrared goggles. Result: no need for public lighting since everybody would see in the dark, with a great economy of energy and emission reduction. Imagine a world without oil and gas and how would you react if given infrared goggles and all the lights will be shutdown.

Finally I will underline that EU is in a good position: countries having a high technological generation capacity are now over the emission commitment limits, while the eastern European member countries – in need of technologies – are under the limits. It is high time to correlate the selling of Kyoto Protocol emission certificates (AAU) with the joint development and transfer of technologies.

Also, one should consider the comparison of Northern EU countries with Southern ones from an emission point of view in a normalized way i.e. keeping in mind that North is exposed to lower temperatures than the South and thus needs more energy, hence more emissions, to cope with this situation.

This is another possibility to enhance the correlation among various regions of the EU. The challenge is to start cooperating not only intra sea regions (e.g. Baltic sea region, Black sea region, etc.) but inter such regions such as the Baltic and the Black sea ones. Emission trading strongly connected with technology development, transfer and implementation may be one scenario to a more sustainable (energetically, politically, etc.) European Union.

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Transport of oil and gas – safety and security of the Baltic Sea

By René Nyberg

The world's second largest low-saline water basin, the Baltic Sea, is essentially a shared shallow lake of the EU states and Russia.

Since the end of the Cold War, economic activity in and around the Baltic, especially sea transport, has grown dramatically. Today 15 per cent of world sea transport takes place in these constricted waters. Statistics show that about 1,350 vessels are on the move in the Baltic at any given time. The fastest-growing group of vessels are oil tankers. Their numbers are stunning. More than 150 million tons of crude now annually transit the Danish Straits. Russia is currently building an additional oil pipeline and a new export terminal on the Gulf of Finland that will add another 50 million tons a year to this traffic. The consensus estimate at the moment is that crude oil exports shipped via the Baltic will rise 40% by 2015.

These facts alone should justify increased efforts to assure maritime safety, especially since maritime safety and the safety of the marine environment are closely intertwined.

The two biggest threats to the Baltic Sea, by far, remain **eutrophication** and **oil transport**. While the building of a gas pipeline will cause some transitory environmental impacts, they are smaller by several orders of magnitude relative to the damage and potential for damage of oil spills. The Nord Stream pipeline, buried in Baltic seabed, will transmit 55 billion cubic metres of gas across the Gulf of Finland to central Europe each year. Now imagine if that amount of gas instead had to be carried by hundreds of LNG tankers in already crowded sea lanes. LNG is the future, probably already for Yamal, but not for the Baltic.

Please, don't misunderstand me. A lot has been done to improve maritime safety in the Baltic Sea. Single-hulled tankers have all but disappeared from the Gulf of Finland, and since 2004, a mandatory ship reporting system (GOFREP) maintained trilaterally by Estonia, Finland and Russia guides traffic and monitors it. New technologies provide excellent opportunities to significantly decrease traffic risks.

Even so, the need for enhanced cooperation and interaction is evident. **The Northern Dimension of the European Union** launched under the Finnish EU presidency 1999 was well received, but really took off only after its overhaul in 2007 when Russia, Norway and Iceland were invited to participate in redrafting the concept. The lesson learned is evident: All players need to be involved early on in development of partnership programs to get the best results. The most topical program to be finalized shortly is the **Northern Dimension Partnership on Transport and Logistics**.

An interesting Russian initiative, which the Finnish Industries welcome, concerns the creation of a **Northern Dimension Business Council**. I am sure we will hear more about it in the coming months and years.

We can see distinctive differences in approach in energy infrastructure projects currently under way. The Nord Stream project was forced to keep all affected parties in the loop from its inception. Of course, this required elaborate environmental studies, demanding technical measures and extensive consultations, and the process is not over yet. Contrast this with oil transport. Russia made the sovereign decision in the 1990s to shift the bulk of oil exports to a new terminal at Primorsk, located at the north-eastern end of the Gulf of Finland. More recently, Russia made a sovereign decision to build the BTS-2 oil pipeline, along with a new terminal at the Russian port of Ust-Luga on the south-eastern shore of the Gulf of Finland. The pipeline and oil transshipment terminal should become operational in 2012.

I will leave it to the audience to judge which approach to energy transport – an ever-increasing number oil tankers plying the Baltic or a gas pipeline encased in concrete below the seabed – merits greater attention, and which, in light of the risks they present, deserves further consultation.

And of course, Russia should ratify the Espoo Convention on Environmental Impact Assessment in a Transboundary Context.

My point is very simple. We all benefit from regional cooperation and environmental consultation, and to get there we need much

greater interaction. This applies to all fields and in all directions. The security issues in the Baltic Sea region are increasing environmental. I do not believe that the mysterious "Arctic Sea" incident characterizes the threats of tomorrow, at least in this part of the world, although terrorist attacks cannot be excluded. Neither do I see classical military threats on the horizon, except for occasional showing of force. It suffices to consult the annual "Military Balance" of the IISS to see the dramatic build-down of military capabilities in the region.

There is a lot of baggage in the relations between the countries of the Baltic Sea. This explains part of the acrimony affecting major energy infrastructure decisions. As we are today in Stockholm, let me just remind you that the original Finnish idea of securing a second source for gas was to extend the existing gas pipeline from Russia via Sweden to Norway. But it was a sovereign Swedish decision not to opt for gas for the Stockholm region. I am not claiming that the gas pipeline issue would have created a major row between Helsinki and Stockholm, save a few caustic remarks. -- And as we all know the Nord Stream pipeline project has its history, too.

Energy is security. For the consumer of energy, energy security means guaranteed delivery, and stable and predictable prices. This, in most cases, needs to be coupled with assured and secure transit. For the exporter of energy, guaranteed and secure demand is often the crucial issue, given the scale of required investment in new production and infrastructure. A strong element of interdependence describes the energy relationship between the EU and Russia.

The integration of the European and Russian energy markets is all but a fact, and the demand for gas is growing. As so often is the case, however, the formalities of such arrangements lag behind. Even if Russia is not prepared to join the energy charter at this time, we need an understanding and a commitment to common rules. We need transparency, reciprocity and non-discrimination, plus consultations and cooperation with all parties and at all levels. In a nutshell, this is what the WTO is all about. As a trading nation, Russia needs reliable customers and stable markets. We need Russia integrated into the world market, because, by definition, it enhances security.

To sum up:

- 1) **Eutrophication and oil transport remain, by far, the top threats to the Baltic Sea.**
- 2) **Piping gas is better than transporting gas in LNG tankers, at least in the Baltic context;**
- 3) **Demand for gas will grow, partly because gas is seen as the bridge fuel in countries opposed to nuclear energy.**
- 4) **The interdependence between Europe and Russia is a fact – a very European phenomenon.**

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Nord Stream – how feasible is the project?

By Łukasz Antas

In an attempt to evaluate the feasibility of the Nord Stream project one comes across the consortium's information policy, which presents significant progress of the project, on the one hand, while on the other meets with reports on endless problems with obtaining consent from Scandinavian countries for the construction of the gas pipeline. A politico-economic analysis has shown that the number of barriers the Nord Stream consortium has to overcome during the worsening economic slump is significant. Gaining customers and guaranteeing gas supplies at the level of tens of billions m³ are just a few of the likely problems. Since Gazprom guarantees gas transport via the Nord Stream, the Russian company will have to deal with this problem. The simplest solution seems to be to reduce the volumes of gas transported via traditional routes and gain industrial customers in Central Europe, which has been successfully tested by a company linked to Gazprom in the Czech market.

How far is the project advanced?

Nord Stream consortium's preparations follow the time schedule which envisages commencement of construction of the first pipe in April 2010 and completion in 2011. The second one is planned to be ready one year later. The logistics of the project, which has been skilfully publicised in the media, is impressive. In total, the consortium has spent at least 1 billion euros on that purpose. Yuzhno-Russkoye gas field has been put into operation to ensure gas supplies in the case of the first pipe, which will have a capacity of 27.5 billion m³. Sales of most of which have already been guaranteed in contracts although 13 billion m³ will be sold to companies co-owned by Gazprom.

As regards the second section of the pipeline, which will have a similar flow capacity and is officially planned to be put into operation in 2012, the activity linked to it has been surprisingly low. First of all, the issue of supply and contracts with customers covering such significant quantities of gas is unclear. Its raw material base, the Shtokman gas field, will be launched with a significant delay (originally planned in 2012). The recession in the EU, which has had a strong impact on Gazprom (its gas production was reduced in the first half of this year by 24.4%), is curtailing possibilities for gaining new buyers of gas from the Nord Stream.

The main barrier to the commencement of real construction of the pipeline is obviously the lack of consent for the building and approval of the Nord Stream's Environmental Impact Assessment report from countries through whose zones the pipeline is to run. This especially concerns Sweden, which demands new research and has been delaying its consent since February 2008, and Finland. In turn, the lack of administrative consent from the two countries impedes the process of applying for bank loans which are expected to finance 2/3 of the project expenses.

Building the chance of project implementation

Although officially Sweden, similarly to Finland, opposes the project out of care for the natural environment, the reasons behind its stance are also political and concern security, including energy security; hence the consortium's attempts to overcome their resistance with political means. Potential 'gifts' are senior positions in the EU administration for Swedes and Finns, Russian customs duty rates favourable for the Finnish industry, etc. In turn, the engagement of France in the Nord Stream project (since Gaz de France has joined the consortium) is expected to facilitate the pressure on Stockholm and Helsinki. A 'domino effect' may happen; Finland – under pressure from Paris and Berlin's lobbying – may grant consent this autumn, which Helsinki has already suggested. Sweden, which wants its representative to become the EU Foreign Minister and has been making efforts to achieve that during its presidency of the European Union, is now more receptive to pressure and may follow in Finland's footsteps. In turn, reaching the end of the administrative path is a necessary condition for opening bank credit lines for the

consortium to provide financial backing for the project, which will be significantly facilitated by the 3.1 billion euro loan guarantees offered de facto by the German government.

Even if this scenario is realised, cost efficiency of the project will still be a problem. Western shareholders of Nord Stream want to avoid losses resulting from underuse of flow capacity (which has been the case with Gazprom's another pipeline, the Blue Stream). It is very likely that they have forced Gazprom's general assembly of shareholders in 2009 to guarantee gas supplies to Nord Stream or financial compensation. In effect, the Russian company has undertaken to a large extent to guarantee supplies and sales of tens of billions cubic meters of gas. One of the solutions to handle the situation is to delay the construction of the second pipe by several years and wait until the demand in the EU has stabilised. The second possibility is to pay the Nord Stream shareholders off by raising gas prices, which will be difficult to do at the time of recession.

An option attractive to Gazprom can be to build both sections of the pipeline and resolve the supply problem by reducing the amount of gas transported through Ukraine and/or Poland. Considering the economic slump in the EU and delays in Gazprom's investment programme, this would be the simplest solution in the initial period of the new pipeline's operation. At the same time, this would enable Gazprom and the Kremlin, which owns the company, to make pressure on the two countries (for example by weakening the financial condition of the transit operators, Europogaz and Naftohaz Ukraine) in order to facilitate Russians' entering local gas markets. In addition to a possible entry to the Polish market, problems with sales could be resolved by taking full control of the East German gas distributor VNG, gaining a larger share of Central and Eastern European markets (Gazprom's Czech arm, Vemex, took over nearly half of the Czech industrial consumer market between 2006 and 2008) and co-operation on gas power plants with Western corporations. Expanding its share of new markets would compensate Gazprom for possible losses generated by its guarantees of supplies via the Nord Stream.

This is just one of the possible scenarios. Nord Stream's main problems, consent from Finland and Sweden and project financing, are still unresolved. The long-lived opposition from Sweden and Finland generates additional costs, which members of the Nord Stream consortium, energy giants, have not foreseen while underrating the potential of the Scandinavian countries. Deepening recession in the European Union, which will impede both gaining financial backing for the pipeline and signing contracts with customers, may be an additional problem. A scenario in which the project supported by the largest EU member states, foremost by Germany, ends up in a failure seems rather unlikely. However, as Germany's E.ON company learnt this September, disregarding local communities' resistance may lead to failure even of such expensive (losses could exceed 1 billion euros) and prestigious projects as the Datteln coal power plant.

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The battle of Nord Stream

By Edward Hunter Christie

The Nord Stream project is sub-optimal from a general economic viewpoint. This has been established by some of Germany's leading energy economists - see Holz *et al.* (2009: 145) and Hubert *et al.* (2009: 20). Complementing this view, my recent work on the topic concludes that Russia's motivation for the project is geopolitical, i.e. to accept a partial loss of commercial profits in exchange for stronger political leverage over Central and Eastern Europe. Finally, as I noted in Christie (2009a), it is questionable whether Nord Stream (NS) will be needed at all given the lower gas demand path that should arise due to environmental policy commitments.

This leaves open the question of why Germany is still backing the project, and what member states who oppose NS might do next.

From an economic viewpoint, Germany is seeking to become a major gas hub for a larger area of Europe, with imports exceeding domestic consumption and, *per force*, a capture of gas trading rents for Germany's national economy. However there is no reason why other member states should support such attempts. Economic rents for existing transit states, notably transit fees, may be irretrievably lost. Germany should therefore not expect any support from the potential losers of the NS project, while German attempts to promote NS will quite reasonably be interpreted as manifestations of a narrow economic self-interest, if not of political obstinacy.

From a security viewpoint, Germany's position is not threatened by the absence of NS. The existence of NS would also not make a positive difference for Germany's security of supply, unless one assumes that Russia has aggressive designs against transit states, notably in the form of supply disruptions. If the latter scenario is considered to be realistic, then Germany's current position runs directly counter to the national security interests of the by-passed countries. The EU lacks strong mechanisms to discourage, let alone prevent, any one member state from pursuing its economic security interests at the expense of other EU states. But what is sauce for the goose is sauce for the gander. Some EU members may start to challenge German interests more forcefully, i.e. an enforcement of 'club rules' through decentralised action.

How might this occur? Several instruments could figure on the menu besides already activated procedures.

As pointed out by a number of observers of the region, the payment of bribes is quite common and poses certain challenges. Concerned states may therefore choose to monitor the activities of selected individuals, even if the latter are nationals or residents of other states.

Another aspect is the deficit of accurate information. In the general case, the best weapons a liberal democracy can deploy are openness, transparency, and maximum disclosure.

A third aspect concerns EU decision making. Germany is just one of 27 member states with only around one sixth of the Union's population. Opposing states may consider building stronger coalitions at the European Council, while linkages with other areas of policy could increase. Conversely, GDF Suez (and therefore France) has announced that it will join the project. Opponents would therefore need to counter that move with a move of their own.

Since decisions cannot always occur at the Union level, opposing states may wish to build new structures amongst themselves so as to accelerate improvements to the resilience of their energy systems, i.e. covering issues such as storage and interconnection, fuel contingency plans, longer-term efficiency and diversification drives, and the sharing of new generation capacities. Legal and institutional cooperation between like-minded states could likewise be boosted beyond existing supra-national commitments, while coordinated opposition against unfavourable external energy projects could become substantial. Finally, member states should develop, collectively if possible, a higher resilience against acts of economic coercion in other areas so as to counteract tactical linkages, e.g. timber imports into Finland.

Much of this discussion would naturally fall away if a united external energy policy came into being. In the absence of such unity, however, member states will continue to look out for their own interests and set up competing coalitions. If the Council cannot then reach sensible conclusions, the next step might be the creation of parallel institutions. This is not – to put it mildly – in the longer-term interests of anyone in the Union, though it may be in the interests of foreign powers. Member state governments should therefore carefully consider the broader strategic implications of their policy stances, and in doing so, recall that the NS project is economically sub-optimal no matter how many partners join it. As for Germany, it would be a deep irony if one of the states that did the most to build the Union were to severely damage it in the pursuit of an ultimately unnecessary project.

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The Baltic Sea – a vibrant ecosystem in peril

By Jukka Nurminen

The Baltic Sea is small and shallow. Its average depth is only 60 metres. Owing to the slow exchange of water through the Danish straits and abundant freshwater runoff, the water in the Baltic Sea is brackish. Its salinity is low compared with the North Sea, ranging from ten per mil in the Danish straits to approximately three per mil at the far end of the Gulf of Bothnia and the Gulf of Finland. It is estimated that it takes 30 years for the water mass of the Baltic to be totally exchanged. As a result, the sea is home to a unique blend of freshwater and oceanic species. Even though the water is brackish, the sea is inhabited by all the major marine phyla. The total number of species is small, which is why each species has a pronounced role in the ecosystem. These characteristics make the Baltic Sea particularly vulnerable.

Baltic Sea's barely explored waters are typically considered cold, murky and desolate. Even to divers the Baltic Sea can all too often appear devoid of life, offering only overgrown algae and the most common fish species seen on ice at any fish markets. But the truth is that beneath the waves of the Baltic Sea thrives a diverse ecosystem of hundreds of species of algae, invertebrates and fish, in which all of the major oceanic species groups are represented – sometimes in breathtaking shoals several thousands strong. At their best, underwater ecosystems of the Baltic Sea swarm with life. Hidden beneath the waves of the Baltic Sea, there is often one of the richest and most vibrant national landscapes of the coastal countries.

Unfortunately, over the last couple of decades the condition of the Baltic Sea has deteriorated alarmingly, as emissions from human activities have remained at an unsustainable level. In addition, inflows from the North Sea have not brought a sufficient amount of saline, oxygen-rich water. Eutrophication and high concentrations of environmental toxins are a reality.

My aim as an underwater photographer since 2003 has been to document the last healthy underwater ecosystems and blooming landscapes of the Baltic Sea before it is too late. I try to reveal landscapes hidden beneath the Baltic Sea which few have seen with their own eyes. I want to inspire people to take concrete action to conserve the Baltic Sea as it is far too unique to be despised.

How does then the condition of the Baltic Sea look underwater? Too often bad. By diving under the waves of the Baltic Sea one must face the unfortunate truth: the Baltic Sea is suffering. The bottoms are in many places oxygen starved or covered by filamentous algae growths that suffocate healthy algae and marine plant ecosystems under them.

The Baltic Sea is in an alarming state and it only offers brief periods in certain spots in which underwater visibility and the condition of the sea bed are good enough to shoot somewhat pristine nature and diverse landscapes. Especially in the Finnish coast only in the outer Archipelago Sea there are reasonably healthy ecosystems left.

In order to conserve the Baltic Sea we must understand that the catchment area of the Baltic Sea is four times larger than the actual area of sea itself inhabiting 85 million people. Therefore, not only the nine coastal states are relevant in preserving the Baltic Sea but also 5 states inland, Belarus, the Czech Republic, the Slovak Republic, Norway, and Ukraine, in the catchment area.

The most serious threat to the Baltic Sea is eutrophication caused by an excessive nutrient loading by human activities. As the nutrient content, essentially the amount of phosphorus and nitrogen, of the Baltic Sea is

rising, the quantities of planktonic algae are increasing. When the algae die they fall to the seafloor where they are subsequently broken down by bacteria. This biodegradation process is slow and oxygen-consuming and the total exhaustion of oxygen reserves in the bottom sediment and surrounding water is an increasingly common occurrence. Once all oxygen is depleted, sulphate continues the oxidation process, producing hydrogen sulphide which is toxic and can even penetrate a diver's skin. The end result is a lifeless, desolate seabed. Pale carpets of hydrogen sulphide bacteria and sediment which has turned into black sulphide mud are a tell-tale sign of this destructive process. Furthermore, millions of tons of nutrients originating both naturally and through human impact are bound in the bottom sediment of the Baltic Sea. In such anoxic conditions these nutrients, especially phosphorus, become released back into the water. In this way, they further increase the growth of phytoplankton, the amount of organic material falling to the seafloor and ultimately the oxygen consumption on the seabed. The result is a vicious circle known as internal loading.

The unfortunate truth is that all sea bottoms in the northern Baltic Sea are anoxic below 100 metres in depth. The salinity gradient interface between water layers, i.e. the so-called halocline, divides water masses more effectively than the temperature interface, or thermocline. In deep waters the halocline is the dominant force in bringing about extensive, continuous stratification. The oxygen situation of deep waters improves only with saline pulses flowing from the North Sea.

In the battle against the eutrophication there is only one structural and permanent way to get results: reducing the nutrient burden to the sea. We have to concentrate on those sources, where the remedial effect is quickest, largest and permanent. Now the focus should be on the municipal waste waters, where the effects are quickest and cheapest. Moreover, new EU norms for the phosphorus loading to the Baltic Sea are desperately needed. Although the EU requirement, 1,0 mg P/l, may be sufficient for the Atlantic Ocean or the Mediterranean, it is clearly too loose for the badly eutrophied, small and shallow Baltic Sea. To achieve sustainable results, more stringent legislation is definitely needed for our Baltic Sea area which should be based on the HELCOM's recommendations for 0,5 mg P/l.

The Baltic Sea needs no more fine words and generalist reports but concrete, focused and measurable actions to be preserved. To save the Baltic Sea there is no time to be wasted. Quick measures with fast impacts are needed. Clear waters can only be preserved for the enjoyment of future generations if we succeed now in the battle against eutrophication.

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Climate change and Arctic security

By Nils Wang

The Kingdom of Denmark includes Greenland in the Arctic, the Faroe Islands in the North Atlantic and Denmark at the entrance to the Baltic Sea. With a 200 NM Exclusive Economic Zone throughout the Kingdom the area in which the Danish Defence Forces are enforcing Danish sovereignty is gigantic, and the northernmost part of this area of responsibility borders the Arctic.

The southern part of the area forms the bottleneck entrance to the Baltic approaches with approximately 100,000 ships passing through the Danish straits every year, making them among the world's most densely trafficked waterways. While 90 % of world trade is carried on ships, 10 % of all ships are either Danish owned or Danish flagged, making Denmark one of the leading seafaring nations in the world.

This explains why Denmark is deeply interested in maritime security both regionally and globally. It also explains why we – as one of five countries bordering the Polar Sea with strategic interests in the Arctic area – are very concerned about climate change and global warming.

The Arctic icecap is melting fast, and the consequences are already beginning to emerge.

In August last year, the first Danish merchant ship transited through the Northwest Passage on a journey from Japan to Newfoundland, thereby saving 15 days at sea compared to the traditional route.

A major Danish shipping line has initiated the construction of a series of ships with icebreaking capability, indicating that sea-transport through the Arctic will become a profitable option in the near future. Obviously, a 40 % reduction of the distance between Europe and Asia and a 25 % reduction of the distance between USA and the Far East will be a tempting cost saver for the shipping industry.

As changes generally create new challenges, a major re-routing of sea traffic is likely to have great and far reaching implications. With regard to commercial activities related to the Sea Lines of Communications, maritime infrastructure, and man made short cuts like the Suez and Panama canals, a significant change of the sea routes will also have significant global economical and security implications. But changes may create new opportunities, too. A 40 % reduction in distance between Europe and Asia could generate a 40 % reduction in fuel consumption and CO₂ emissions from ships. Thus, one of the more helpful factors in our common strive to reduce CO₂ could ironically be the shrinking of the Arctic icecap.

Receding ice will give way for exploitation of oil and gas resources. Some estimates indicate that the Arctic could hold the last great undiscovered hydrocarbon resources on Earth, maybe as much as 25 %. This will cause increased maritime activities in the Arctic, but it could also lead to a race for resources, with serious implications for security policy, and not least for the environment. We might see territorial claims, or conflicting interests – of which some have already surfaced.

The only way to meet the challenges of increased maritime activity in the Arctic is cooperation, as it must be of common interest that territorial claims, disputes over access to resources or other conflicts of interests are managed and settled in an orderly fashion within the international legal framework. We must avoid conflicts or disputes about resources, land or sea territory, which might otherwise

obstruct the close local cooperation needed to address the many challenges, which none of us can handle alone.

In May 2008 the five nations bordering the Arctic Ocean – Canada, Denmark, Norway, Russia and the United States of America – met in Ilulissat, Greenland, to sign what is now known as the "Ilulissat-declaration". The countries agreed to settle territorial claims in accordance with the international legal framework, to live up to common responsibilities for the protection of the Arctic, and to cooperate in areas such as Search and Rescue and protection of the environment.

With the expected raise in maritime activity in the Arctic, we will have to establish an effective Search and Rescue organisation and an environmental response capacity that can deliver an acceptable protection of the fragile ecosystem.

In recent years Greenland and adjacent waters have seen an explosion in polar tourism. In 2007, 140 cruise ships carrying thousands of passengers visited Greenland's icy, complicated and largely uncharted waters. This constitutes a huge challenge in a Search and Rescue perspective, which can only be met through international safety regulations and operational cooperation between navies and coast guards in the Arctic area.

So, to enable Security and Defence Policy to take climate change into account, we need to establish a continuous presence of coast guard and naval units in the Arctic in order to regulate the activities and to control the exploitation of the resources in the region. This can only be done effectively if the five bordering nations cooperate on the operational level. Cooperation on the operational level requires cooperation on the political level, and the Ilulissat-declaration is an important step in that direction. But a physical presence of coast guard and naval assets requires logistic support, and there is almost no maritime infrastructure to support ships north of the Arctic Circle. So also from an infrastructural point of view there are some considerations and investments to do.

To sum up, we will need coast guard and naval presence in the area. We will need to survey the area to produce reliable sea charts. We will need to establish maritime traffic management to ensure safe navigation. We will need to create effective Search and Rescue capabilities. We will need to control fishing and hydrocarbon resources, and we will need to establish environmental response capability to ensure protection and preservation of the fragile marine environment of the Arctic Ocean. But most importantly: we need to do all this in close cooperation and partnership with each other.

Nils Wang

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Arctic security – zero sum or working together?

By Clive Archer

Ever since a group of Russian researchers planted a Russian flag at the North Pole in August 2007, there has been increased interest in the strategic importance of the Arctic region. Given the wide blend of issues involved in the international relations of the Arctic, will there be attempts to grab an advantage by one state or more, or will the region become one of cooperation mixed with a certain amount of peaceful competition?

Background

The Arctic region had strategic importance during the Cold War when NATO and the Soviet Union faced each other across the Arctic with aircraft, missiles, navy ships and surveillance stations. A major change came in 1987 when Gorbachev put forward in Murmansk proposals for cooperation in the Arctic. Though the arms control side of the Murmansk initiative was seen as one-sided by NATO states, scientific and environmental cooperation did bear fruit. Soon a network of institutions was established to encourage and coordinate such cooperation in the Arctic and, by 1996, an Arctic Council was created as an over-arching body for such activity.¹ The end of the Cold War and of the Soviet Union ended military confrontation in the region.

However, within twenty years of the Murmansk initiative, the Arctic Sea was again becoming an area of strategic activity and of Great Power contention. Press and academic articles warned of potential conflict there.²

The main impetus for new interest in the Arctic region is threefold. First, the effects of global warming on the Arctic have led to increased concern for the indigenous communities and about environment degradation. They have also meant that the region could be opened up more for resource exploration and for transport. Secondly, as Russia has renewed its naval fleet and built up its forces after the decline of the Yeltsin years, concern has been expressed about Russian intentions in the area.³ Finally, legal issues have come to the fore. There are several jurisdictional disputes concerning the division of the seas and sea-bed in the Arctic seas. The United States and Canada disagree about the status of the straits; Norway and Russia have a long-running disagreement over the Barents Sea; Canada and Denmark have a tiff about Hans Island near Greenland. The UN Commission on the Law of the Sea, of which all the states around the Arctic are signatories except for the US, has a process whereby states can claim sea-bed beyond a 200-nautical mile zone. The Commission on the Limits of the Continental Shelf, that received arguments from states concerning their claims, has asked for submissions by mid-

2009, encouraging scientific and diplomatic activity by the Arctic states.

The strategies

As a result of these factors, most Arctic states have issued Arctic strategies over the last few years. One of the first was Norway, concerned about the development of resources in the Barents Sea and also about the growing Russian presence. The balance seen in Norwegian policy is common to most national Arctic strategies. Concern for environmental degradation is matched by a wish to develop resources in a sustainable way. There is a support for international cooperation, especially to solve any jurisdictional disputes, together with a stress on asserting sovereignty and a presence in the area.⁴

Russia's new Arctic strategy was agreed in September 2008. The region was seen in economic terms with its resource reserves and Northern Sea Route contributing to Russia's economic development. This resource base had to be protected and Russia's borders secured. The maritime Arctic zone was to be defined both by national legislation and international agreement. Some see this as part of an assertive Russian policy and that '(c)onsidering that energy is a primary instrument of Russia's power, clashes are most likely to occur in regions where energy is to be won or lost. The Arctic is such a region.'⁵ However, Russia's Arctic strategy does value international cooperation, and government spokesmen have stated their preference for solving Arctic maritime disputes by agreement.⁶

The US Arctic strategy was issued during President Bush's last days in office.⁷ The National Security Presidential Directive 66 again stressed the need for sustainable resources and to protect the environment in the Arctic. It emphasised national security and homeland security interests such as missile defence, maritime presence and maritime security operations. It also called upon the US Senate to ratify the UN Convention on the Law of the Sea as the international legal basis for advancing US interests in the Arctic and called for active international cooperation to solve problems.

Denmark's main consideration in its Arctic strategy is the changing environment and close cooperation with Greenland. Also of note is the European Union's involvement in the Arctic. The November 2008 Communication from the European Commission on the EU and the Arctic region stressed protection of the Arctic environment, sustainable use of resources and the development of multilateral governance. All the above strategies have been issued in the last few years and have emphasised "soft security issues" –

¹ See David Scrivener, *Environmental Cooperation in the Arctic: From Strategy to Council*, Oslo: The Norwegian Atlantic Committee, Security Policy Library No.1, 1996. The members of the Arctic Council are Canada, Denmark, Finland, Iceland, Norway, the Russian Federation, Sweden and the United States. See also the Arctic Council web-site at http://arctic-council.org/section/the_arctic_council

² See for example, 'Leading article: The next colonial scramble' *The Independent*, 25 July 2008, Christopher Mason, 'US and Canada bury hatchet to curb Russia's Arctic bid', at www.FT.com, August 18th 2008, Scott Borgerson, 'Arctic Melt: The Economic and Security Implications of Global Warming', *Foreign Affairs*, March/April 2008 at <http://www.foreignaffairs.org/20080301faessay87206/scott-gborgerson/arctic-meltdown.html>

³ The Economist, 'The Arctic contest heats up: What is Russia up to in the seas above Europe?', at www.economist.com, October 9th 2008.

⁴ Kristine Offerdal, 'Norway: new building blocks in the North. March 2009', *Geopolitics in the High North* at http://www.geopoliticsnorth.org/index.php?option=com_content&view=article&id=84:arctic-strategy-documents&catid=1:latest-news

⁵ See Marcel de Haas, 'Russia's Arctic strategy – challenge to Western energy security', *Expert Article 373, Baltic Rim Economies, Bimonthly Review 4*, 2009, pp.20-21.

⁶ Katarzyna Zysk, 'Russia: Arctic Strategy. September 2008', *Geopolitics in the High North* at http://www.geopoliticsnorth.org/index.php?option=com_content&view=article&id=87:russian-national-security-strategy&catid=1:latest-news

⁷ The White House, 'National Security Presidential Directive and Homeland Security Presidential Directive, January 9 2009' at <http://georgewbush-whitehouse.archives.gov/news/releases/2009/01/20090112-3.html>

the environment and resources – rather than traditional military “threats”.

Conflict or Cooperation?

How might the Arctic states deal with the challenges facing the Arctic region? These can be summarised as utilising the area’s resources while protecting its fragile environment, and maintaining national interests whilst negotiating international agreements.

The Arctic Council is a major instrument of international cooperation. Its membership includes states with territory within the Arctic Circle, with six groups of Arctic indigenous peoples as permanent participants and a range of non-Arctic states and international organisations as observers. The Council is likely to be more active in the scientific and environmental areas.

Bilateral and multilateral negotiations are needed for jurisdictional questions. The work of the Commission on the Limits of the Continental Shelf is crucial and it is important that the US ratifies the Law of the Sea Convention and becomes part of this process as soon as possible. In May 2008 the five states bordering the Arctic Sea – Canada, Denmark (for Greenland), Norway, the Russian Federation and the United States – agreed the Ilulissat Declaration whereby they pledged to solve their Arctic legal disputes by using the law of the sea, and to cooperate over protecting the marine environment. However, they rejected the notion, floated by the European Parliament, of an Arctic treaty similar to that covering Antarctica.

The Arctic has recently attracted increased attention. This could lead to a new grab for resources and to conflict, but so far all Arctic states have acted with restraint and have expressed the intent to solve problems peacefully. Urgent attention to the Arctic environment is required by these countries, and other interested parties. The institutions of cooperation are in place; national action is now needed.

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Renewed governance is the key for the future of the Arctic

By Lotta Numminen

Climate change causes major shifts on the political agenda of the Arctic. The melting ice creates new commercial opportunities, such as access to energy resources and shipping lanes, thereby bringing the whole Arctic region into the wider global economy. Simultaneously, environmental crisis caused by the melting ice poses major threats regionally and globally. This new situation puts pressure on the governance of the Arctic, which is ostensibly the key for the sustainable Arctic future.

The Arctic region is warming faster than the rest of the world. Warming causes melting of sea ice in the Arctic Ocean as well as circumpolar glaciers and permafrost. Melting of the sea ice allows access to commercial potentials for the five Arctic coastal states (Canada, Russia, the US, Norway, Denmark/ Greenland): these being major energy reserves in the Arctic Ocean seabed and also new sea lanes. On top of this, the coastal states have acquired a set of new, complex issues to deal with. The issues include, for example, unresolved bilateral maritime borders; sovereignty questions related to sea lanes; the future status and use of the High Sea region and outer continental shelf beyond the coastal states' Exclusive Economic Zones (EEZ); establishment of maritime Search and Rescue arrangements; and management of trans-boundary resources such as fish stocks, among others. In addition to this, the melting ice has caused an environmental crisis in the Arctic region with major global consequences projected for the future: sea level rise, shifts in ocean circulation patterns, and the acceleration of global temperature rise.

In 2007, Russia sent a submarine expedition to the oceanic floor of the North Pole and planted a titan flag in the subsoil of the sea. Russia's manoeuvres in terms of the symbolic flag planting attracted huge media attention and started heated debate referred to as "resource competition" for territorial claims of the outer continental shelf beyond the Arctic states EEZs. The escalating tensions between the states were demonstrated by increased military manoeuvres and provocative statements from some statesmen and military officials. Whether the provocations have been a manifestation of domestic, internal political developments within the coastal nations rather than international politics is an issue open to debate. Without doubt, however, the rhetoric of the coastal states has been assertive and sometimes even aggressive during the past two years.

These parallel developments of military posturing and environmental change pose great challenges for the governance of the Arctic. Since the Cold War period, the region can be characterized as a space of peaceful multilateral cooperation. In 1987, Mikhail Gorbachev launched the so-called "Murmansk Initiatives", which led to creation Arctic Environmental Protection Strategy (AEPS) in 1991 and later, in 1996, to the establishment of a whole new system of governance for the Arctic, - the Arctic Council.

The Arctic Council was designed to improve co-operation and dialogue in areas of mutual concern, such as environmental matters. However, the Council was not given legal form and has, in the light of the recent developments, been criticized for being too weak an institutional structure, given its soft law status and ad hoc funding system. The success of the Council, on the other hand, has been in that it amalgamates all the eight Arctic states as well as the Arctic indigenous peoples in the decision-making process. Additionally, the Council has integrated science into the cooperation framework by organizations such as AMAP (The Arctic Monitoring and Assessment Programme) and scientific

reports such as the Arctic Climate Impact Assessment (ACIA).

As a response to sharpened voices in 2007, Denmark invited the five coastal states to a meeting to Ilulissat, Greenland, in May 2008. The result of the meeting was the Ilulissat Declaration made between the five coastal states. In the Declaration the states committed to "ensure the protection and preservation of the fragile marine environment of the Arctic Ocean" and to "the orderly settlement of any possible overlapping claims." The meeting was criticized because it excluded the three non-coastal Arctic states of Finland, Sweden, and Iceland, along with the representatives of the indigenous peoples, NGOs and the Arctic Council. Furthermore, concerns about marginalization of the Arctic Council were expressed.

Yet it can be argued that the Danish initiative succeeded in several respects. For example the US, which as the only coastal state not to have ratified the main legal framework regulating the use of the sea areas beyond the coastal nations' EEZs called United Nations Convention on the Law of the Sea (the UNCLOS), was a signatory party of the Declaration. The Declaration also opened constructive dialogue between all the Arctic coastal states and signalled the urgent need for a renewed and updated governance arrangement in response to the rapidly changing Arctic region dynamics.

After the heated debates of year 2007, discourse deliberating the circumstances of the Arctic has changed. On the one hand, the global financial crisis seems to have channelled Arctic states' attention increasingly towards the predicaments of their own economies in the face of the global market situation rather than announcing the establishment of new Arctic military installations and increased military presence in the Arctic. On the other hand, there is a wide acknowledgement that the main issue in the Arctic is the environmental crisis of the Arctic ecosystem, including melting ice and its potentially catastrophic worldwide consequences.

In the current situation, the main challenge for the Arctic is that there exist major gaps in its present governance. The main challenge for the future development of the region is to find ways to combine environmental protection with potential commercial activities in a sustainable manner. These circumstances put pressure on extending the mandate of the Arctic Council. How this is to be done, is a critical issue that needs/demands a solution. The Arctic region in the future can – in the best case - provide the international community with a model of how to manage and govern dilemmas, disputes or even conflicts related to and emanating from climate change. This is, however, a process that requires engagement from all the Arctic states. It may also require acceptance of the involvement of international actors, such as the EU and the UN.

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After Pikalevo

By Olga Kryshantovskaya and Stephen White

'Russia, Forward!', declared President Medvedev in his recent message (Rossiiskaya gazeta, 11 September 2009). Not that anyone had been suggesting Russia should move backwards. And for many of his critics, it's a bit late for a message of this kind when Medvedev himself has already held the commanding powers of the Russian presidency for a year and a half.

Are they, in fact, commanding powers at all? There has been little sign of Medvedev eclipsing his mentor, Prime Minister Putin, and the expert surveys – in Nezavisimaya gazeta, at the end of every month – put Putin in first place among the country's influential politicians with Medvedev in second place. The Prime Minister's remarks to the Valdai forum about the kind of contest that will take place in 2012 reinforced the impression that Medvedev is no more than a locum tenens, keeping the seat warm until Putin himself can return at the next election – and then perhaps for two six-year terms.

There are other questions that matter even more – not the relative positions of president and prime minister, but the position of the ruling group as a whole in relation to a society that has suddenly begun to experience recession after a decade of rapidly rising living standards. And that has begun to show, at Pikalevo and elsewhere, that it can take direct action if it can see no other way of defending itself.

Kto vinovat? It's the eternal Russian question. And just as it was the boyars who appeared to be to blame in the long Tsarist years, it's the oligarchs who are most often held to be responsible in post-Pikalevo Russia. They lost colossal sums themselves as a result of the international financial crisis – more Russians, relatively, left the Forbes list of billionaires than any other nationality. But it's not the reputations of Putin and Medvedev that have suffered – it's the oligarchs and state officials who helped themselves from the public purse when the going was good, and who are now looking to the Russian government to rescue them.

But the government itself is worried that massive layoffs could lead to an 'Orange' scenario. And with a budgetary deficit, it is no longer possible to buy off all important interests in the society in the way that was possible in earlier years – the army as well as pensioners, poor as well as rich regions, public employees as well as the private sector. 'To govern', it is said, 'is to choose.' Until last year, the Russian government could more or less choose everyone. But no longer. And with less to go round, there is more competition for what is available. In Russian circumstances, this does not mean a discussion with the electorate and then a popular mandate for a particular way forward. It means an increasingly bitter struggle to exercise influence on government officials at the same time as government officials are themselves increasingly aware of the need to hold popular discontent in check by maintaining current levels of public expenditure. Indeed in many respects, government officials are likely to find themselves closer to the concerns of ordinary people than to hard-pressed oligarchs (and former oligarchs).

On our evidence, there is no substantial difference within the 'tandem' about the issues facing the country – even if Medvedev has occasionally chosen to present himself as more liberal in tone. His instincts are managerial and technocratic – particularly the repeated suggestion that computer technology offers some kind of solution to deep-seated national problems, when it is clearly no substitute for a genuine political process. What's the point of a presidential blog if nothing changes? Or of a Duma in which parties with more than 5 but less than 7 per cent of the vote win one or two of the 450 seats but United Russia takes more than two-thirds? The most significant single change was the extension, last December, of the presidential term to six years and the parliamentary term to five years – both of which take the institutions of government even further away from ordinary citizens.

In fact, it seems, the two work closely together, often following each other's speeches at major events, and taking the key decisions jointly without the need to make use of more formal and representative procedures. Putin, as head of government, takes primary responsibility for the economy, in practice delegating a great deal to first deputy premier Shuvalov, who was the one who presented the government's report on its handling of the economic crisis to the Duma in mid-September. Medvedev, as in the Georgian

crisis last year, leads on political and constitutional matters – on which more is expected in his next presidential address in November. But we see no sign of the kind of division that the US administration claims to have seen – or may have been trying to cultivate – between president and prime minister. And if any change takes place in the leadership in the near future, it seems most likely to concern finance minister Kudrin – so that someone appears to have paid a price for rising levels of unemployment, and who better than the minister who has been most openly pessimistic about the chances of a recovery.

Medvedev, in his message, called for a political system that would be 'open, flexible and internally complex'. But just like Putin, he condemned the 'paralysed state' that had developed during the Yeltsinite 1990s, and insisted that there would be no copying of 'foreign models' of a kind that might threaten the country's national security or social stability. It might have been possible to take this position when world oil prices were at record levels. In our view, it is not a sustainable position when choices have to be made among competing priorities. It is Russians themselves who should be choosing these priorities – not well-intentioned officials on their behalf.

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Their work is supported by the UK Economic and Social Research Council under grant RES 062-23-1542.

Latvia's fiscal system – the need for new approaches

By Alexander Gaponenko and Michael Rodin

Latvian economic crisis, the ruling elite and the budget

The world financial crisis took in Latvia is very difficult for the economy and society form. The main reason for such a tragic state of affairs is not an effective use of Latvia's ruling elite of the entire set of instruments of government, including the budget system. The refusal of the ruling elite of a viable fiscal policy is associated primarily with its desire to protect themselves and the social environment from the adverse effects of the crisis, to shift its entire burden on the poorly protected populations. There is a profound misunderstanding of the Latvian ruling circles of the need for change in the current process of budgeting in a crisis.

Latvian model of extensive management and serving its budget system

Economic development in Latvia since 1991 was of predominantly extensive nature that is passed through the involvement in the production of new labor and capital resources. All this time, the Latvian fiscal policy was part of an extensive model of economic management. This is clearly seen when comparing the Latvian budget figures with the European, and especially with the performance of the Scandinavian countries, whose economies are developing on an intensive basis.

In Latvia the amount of taxes collected in the budget was in 2006 only 30, 1% of the gross domestic product (GDP). For comparison, the average for the group of countries within the EU-27 in the same year, the tax burden on the economy amounted to 39, 9%. At the same Scandinavian countries the tax burden on the economy was more than 45% of the GDP produced. That is, in Latvia, the tax burden on the economy was a third lower than the European average, and half less than in the Scandinavian countries. The tax burden on labor in the EU-27 countries in 2006 was averaged 34.8% of its value. In Latvia, the load on the labor force was 33.5%, that is little different from the average, although it was lower than in the Scandinavian countries by 5-7 percentage points. The tax burden on capital in the EU-27 in 2006 was averaged 29.0% of the produced income. In Latvia, the same figure in 2005 was only 9, 6%, i.e. three times less than the average. Finally, the tax burden on consumption in the average EU-27 in 2006 accounted for 34, 8% of the value of household expenditures, while in Latvia, only 20, 0% or three-quarters below. In general, we can say that in Latvia has developed budget system that was attractive to the capital, but was not conducive to the reproduction of their own labor resources, stimulate consumption, but not the accumulation of capital.

Latvian social model and its budget base

As well as economic, social Latvian model can be characterized as extensive. For social protection in 2006 in Latvia were spent from the budget amounted to only 12, 2% of total GDP produced. For comparison, the EU-27 this indicator was in 2006 - 26, 9% and in the Scandinavian countries exceeded 30%.

The second important element of the budget expenditures on social services are spending on education. According to the OECD to the needs of education in Latvia were spent in 2006 4.5% of GDP, but the national average OECD was 4,8% and half less than in the Nordic countries. In general, we can say that Latvia was not developed in the European social model characterized by a high level of expenditure on human capital formation, widespread state involvement in funding through the budget.

Expenses on state apparatus

The bulk of the cost of the Latvian budget accounts for the maintenance of the state apparatus. With a high degree of reliability, these costs can be calculated as the sum of the costs of the budget to pay salaries to employees of the state apparatus, the current consumption materially and consumption of fixed capital of this apparatus. In 2008, the total cost of the state apparatus were already 3589 million lat or 56.0% of the state budget and 22, 1% of GDP.

Latvian public debt and its management

All of the time, Latvia has been relatively small and constantly decreasing budget deficit and public debt. In 2007, the consolidated budget was even recorded a surplus of 117.2 million lat or 0.8% of the total GDP produced. Public debt in the same year amounted to 1,492 million lat or 8.2% of the GDP. This was one of the best economic indicators in Europe. In 2008, due to non-balanced economy and an erroneous decision of the authorities take over the debts of a private bank Parex, the budget deficit had reached 426.3 million lat or 12.7% of GDP and public debt had risen to 2,770 million lat or 18.1% of GDP.

Economic crisis and its impact on the budget system

The economic crisis pushed long exhausted growth, extensive Latvian economic system to collapse. The volume of production GDP fell for the first 6 months of 2009 to 18,4%, unemployment reached a level of 11,2% of total employment. Reducing income of firms and the population led to a substantial loss of tax revenue to the state budget. For 8 months of 2009, they decreased by 31.1% over the same period last year. In the most reduced the value added tax (28%), tax on enterprises income (61%) and social security contributions (15%). However, the corresponding drop in income reduces the overall volume of budget expenditures has not happened. As a result, fiscal burden on the economy has increased significantly. If in 2007 the level of expenditure of the Latvian budget amounted to 35, 9% of the GDP, while in 2008 it was already 39, 9%, while in the first half of 2009 reached value 43, 9% of the GDP. Thus has been one of the highest in Europe, levels of the budgetary burden on the economy. The high costs of the budget in a sharp drop in revenues supported by increasing the national debt and growing budget deficit. In the first half of 2009 budget deficit has totaled 458 million lat, a public debt 2.949 billion lat or 22.7% of total GDP.

Influence of Latvia's fiscal policy on the economy

The world economic crisis had a negative impact on Latvia through reduced demand for its exports, a decline in foreign investment and credit resources. But government measures of fiscal stimulus decreased of domestic demand, public investment program and the promotion of credit activity of banks. From 1.1.2009, the main rate of value added tax was increased from 18% to 21%, and on socially significant goods from 5% to 10%. At the same time were increased excise taxes. Thus, the increased cost of goods and services that are acquired and the population was reduced domestic effective demand. Instead of the planned increase in tax revenues to the budget there was their sharp decline. Entrepreneurs exporting goods were detained for long periods of time, refund of value added tax, which deprived them of working capital and undermine the possibility of even maintain export volumes. Expenses for capital investments

from the state budget declined from 419 million lat in the pre-crisis 2007 to 145 million lat during 8 months of 2009, or from 9, 7% to 6, 0% of total expenditure budget.

Social effects of fiscal policy of Latvia

The reduction of budget expenditures during the crisis happens. The least reduce the consumption of the state apparatus. In the first quarter of 2009, total cost of the state apparatus, as compared to the fourth quarter of 2008, decreased from 1.013 billion to 847 million lat, but their share in the structure of the budget has increased from 44,8% to as much as 58,6 %. Even stronger than the proportion of the cost of maintaining the state apparatus grew up being compared to quarters of GDP - from 22,1% to 25,8%. The share of expenditure on salaries of employees of the state apparatus in general budget expenditures grew 25, 6% to 29, 4%. If in 2000 it amounted to 188, 4 thousand people, then in 2008 had 212,2 thousand people, accounting for 21, 1% of total employment. The nature of the reduction of social expenditures of the budget shows the contents of the Latvian

legislation began its operation in 2009. From 1.6.2009, the value of all pensions reduced by 10%, while the working pensioners by 70%. Mother and family benefits are reduced by 10%. It is reduced the size of non-taxable minimal wage from 90 to 45 lat. The decision to terminate the indexing of all pensions is made. In general, we can talk about that in a crisis Latvia's ruling elite is much weakened public support for socially disadvantaged groups.

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The crisis in Russia and the oligarchs

By Stephen Fortescue

Two events in recent years suggested a grim future for Russia's oligarchs, the buccaneering entrepreneurs who so controversially gained control of Russia's resource assets in the 1990s and no less controversially became fabulously wealthy as a result. The first was the October 2003 arrest of Mikhail Khodorkovsky and the subsequent transfer of ownership of his Yukos oil company to the state-owned Rosneft. The second was the global financial crisis, which put enormous pressure on their cash flows and so their capacity to service substantial debts.

So far, however, they have survived both these events. At the time of the bankruptcy of Yukos it seemed possible that it was the first stage of the full renationalization of Russian resource wealth. That did not occur. Abramovich sold his Sibneft to Rosneft, and then invested in the steel and coal sectors. Beyond that there have been no changes in ownership among the Russian oil majors. (At the next level below, Gutseriev was dispossessed of his Russneft in Yukos-style fashion, although it is still likely to end up in Deripaska's empire.) Ferrous and non-ferrous metals are still privately owned. Would be state oligarchs such as Sergei Chemezov have made limited headway, he being fully occupied with his 'sunset' industrial assets. The Yukos affair, it appears, was more about enforcing the rules of the game, above all the payment of tax. The oligarchs, although cowed and obeisant, are still allowed to lobby the government and are consulted, individually and collectively, on government policy, including the all-important tax arrangements. They no longer write the rules to suit themselves, but they are by no means ignored.

Neither has the state taken advantage of the second recent event, the global financial crisis, to dispossess the oligarchs despite having more secure legal grounds on which to do so than it had in 2003. The oil companies have not been particularly vulnerable in crisis conditions. Marginal tax rates on high-priced oil were so high that a drop in price has had little effect on after-tax earnings. But a number of metal magnates, above all Oleg Deripaska of Rusal, have suffered as commodity prices dropped and debt service became a heavy burden. But neither Western creditors nor the Russian state has shown much inclination to seize the shares they hold as security; so far they have been prepared to restructure the debts. Only a small proportion of the late 2008 emergency allocations of money from the country's sovereign wealth fund to firms unable to make debt repayments or meet margin calls was taken up. Owners preferred to restructure existing loans, rather than take up the more expensive and more threatening – in terms of the consequences of non-payment – emergency credits. Western creditors were presumably even less interested in suddenly finding themselves the owners of substantial but minority shareholdings in Russian resource companies than the Russian state was, and so agreed to restructures.

So assuming that with the help of their creditors the oligarchs survive the immediate crisis, what does the future hold in store for them?

1) Their relationship with the state will for the moment remain essentially the same. Putin wants to retain a significant private sector. He does not want to give his erstwhile colleagues from the security services unlimited access to Russia's resource wealth, partly because he plays the standard game of 'divide and rule' and so will not give too much to any single group; partly because he

has no greater faith in their management capacities than the oligarchs. Chemezov is a bellwether in this regard. He has clearly overreached himself and the state is unlikely to further indulge him.

- 2) The crisis has provided a sharp reminder that the oligarchs are limited, in terms of deep financial clout, in the degree to which they can develop their businesses and so the Russian resource sector. While they might have survived the crisis, it has revealed their pre-crisis expansion abroad, with its 'global company' pretensions, to be just pretensions. At home their already limited investment capacity has been shrunk even further. There are no indications that their credit lines have been totally closed, but credit is not going to be enough to finance the investments required in their sectors. Both pre-crisis expansion and the crisis itself have perhaps also revealed the limited capacity of the oligarchs to manage sprawling empires.
- 3) How then will the massive investments needed be funded and where will the know-how and management expertise come from? Given the shortage of freely available oil worldwide, Western oil companies feel obliged to provide funding and know-how to the Russians, regardless of regular atrocious treatment. Mining companies, with more global options, feel no such obligation. If they do not want the sector to suffer long-term decline, both the state and the oligarchs will have to give some ground to outsiders. If foreign companies cannot get reasonable terms, the current situation of virtually no new holes having been dug since Soviet times will continue. The foreign companies will be happy to leave the minerals in the ground.
- 4) Even if the oligarchs survive and indeed thrive, with adequate funding and infusions of know-how and expertise, will that provide impetus for the future development of the Russian economy? The oligarchs have often been criticized for producing a highly concentrated and resource-oriented economy. In fact, for a time they appeared to be the champions of diversification. Those investments generally remain in place. However the doubts about overstretch in their core businesses must apply even more in their peripheral businesses.
- 5) Sectoral considerations apart, what is the future of ownership as the oligarchs age? No preparations for dynastic succession are evident. Will their assets move into public ownership; if so, who will the investors be? Or will they slip into state ownership? Those questions will be answered by the state, with little oligarch influence on the answers. At the moment the state is reluctant to make up its mind, and it is difficult indeed to predict an outcome.

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BMD-Day for global security – new opportunities – old uncertainties

By Irina Kobrinskaya

September 17 has high chances to become a historical date – the start of building a new Euro-Atlantic or global security system of a modern 21st century type, i.e. inclusive, fare and effective. That day the US President B.Obama made public the decision to halt the plans of allocating elements of the **B**allistic **M**issile **D**efense in Central Europe. Observers were most curious about the reaction of Russia, and positive reaction of President D.Medvedev appeared among first. It was **Barac-Medvedev Day**.

Still, the next few hours and days revealed the whole spectrum of complexities and uncertainties dimming cloudless future of global security. A flow of declarations and comments regarding US decision on BMD halt touched upon various – national or even parochial and global, tactical and strategic, security, political and economic – angles. Majority concerned fleeting, but sometimes decisive political *mise en scene*, less – the military-political substance. After the dust fell, but before key decisions have – or have not – followed few principal matters can be pointed out.

Timing

No doubts, the time was chosen by B.Obama to reach maximum synergy: on the eve of the UN General Assembly and dozens of bilateral meetings on the highest level, G20 summit, meeting of the sextet on Iran, during the informal meeting of EU heads in Brussels, less than 100 days before the US-RF START negotiations deadline. The symphony was enriched by the 'come-together' address to Russia by new NATO Secretary General. Timing stressed the seriousness of the US Administration intentions not only to speed up the US-Russian reset, but to declare a basic change in American foreign policy from unilateralism to multilateral cooperation and stake on allies, from peremptory democratization zeal to more tolerant, even philosophic approach to the progress of democracy. Obviously timing signaled for new, in fact unprecedented opportunities for strengthening global security.

Still the very day, 17 September, 70 years after Red Army crossed the Polish border in 1939, caused twice as deep disappointment in Poland, which pushed Washington for BMD project. A bitter reaction of Polish leaders (we omit for the sake of place the nuances of Polish political scene) marks another significant matter –

Optics and perceptions

The reactions to B.Obama's decision again exposed gaps in mentality and vision of Euro-Atlantic and global security. Germany, Great Britain and France familiar with terrorism are really concerned by Iranian threat and nuclear proliferation. They welcome realistic plans of more effective defense against real threats (which rather could be medium and short-range missiles). Also, striving under the pressure of increasing Muslim population to find the narrow path between tolerance, democracy and effective means to preserve their national identity, Germany and France are interested in consolidation of the European Union, including military-political sphere. For 'Old Europe' Obama's new approach means more Europe in global security. But is European Union ready for more responsibility?

Obama's plan also gives more means to closer engage Russia, which 'Old Europe' realistically considers to be a necessary element of European security, a real and last **frontier** of Europe, in particular, taking into account NATO's problems in Afghanistan and instability in nuclear Pakistan.

In Central and Eastern Europe cold war and ages old stereotypes and fears of Russia (and Germany) gave new parochial sprouts on fresh yeast of 1990-ies - 2000-ies uneasy experience of integration and globalization. For Poland US BMD was not about Iran, but about Russia, or worse – Russian-German cooperation. Warsaw, which made highest stakes on the United States, and not NATO, as the only security guarantee, took the news as a treachery on the part of the strategic and most reliable partner. For Kyiv and Tbilisi Obama's decision meant distancing of their NATO plans (a propos Obama did not meet with Yushchenko and Saakashvili).

Baku perceived it mostly as eventual possibility to raise its political profile in the region, in case Gabala radar – as Moscow suggested earlier – would be an element of the antimissile defense.

Finally, Moscow decided this is 'about Russia'. On official level Russia welcomed the changes in Washington as a winner. Exactly as a winner V.Putin immediately put forward demands for further concessions: no restrictions on export of technologies and WTO membership. Apart from propaganda, Moscow, anyway, realizes, that this new game plan would demand from Russia much more and real, not just words as during Bush Administration era. The words – installing or not installing Iskanders in Kaliningrad district won't be enough. What Obama suggests is to turn from rhetoric confrontation to practical cooperation. Is Russia really ready for it?

Decision-Day for Russia

Russia is concerned with eventual Iranian nuclear threat. Thus, it is quite possible, that regardless of C-300 contract and Bushehr plant, Russia may join, or not veto new sanctions against Iran. Russia has to be utmost careful not to spoil contacts with Iran, because Washington still hopes to gradually engage Iran into civilized world policy and counts on Moscow in this regard.

Russia is interested in re-negotiating START, in significant cuts of strategic nuclear weapons, because it is loosing this game to the US.

Russia is interested in long-lasting stabilization in Afghanistan, because otherwise it would face a chain of conflicts and instability in Central Asia and would sink in the drugs-flood from there. That is why Russia will and is already cooperating there with NATO.

Russia is interested in nuclear non-proliferation and disarmament, and it will support Obama's efforts in this respect, also for the reason that it serves to strengthen its positions in global affairs.

All that was many times declared by Moscow but found no response.

Now, that the response is there, would Moscow follow its declarations? Taken together, all these initiatives and solutions basically change the nature of Russian-Western, Russian-American relations and sentence Russia to cooperation. Which Moscow a propos considers sine qua non for modernization of the country.

The question is, whether in this 'new brave world' Russia is ready to openly and equally compete with the battle-field allies in the post-soviet space? These same September days Washington has clearly signaled its interest in closer ties with Turkmenistan as a 'leader in the energy sphere in the region', and in the new Washington mood State Secretary H.Clinton said, that she did not see big problems with human rights in Turkmenistan(!). Is Moscow ready to abandon traditional and comfortable habit to look for enemies in the West? Or to neglect Ukraine or Belarus sovereignty? The most recent polls show that such moods are still rather popular.

In other words, is Russia finally ready to make a choice in the process of self-identification, adhering itself, as it was reiterated many times on the highest official level, – with all its peculiarities – to the Euro-Atlantic civilization?

With high probability this may be the D-Day for Russia.

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Do we have enough university collaboration?

By Jukka-Pekka Bergman

It is well known that success in global competition is and will be based on more and more knowledge intensive innovations, talents, R&D and international collaboration which are very often supported by universities and research institutes. In the Northern Dimension Region, as part of the "knowledge economies", universities and their networks are traditionally seen as the main sources for regional development and welfare.

Today's momentum for change and new forms of collaboration has also been recognized in universities and research institutes. As regions, universities themselves are undergoing restructuring and reorientation processes. They are creating new strategies and looking for new partners. Universities are increasingly dependent on each other. In addition, the surrounding environment continuously requires new initiatives and more benefits from research and educational programs to facilitate the circulation of intangible goods and services that are crucial to innovation and the competitiveness of the regions.

Even though universities would like to cover a wide range of scientific fields to respond to the external demand as thoroughly as possible, they cannot. The surrounding environment is becoming more complex and systemic. In their limited range of resources, universities need to focus on their operations and find partners to complement their capabilities. Therefore, networking activities have reached a central role in the daily operations of academia.

As a consequence, international and especially cross-border collaboration is seen as one of the most effective and beneficial approaches to respond to the needs of the surrounding environment. One reason for cross-border collaboration is the common history of the regions and their actors. Universities know each other and have very often shared visions and goals.

With a common background, the universities in the Northern Dimension Region are developing collaboration from two different approaches: very focused collaboration among a limited number of partners and an open network covering a wide range of scientific research areas.

As an example of focused cross-border collaboration, six universities in St. Petersburg and three universities in Finland have established the "Finno-Russian Innovation University" to enhance research in the field of design, business and technology. The Finno-Russian Innovation University is an alliance between Finnish and Russian universities aiming at establishing a constant and dynamic structure for state-of-the-art research and education by combining technology, business studies and design. The planned core activities of the alliance are 1) conducting research in the fields of technology, business studies and design which support the initiatives of the EU and Russian Innovation policy, 2) managing and enhancing Russian co-operation in Finland in the field of research and educational activities and 3) acting as a link between the EU, Finland and Russia for the collaboration of the universities and other organizations related to research activities in the field of technology, business and design.

There are several motives for the alliance Finno-Russian Innovation University from the technology and innovation management points of view:

- Going wrong with ICT investments is more expensive/critical than earlier.
- The number and complexity of technologies are increasing.
- Life cycles of technologies are shortening.

- Networking and co-operation are important to the absorption of the needed knowledge for learning and to the division of costs.
- There is strong causality between technology development activities and the success and well-being of the organization.
- Technology development times have become longer and technology and product life cycles shorter.
- There is increasing pressure for immediate commercialization of the research results.

As a whole, the general purpose of the Finno-Russian Innovation University is to provide common processes and tools for top level research groups to create large international research projects and promote regional and international collaboration between business and scientific forums.

Another example of the cross-border collaboration is a model for an open networked organization called the Northern Dimension University (NDU), which connects universities and research institutes to provide high-quality demand-driven research aiming at serving both the public and private sectors.

The idea of having an academic and scientific institute for the Northern Dimension (ND) was raised on the ND agenda in the Northern Dimension Senior Officials' Meeting in St. Petersburg on November 21, 2007. Originally, the idea of NDU was generated by the St. Petersburg State University (SPbSU). Later on, the concept of NDU has been developed in co-operation with other universities and scientific institutions, and within the ND structures.

The Northern Dimension Institute (NDI) is an open network of universities and research institutes combining expertise in the priority sectors of the ND Policy¹, i.e. providing high-quality research (and later also education) in the fields of energy and the environment, public health, logistics, and culture and higher education². However, NDI is an open format and, if required, parties interested can continually develop the ideas further also in other interest areas.

The creation and transfer of knowledge for NDI is based on active collaboration between its partners and interest groups. Thus, NDI continuously follows the ND Policy to maintain close interaction between the decision makers, researchers and business. Furthermore, NDI facilitates the achievement of joint research applications by partner universities e.g. for major European and Nordic sources of financing.

NDI creates added value for policy-making, the academic world and regional development. The main contributions can be summarized by stating that firstly, in its initial phase, depending on basic funding for activities and project funding for research, NDI e.g.

¹ The ND Policy refers to the Political Declaration on the Northern Dimension Policy and the Northern Dimension Policy Framework Document.

² Research themes connected to the Northern Dimension partnerships: the Northern Dimension Environmental Partnership (NDEP), and the Northern Dimension Partnership in Public Health and Social Well-being (NDPHS); as well as to the partnerships in preparation, the Northern Dimension Partnership on Transport and Logistics (NDTLP) and the Northern Dimension Partnership on Culture (NDPC).

- creates new research partnerships for cross-border co-operation and regional development in the ND region,
- conducts research of high policy relevance focusing on the priority sectors of the ND and contributes to the development of instruments to implement the ND Policy (such as ND partnerships),
- brings together already existing networks of universities and research institutes,
- enhances international research and offers a forum for working in multi-national research groups. By providing internationally recognized research, the partners of NDI have possibilities to improve research in their organizations and contribute to regional development work; and
- supports decision-making in the ND Policy framework by producing research of high policy relevance. This includes gathering together existing research projects and results of importance to NDI and producing tailored research for ND policy-makers.

Summarizing, the Northern Dimension Institute (NDI) is an open networked umbrella organization of universities and research institutes. The main goal of NDI is to promote organized multidisciplinary research in the ND Policy priority sectors: energy and the environment, public health, logistics, culture and higher education. Thematic research groups are to be created in each of the above-mentioned priority sectors, but also other areas of interest can be brought to the agenda of NDI.

Several authors, also the ones of this Journal, have aptly pointed out that the Northern Dimension and Baltic Sea regions are not lacking common forums and organizations. For example, CBC, Arctic Universities, the Barents Institute, BASREC and BSSSC exist to facilitate collaboration. The existence of this kind of facilitators is indeed a good sign of tight and intensive co-operative activities. We however need to find out our real regional competitive advantages. The Finno-Russian Innovation University is focusing on innovation research combining regional resources to increase the innovativeness of the cross-border region. The Northern Dimension Institute is connecting the universities of the region as an open network to promote multidisciplinary research in the ND Policy priority sectors and securing the information and knowledge flows in the region.

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Towards a European eco-efficient economy

By Måns Nilsson

The current Swedish presidency of the European Union is struggling with three difficult policy problems. The first is managing the global economic recession and developing a new economic momentum in Europe. The second is to prepare for a new "Lisbon" strategy for how to enhance Europe's competitiveness in an increasingly competitive world economic order. The third is to deal with the threat of climate change, which includes both to keep all Member States on board for serious mitigation commitments, and to lead Europe in securing a global deal in Copenhagen in December.

Although these three policy agendas are often treated separately in the political system, it is increasingly clear that they are linked and must be treated together. The way forward can be described as the quest for a European eco-efficient economy.

Europe has been and can continue as a global leader in climate and energy policy. It has made tough commitments both on emissions reductions and expansion of renewable energy. But Europe must become better at innovation and growth of new industries and businesses. Europe's innovation power is currently weaker than for instance Japan and USA. We have problems, for instance, when it comes to venture capital and assisting companies through the "Valley of Death" between demonstration and market introduction.

The eco-efficient economy relies not only on innovative green companies. At the same time as strengthening innovation, Europe must also support the development and transformation of existing important industrial sectors such as heavy engineering, chemicals and steel.

Sweden has made the eco-efficient economy a profile issue during its presidency. Which issues need particular priority? I want to stress three points: systems efficiency, technology development, and a global price on carbon.

Systems efficiency has to do with how we use and distribute energy, in the form of heating and cooling systems, urban planning and transportation systems. 54% of Europe's energy is today imported, at a cost of 350 billion Euros. Heating and cooling take up half of all energy use in Europe. At the same time, there are enormous losses in existing systems. The European Commission estimates that we today are wasting around 20% of all energy. Many countries in Eastern and Central Europe, such as Poland, have the infrastructure in place and can act on major opportunities for efficiency improvements and savings throughout their systems, as well as convert to renewable fuels.

The concept of sustainable cities has received a lot of attention in media but progress has so far been on small scales and in relatively isolated "good examples". Still, opportunities are everywhere. They have to do with how we manage existing buildings and structures, and improve on for instance insulation and energy use. But it also has to do with how we build new cities and housing, and how we plan for access and mobility. Since 75% of Europe's people live in cities, this is key.

New technology development concerns renewable energy in its various forms but also other bioresource-based technologies such as biotechnology, biomaterials and green chemicals. These technology fields require further public action if they are to deliver. Today, only around 12% of energy research and development is allocated to renewable alternatives. The development of the second generation biofuels must accelerate. And Europe's leaders cannot turn its back on the opportunities in using advanced biotechnologies for sustainable development.

The car industry is important for Europe, and it is beginning to take climate change seriously. But industries have also been conservative and sometimes quite short-sighted. The EU needs to govern more actively the transition to cleaner transport. Governments are starting to look at carbon-differentiated vehicle

licensing fees, but need to do much more on congestion charging, road pricing and differentiated parking fees.

A global price on carbon is needed if measures for systems efficiency and new technologies are going to reach its full potential. Europe can be one step ahead. But Europeans account for 12% of global greenhouse gas emissions. China and the US account for 50%. We will never fully get around problems of competitiveness and carbon leakage, and the political difficulties that come with them, without a global price on carbon. Most European countries already have high fuel taxes but elsewhere in the world they tend to be low. Developing economies are claiming their right to release greenhouse gases into the atmosphere just like the developed world has done for decades. But why are negotiations so fixed on volume commitments? Let us start talking instead about price mechanisms which are competition neutral.

To move forward with this eco-efficient economy agenda, we must "lock-in" on pathways for sustainable transformation. It is doubtful whether existing decision making institutions in Europe will be able to achieve this. Therefore, three institutional changes need to be set in motion.

First, we need better-informed policy debates. Decision makers must better understand how socio-technical systems develop, and what impacts there will be from different decision alternatives. In fact, both environmentalists and industries see this as the major deficiency today (but for different reasons!)

Second, we need stronger policy integration. Decision making must be better coordinated. Today, at best there is some kind of consultation and discussion between different departments. Europe needs better coordination and integration of policy fields such as energy, transport and agriculture, and up to international negotiations in climate change, trade and security.

Third, we need technology-specific support measures. Generic instruments such as taxes and emissions trading need complementing with targeted measures for innovation, entrepreneurship and new technology markets. We cannot only let the market resolve it, but must accept that new technologies require early-market support. Through well-designed technology support, Europe can be a lead market for eco-efficient products and technologies – and an attractive place for investments globally.

If the EU leads the way and sets in motion these policies, Europe can create an eco-efficient economic development, where it stands competitive, where climate change is managed, and where resources are not being wasted – at the same time as there will be a new dynamic in the economy. This will determine whether Europe can be a global leader in the global transformation towards sustainable development

A European Eco-efficient Economy was published by the Stockholm Environment Institute in June 2009 and can be downloaded at: <http://www.sei.se/publications.html?task=view&catid=5&id=1241>

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Innovative thinking on environmental issues – the Baltic Sea is in urgent need for protection

By Miina Mäki

Over the last decades, the condition of the Baltic Sea has declined alarmingly. There are nearly 90 million people, in 14 states, living in the catchment of the Baltic Sea. The well-being of the Baltic Sea has become threatened due to increased discharges from human activities. This poses a serious threat not only to the Baltic Sea environment but also to tourism, fishing and other businesses closely related to the Baltic Sea.

The main problems of the Baltic Sea are not local but widespread in space and time. The countries surrounding the Baltic Sea seem ready to invest resources in marine conservation and start addressing the problems as a unified front. Clear evidence of shared concern emerged from the Krakow meeting of the Helsinki Commission (HELCOM) in the middle of November, 2007. The countries around the Baltic Sea made a commitment to reverse the trend and bring the dying sea back to life.

Taking action for a cleaner Baltic Sea

The mission of the John Nurminen Foundation of Finland is to preserve the Finnish heritage in maritime culture and seafaring. In 2005, the Foundation initiated the Clean Baltic Sea project. The Clean Baltic Sea project supports actions to implement the new Helcom recommendations on wastewater treatment by improving phosphorus removal at wastewater treatment plants around the Baltic Sea and aims at visible improvements in the conditions of the Baltic Sea. Phosphorus is the limiting nutrient for the growth of blue-green algae. Therefore, in order to combat the mass occurrences of the blue-green algae reducing phosphorus emissions is of primary importance.

Concrete action and cooperation between the countries around the Baltic Sea are required in order to solve the problems of the Baltic Sea. The Foundation's operational policy is to act as a catalyst between the different sectors of society and the countries around the Baltic Sea, and to hasten the actions which are critical with respect to the condition of the Baltic Sea. The Clean Baltic Sea project has been supported in Finland by the Finnish Ministry of the Environment and numerous big enterprises as well as private persons.

Model for efficient operations obtained from business life

With the best ways possible, the Clean Baltic Sea project aims to combine the expertise and resources of the private and the public sectors to the benefit of the sea environment. In accordance with its ideology, loaned from business life, the rule of thumb of the Clean Baltic Sea project is to allocate the activities to where the best results can be achieved with the lowest cost, in other words, obtain the highest positive environmental effect.

The cooperation locations of the project are selected with the assistance of different fields' experts, on the basis of the largest possible emission reduction, cost-effectiveness and the measurable environmental effects. The goal of the project is to reduce the eutrophication of the Baltic Sea in a quick and visible way.

Aiming at an emission reduction of 2 500 tonnes of phosphorus

The Clean Baltic Sea project focuses on intensifying phosphorus removal from the wastewaters of cities located in the catchment of the Baltic Sea. The John Nurminen Foundation implements the project in close cooperation with the partner cities. In phosphorus removal, the Foundation's goal is to achieve the level of 0.5mg of phosphorus/ litre of purified wastewater, which is also the recommendation by the Baltic Marine Environment Protection Commission Helcom.

The aim of the Helcom Baltic Sea Action Plan, signed in 2007 in Krakow, is to reduce 15 000 tons of annual discharges of phosphorus. The total phosphorus load to the Baltic Sea is estimated

to be some 30 000 tons annually, which makes the Helcom target really ambitious. The objective of the Clean Baltic Sea project is to reduce some 2 500 tons of annual phosphorus discharges, via voluntary cooperation of project target cities, and through the most cost-efficient way.

Targeting the biggest pollution sources through voluntary actions

The project was started in St. Petersburg in 2005, in close cooperation with the Vodokanal and the City of St. Petersburg, with the aim of reducing the annual phosphorus load from St. Petersburg's wastewater into the Gulf of Finland by 1,000 tonnes. The project has successfully introduced the chemical phosphorus removal process at the biggest wastewater treatment plant of St. Petersburg. A major milestone was reached when the chemical treatment process was launched at the biggest Central wastewater treatment plant in October 2007. In St. Petersburg, the work continues at two other large-scale wastewater treatment plants where the target level for phosphorus removal will be achieved during 2010. According to ecological models, the project is expected to demonstrate a visible effect on the condition of the Baltic Sea within a few years.

In the summer of 2008, a letter of intent was signed with the City of Warsaw aiming at making phosphorus removal more effective at the wastewater treatment plants in Warsaw. The Swedish Baltic Sea 2020 Foundation is the partner of John Nurminen Foundation in the project in Poland. In the future, the Foundations wish to have several partner cities into the project from Poland. However, in the light of current information, it seems that, at least in some big cities, the Poles might even be capable to reach the Helcom recommendation on phosphorus removal by their own investments at the modernized treatment plants.

In 2009, the Foundation launched a new application-based approach to reduce phosphorus discharges. It is targeted to cities and water companies, who are interested in taking voluntary action in reducing their discharges. A project agreement with Riga Water was signed in Helsinki on 15th September, 2009. It represents the first example of the new application-based project targeting, as it was the Riga water company who first approached the Foundation when looking for funding for more efficient nutrient removal at their wastewater treatment plant.

The application for funding can be sent to John Nurminen Foundation and it should include some basic facts on the present situation of wastewater treatment and on planned investments at the plant. Examples of possible forthcoming locations for the project include South-Western Russia, the Baltic Countries and Belarus, where there still are big cities with insufficient wastewater treatment, and, the most important, the will for action. The Foundation way of thinking positively: where there is the will, there is the way.

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Towards understanding of spatial and temporal differentiation of innovation activities in Baltic Sea Region

By Toni Ahlqvist

Already some 15 years or so the impetus of innovation has been thriving in socio-economic research and related policies. As an overarching theme of research and development activities, the 'innovation' has been actively raised as the cornerstone of future prosperity in western – and also increasingly in so-called developing – economies. However, along with this innovation thrust, something peculiar has happened to the concept of 'innovation'. It has become a strong boundary object, i.e. a concept that has such a fluid and wide coverage that almost all thinkable research and policy actors can somehow link to it. The peculiarity in this situation is that, at the same time, the meaning of 'innovation' has become somewhat monolithic and imperative, referring mainly to the promise of enhanced economic efficiency. In this vein, the idea of 'innovation systems' – be they European, Baltic, national or regional – has also become quite mechanistic. The invariably tightening competition between all the economic units – be they nation states, regions or firms – has raised such cardinal markers as economic efficiency and commercial success to the fore and relocated more cultural meanings, like creative latitude, ideational richness or differentiation, to its hidden margins. This conceptual trimming, I argue, cuts off some important aspects in our understanding of 'innovation' and 'innovation systems'.

What this situation then means for Baltic Sea Region? How could we return these hidden cultural meanings to these concepts? And how could we restore the idea that innovation, and also development of technologies, should be driven by more grandiose societal aims and needs than mere economic efficiency? Is there any way to return such archaic issues, like people and common good, to the sphere of R&D in this era when economic goals are almost beyond exception seen to supersede political goals? Some solutions to these questions may come out of research activities that have been completed at VTT in recent years.

First answer may spring from the efforts to understand the plurality and differentiation of regional innovation systems in a more systematic way. In a recent study made by VTT, named *Geography of Finnish Innovations*, we analyzed, via our database of some 4500 Finnish innovations dating from 1945 to 2007, the geographical aspects of regional innovation activities in Finland. One of its most intriguing results was the realization that there is indeed a plurality of regional innovation systems in Finland. When we analyzed the Finnish innovations through measures of absolute quantity, the activities were clearly focused on Helsinki capital region and to the biggest university regions. However, when we analyzed the innovation activities in relation to the size of the regional innovation environments, the national 'innovation surface' was much more even and differentiated. In Finland, there are several industry-based innovation centres besides the capital region and university regions that have quite strong innovation activities that might not show in the quantitative analyses of e.g. patent publications or R&D outputs. These innovation activities may spring from unique trajectories embedded in the local environment. The result shows that regional innovation systems have strong local linkages and characteristics, and these local features are important for comprehending the whole concept of 'innovation system'. The study reveals that there is a need to understand the differentiation of regional innovation systems

more thoroughly than is currently possible via the lens of quantitative economic efficiency.

The second answer – along with the regional differentiation – is opened by approaching the innovation systems as spatiotemporal entities, i.e. units that have unique development paths in three temporal levels, namely future, present and history. In the years 2005–2007, VTT completed a study called *Nordic ICT Foresight* with three Nordic research organizations, namely DTI (Danish Technological Institute), FOI (Swedish Defence Research Agency) and SINTEF (Foundation for Scientific and Industrial Research at the Norwegian Institute of Technology). In this study we made future-oriented analyses of the potentials of Nordic ICT applications in four thematic areas: experience economy, health care, production economy and security. Our analysis was based on the comprehension of the evolutionary features that have led to the present stage of ICTs and to the visionary societal goals 10 years beyond the present set in these four areas. Thus, we analyzed ICTs as evolving processes consisting of different temporal spans and specific spatial characteristics, e.g. features that are common, complementary or specific to the studied Nordic countries (Denmark, Finland, Norway & Sweden). After systematic assessment, based on e.g. scenarios, roadmapping and action planning, we formed two kinds of ICT utilization strategies for Nordic region. The first strategic set was so-called implementation strategies, i.e. activities that are based on unique Nordic characteristics and therefore could be proactively fostered. The second set of strategies was adaptive strategies, referring to wider global level development streams that Nordic region should adapt to.

To conclude, what are the most important lessons of these two case examples from the perspective of Baltic Sea Region? Firstly, when studied more carefully, regional innovation systems are systemic entities that are simultaneously locally specific and globally adaptive. To put it bluntly, regional innovation systems are spatially differentiated. Secondly, the spatial differentiation opens up a space for temporal differentiation. Regions are not just passive building blocks in global economy – regions entail a capacity of proactive construction of their own futures, e.g. by creating strategic regional visions and back-casting transition steps to realize these visions. And to return to my philosophical plea for creative latitude, I think that this understanding of spatial and temporal differentiation of regions and regional innovation activities opens up a possibility of bringing people, culture and wider societal goals back to the concepts of 'innovation' and 'innovation systems'.

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Innovation policy in Russia during the economic crisis

By Irina Dezhina

The Russian innovation system continues to be in transition during all the post-Soviet period. At the present time it combines elements of Soviet structure (large government sector of science) with new forms (new types of technical and financial infrastructure). In comparison with other developing economies the strength of the Russian innovation system is in the volume of resources, especially R&D personnel, and in the large-scale educational system. The major weakness is mainly in the quality of governance, i.e. in such characteristics as the rule of law, and the quality of government regulations. In addition, Russia is lacking large science-intensive companies, on the one hand, while there is not a sufficient number of small innovative enterprises, on the other hand. One of the serious reasons for low demand for innovations (including R&D) from industry is in the inadequate level of competitiveness and the monopolization of many Russian enterprises. The mechanisms aimed to stimulate companies to invest in R&D (indirect measures, different forms of public-private partnerships, technical regulations and such) are underdeveloped.

As a result, by the knowledge economy index (KEI) that the World Bank calculates annually, Russia is in the group of countries with medium-low income. It occupies the 61st position out of 134 countries for which this index is calculated (data for 2008). This is a decrease in comparison with 1995 – the year when such index was calculated for the first time. The KEI consists of four sub-indices: economic incentive regime, innovation, education, and information-communication technologies development. For Russia the strongest component is education and the weakest – economic incentives regime.

During the latest years the emphasis of the government innovation policy was on the measures that should strengthen or establish linkages between R&D organizations, universities and business in order to stimulate knowledge transfer and commercialization of R&D results. In this area the major initiatives were concentrated in the following areas:

- 1) encouraging cooperation between the R&D sector and private companies through support of joint projects, implemented in the framework of Federal Goal-Oriented Programs
- 2) support of small innovative enterprises through R&D grants and creation of technical infrastructure (such as technology parks);
- 3) introduction of some indirect measures aimed to stimulate innovation in the private sector (a number of tax privileges and tax exemptions – they mostly came into force in 2007-2008 and their effects are not clear yet).

The influence of the economic crisis on the Russian innovation system was the most visible through the indicators of private expenditures on R&D – they started to decrease dramatically. It has happened against the background of quite low business enterprise expenditures on R&D (during the last 4-5 years the share of business enterprise sector was fluctuating around 22-24% of the total intramural expenditures on R&D). Large enterprises that had the biggest expenditures on R&D had cut investments in research as well as their in-house R&D divisions¹. By the end of 2008 private firms' expenditures on R&D have decreased by 80%, business angels financing – by 50%, financing from venture funds – by 40% in comparison with the pre-crisis period².

Evidently the crisis did not stimulate companies to outsource R&D from the government sector of science. Before, outsourcing was gradually developing though many companies with large R&D divisions preferred to support R&D projects in-house or to buy technologies abroad because this was often cheaper than placing orders to government R&D institutes or universities. Companies explain the low demand for outsourcing from government-owned R&D organizations and universities by³:

- the workforce problems that exist in the government sector of science and in universities (lack of researchers in the most productive age of 35-50 years old);

- problems with the rights to intellectual property, especially the one that was created before the start of the project with industry;
- quality of the results: usually it is higher in R&D but not technology.

The crisis also influenced the position of small innovative enterprises. Large and medium companies not only decreased their own expenditures on R&D but they also cut orders to small companies. Simultaneously banks stopped giving credit to small innovative companies⁴. All this created very unfavorable conditions for small firms which may cause sharp decrease in their number.

The government's reaction to the crisis was also in the decrease of its expenditures on R&D. In 2009, depending on the Agency and type of Programs, the cuts in financing of R&D varied from 15% to 30%⁵. In comparison, Western European countries and USA have chosen a strategy to cope with crisis through increased support of R&D and innovations. In the USA the new President has announced that additional financing will be given to science, including support of fundamental research. At the EU countries governments plan to apply more proactive indirect measures stimulating private investments in R&D such as tax privileges. In developing countries (China, India) the crisis is seen as a chance to attract additional financing for R&D from abroad. Thus, governments of these countries put special emphasis on measures that may encourage inflow of foreign investment: reconsidering the intellectual property legislation, giving tax privileges to innovative companies. This, in combination with comparatively inexpensive workforce, indeed attracts foreign investments into local R&D.

In the crisis conditions the strategic approach of the Russian government was not to create new mechanisms but more effectively to use the existing ones. The emphasis is on such measures as support of small innovative enterprises, creation of technical and financial infrastructure for start-up companies, stimulating demand on R&D from the side of industry. Most of these measures are currently under development. Taking into account the general economic environment, budget cuts on R&D, and low efficiency of existing innovative infrastructure, the likelihood that these measures will be instrumental is not high.

Overall, the government has developed about 100 measures to cope with crisis, which are not directly related to innovations⁶. Most of measures are centered on the support of large companies but not in areas of technology modernization, product diversification and such. The implementation of these measures has led to unequal treatment of companies, and, as a result, to deterioration in the competitive environment⁷. Further, the lack of a competitive environment is harmful for innovations. Therefore there is not only delay in the development of anti-crisis measures to support innovations but those economic measures that were so far developed and implemented were anti-innovative by their nature.

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⁴ http://www.strf.ru/innovation.aspx?CatalogId=223&d_no=17567

⁵ http://strf.ru/organization.aspx?CatalogId=221&d_no=19448

⁶ Simachev Yu., Yakovlev A., Kuznetsov B., Gorst M., Danil'tsev A., Kuzyk M., Smirnov S. Assessment of Policy Measures to Support Russia's Real Economy. Bank of Finland, BOFIT Online, 2009, no.6, p.5.

⁷ Simachev Yu., Yakovlev A., Kuznetsov B., Gorst M., Danil'tsev A., Kuzyk M., Smirnov S. Assessment of Policy Measures to Support Russia's Real Economy. Bank of Finland, BOFIT Online, 2009, no.6, p.17.

¹ http://strf.ru/science.aspx?CatalogId=222&d_no=17095

² <http://inno.ru/press/news/document33157/>

³ The summary of companies' observations concerning outsourcing is based on personal interviews conducted by Irina Dezhina in June-July 2009 with the top management of a number of innovative companies in Moscow.

Challenges and new directions for Finnish innovation policy

By Tuomo Uotila

Innovations are widely seen as the driving force of economic growth and competitiveness not only in individual companies but also at national and regional levels. The recent discussion about developing competitiveness and innovation capability has dealt with innovation systems, which can be called either "national innovation systems", "regional innovation systems" or "sectoral innovation systems" depending on their context.

In Finland the concept of national innovation system and innovation policy has its roots at the beginning of the 1990s, though already in the early 1980s important measures had been taken to strengthen the country's technological base. Earlier than any other European country, Finland declared knowledge-intensity and technological superiority as the country's strategic policy objectives. By the 1990s the focus had shifted more towards networking and innovation policy. The concept of the national innovation system was adopted in the political discourse to emphasise that both producers and users of knowledge were looked upon as an entity and that innovations emerge from the interplay between these.

In recent years the Finnish innovation system has done remarkably well in several international rankings, but despite this past success, new trends have emerged to challenge the current Finnish innovation policy. Among the strongest of these trends are globalization and the increased importance of users in innovation process i.e. user driven innovation, which means the integration of users into the innovation process to create ideas, to test them and to facilitate the spreading of innovations. Professor Antti Hautamäki from University of Jyväskylä has even questioned the whole existence of an innovation system as "a national level concept". This is due to the fact that knowledge, the fuel for innovation, is more and more created in international cooperation and contexts. If the national innovation system refers only to knowledge and technology creation at national level, it, according to Hautamäki, also refers to a world that does not exist anymore. Adopting new knowledge and new things is as important as creating them. As a result of this globalization trend companies, including Finnish ones, are nowadays operating as members of global value networks. So far the Finnish innovation policy has, however, very much relied on cluster based development activities the default value being, that the clusters are operating from domestic home base. This on the other hand has led to criticism, that the current innovation policy is outdated.

In this new innovation environment a new approach, a paradigm of open innovation is needed. The basic idea behind open innovation paradigm is that organisations should aim at innovations by collaborating with companies, research institutes, universities, customers, suppliers etc. rather than carrying out R&D in "closed laboratory settings".

The above mentioned trends and challenges are by no means separate, but closely intermingled and connected with each other. One possible solution for these challenges is in adopting a more holistic approach to innovation policy. Even though the systemic view acknowledging the roles of

knowledge producers and knowledge users in innovation activities was adopted in Finland very early, as compared to many other European countries, it still can be claimed, that so far the Finnish innovation policy has been "an extension" of science and technology policy emphasising the science push effect in creating innovations.

Now it seems that in Finland the innovation policy is given a more holistic content than what it used to have. The national innovation strategy approved in 2008, at least at rhetorical level acknowledges that "while the knowledge and competence exploited may arise in a scientific community, the broad-based innovation concept emphasises the significance of individuals, enterprises, public operators and user communities as producers of knowledge and competence, alongside the world of academic research". Understandably, this is a strategy document and leaves open many practical issues. Among them is a very much unresolved question, how to ensure and to promote the needed dialogue between national and regional level in formulating innovation policies.

However, this kind of policy formulation adopted in the new national innovation strategy is very well compatible with the recent theoretical discussion on STI- (Science, Technology, Innovation) and DUI- (Doing, Using, Interacting) modes of innovation. The STI mode of innovation refers to the way companies use and further develop this body of science-like understanding in the context of their innovative activities and it relates to the use of explicit knowledge. The STI mode of innovation and learning, even if it starts from a local problem, will make use of "global" knowledge all the way through and, ideally, it will end up with "potentially global knowledge".

The DUI mode of innovation and learning most obviously refers to know-how and know who, which is tacit and often highly localised. While such learning may occur as an unintended by-product of the company's design, production and marketing activities, the DUI-mode can also be intentionally fostered by building structures and relationships which enhance and utilise learning by doing, using and interacting.

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Small business in Russia – trends and outlook

By Anatoly Zhuplev

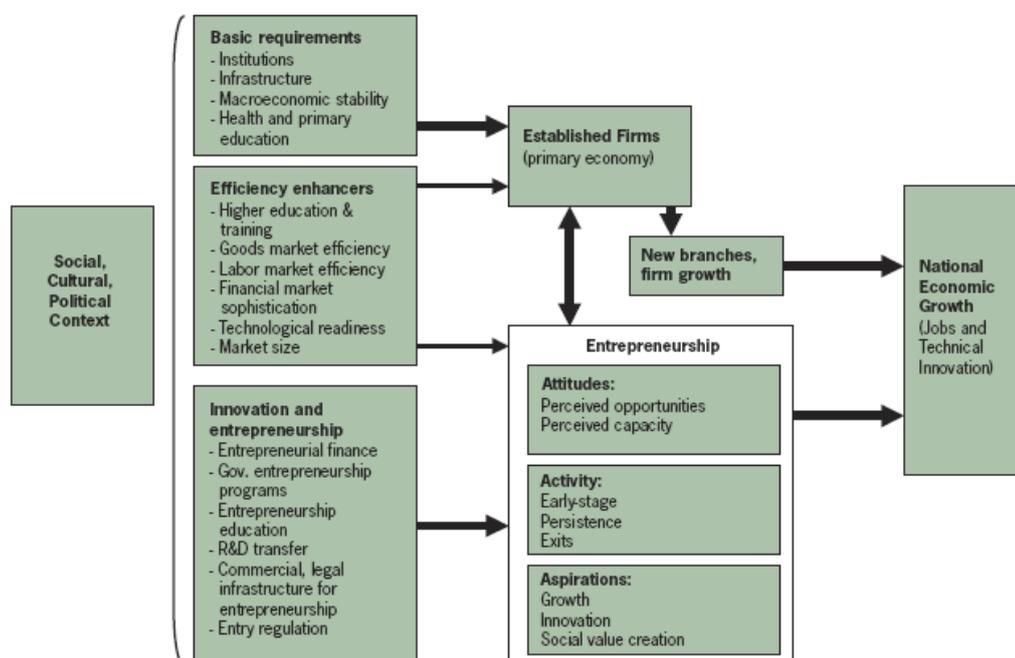
Background

Socio-economic prosperity, growth, employment and technical innovations depend on many factors and conditions where small business enterprises and entrepreneurship (SMEs) playing crucial role (Figure 1). SMEs in Russia, with its important political-economic role in Eurasia, affect both Russia itself and neighboring countries in the “near” abroad and beyond.

Figure 1 Global Entrepreneurship Monitor (GEM)

Framework

(http://www.gemconsortium.org/download/1250272833061/GEM_Global_08.pdf, p.10)



Over centuries, SMEs have not played significant economic roles in Russia, compared to the world's most developed economies. Seven decades of communism following the 1917 Bolshevik Revolution have continued this trend, in effect halting SME developments and creating restrained cultural attitudes towards entrepreneurship among the masses. Throughout moderate liberalization in the late 1980s and eventual demise of the USSR in the early 1990s, followed by roller-coaster years under Yeltsin and a relative stabilization under Putin SME climate in Russia has improved.

Current Developments and Trends

According to the latest Global Entrepreneurship Monitor 2008 report, Russia ranks among the least entrepreneurial countries in its reference group. Some other studies (Russian SME Observatory Report, 2002; U.S. Agency for International Development, 2004) find that private entrepreneurs – natural persons (a major component of the SME sector) dynamics are comparable to European countries. In the mid-2000s SME sector in Russia was responsible for 10-11% of the GDP and 13% of employment nationwide (Zhuplev et al., 2004). Despite more than a decade of the post-communist revival of SMEs since the late 1980s, reliable and comprehensive information often available only from western-sponsored research projects,

while Russia's home-based scholars and academics are generally poorly paid, concentrated mostly in few major cities (mostly Moscow and St. Petersburg) and often focus on their personal economic survival and other priorities rather than scholarly research. Adding to the problem and, indeed, part of the problem is the Russian government that provides inadequate attention, financial and organizational support for SME research and development- SMEs typically rank low in government priorities. Although widely recognized as having progressed in SME development in absolute terms, compared with the Soviet past, Russia continues to hold cultural reservations towards entrepreneurship (Global Entrepreneurship Monitor, 2009).

The latest World Bank's survey (Doing Business, 2009)

ranks Russia #120 out of 181 economies on the ease of doing business with the following rankings in the ten key subcategories: starting a Business – #65/181, dealing with construction permits – 180, employing workers – 101, registering property – 49, getting credit – 109, protecting investors – 88, paying taxes – 134, trading across borders – 161, enforcing contracts – 18, and closing a business – 89. Russia's overall ease of doing business world ranking in 2009 worsened by 8 percentage points (largely due to problems with obtaining construction permits and getting credit).

According to Russian government statistics, there are 6 SMEs per a thousand

people in Russia, compared to 45 in the EU, 49.6 in Japan, and 74.2 in US. More than 50% of the SMEs are located in Russia's Central and North-Western federal districts, among them disproportionate 25% are located in the capital city of Moscow that is comprised of just 7.43% of the total Russian population. Small business is still underdeveloped in the Far Eastern (4.8% of the total number of SMEs), Ural (6.7%) and Southern (9.7%) federal districts. About 46% of all Russian SMEs operate in retail trade and food service, about 14% — in construction service and about 14% — in production industries (Zhuplev, Shtykno, 2009). During Putin's first presidential term his administration initiated economic reforms, including the flat tax system, strengthening of the banking sector, improvements in the SME registration and reporting procedures, etc. These and other measures have had significant impact on motivations, obstacles and other parameters of starting and operating small business ventures. One of the most important improvements has been a wider, simplified access to loans and other sources of financing, although availability of venture capital in Russia, especially for high-tech/high risk start-ups, is still scarce. With financial windfalls from the skyrocketing world prices for energy and mineral resources the Russian economy has been steadily improving in the 2000s. The period of economic stability during Putin's second presidential term (2004-2008) and growth in population's purchasing power have contributed to an increase in the number of SMEs with

the medium level of sales and a decrease in the number of those with low sales in 2008. That has also signified a shift toward higher number of employees working in a business and a decline in the number of additional businesses owned. Economic stability has also instilled a sense of safety for private investors, thus facilitating increase in domestic private investment as a source of financing business. The worldwide economic crisis struck Russia in late 2008 hampering entrepreneurial developments in many ways, with particular severe impacts on SME financing

Longitudinal Study of Russian SMEs

A recently conducted small scale longitudinal survey (Zhuplev, Shtykhno, 2009) contrasted and compared the state of Russian SMEs over a period of fifteen years, in 2008 against 1994, in the beginning of the post-Soviet transition. Summarized below are major findings of this survey reflecting the state of affairs as of summer 2008, before the advent of the economic downturn.

- The development of business infrastructure in Russia, especially in the national capital and other major cities, has improved finding information on markets, products, and prices, realizing transportation, advertising and other business functions, as well as setting up communications (phone, fax, etc.). At the same time a shortage of business real estate in capital cities caused by an increased number of businesses entering market has made it more difficult to find office and operating space. Meanwhile, the development of business infrastructure has not facilitated opportunities for acquiring knowledge and skills needed to start up and operate business, as well as in production and operational management; those issues still present a significant problem for the growing number of young entrepreneurs.
- Improvements in the Russian banking sector assured by stricter governmental requirements on the banking transparency (which lead to a license withdrawal for some weak banks or banks of dubious origin in 2002-2007) and introduction of the Deposit Insurance System in 2004 by the Central Bank of Russia have facilitated streamlining of currency transactions, improved safety of monetary system and overall simplification in conducting banking and financial operations, as well as a slight decline in importance of high interest rate as an obstacle. Also, simplification in the accounting system for small business has led to the downshift in rating the accounting and bookkeeping as a problem.
- Rampant crime against private businesses so common in Russia in the 1990s, are no longer perceived as an issue of top magnitude, while bribery and influence peddling, together with unfair competition, are perceived as more important obstacles. That may be a result of both the dynamics of these processes in reality and entrepreneurs' increased knowledge/awareness.

- The number of young small business entrepreneurs in Russia has increased significantly, thus raising the need and demand for business consultancy and services.
- Reduction in unemployment, a shortage of labor force in the capital cities as well as lack of human resource management experience due to the low level of SME development in the 1990s have led to an elevated importance of finding good and reliable employees and high level of perceived difficulties in managing employees.

SMEs in Russia tend to demonstrate growth in the number of companies, the number of persons employed, the volume of sales and the number and share of female entrepreneurs (the latter is particularly evident in the service sector). This growth has been facilitated by positive changes in the taxation regime and streamlining of the licensing procedures but at the same time hampered by worsening situation with the red tape and bribery.

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Recent trends in M&A and privatization in Belarus

By Maksim Salahub

Belarus, a country which for years remained the land relatively unexplored by prominent international investors, has become an emerging market which now strongly attracts attention of international companies and investment funds. There are few major reasons for that. The government today is still the largest owner of property and „businessman“ in this country (over 70 % GDP is generated by public sector) which means there is good potential for investment and privatization. Ambitious privatization campaign proclaimed in mid-2008 is being implemented at an increasingly fast pace, despite of the currently unfavorable economic cycle. The Government has undertaken to significantly deregulate the business environment, and both domestic and foreign companies have already appreciated improvements in the area of company foundation, licensing and certification, land allocation, taxation. Still, many niches in this 10 million market remain relatively unoccupied, while demand for goods, work, and services of European quality is permanently increasing.

2006 – 2008 has seen a number of notable acquisitions and privatization deals in such areas as telecom, banking and insurance sector, construction industry. In the current economic cycle, the scale of the deals has become smaller, and buyers are now focusing on different industries. Today we more frequently see investors interested in Belarus' IT sector (especially setting up a company with residency in Belarus High Technology Park, or making a joint venture with the existing Park resident), wood working industry, and food enterprises (especially those producing dairy products). There are several specific tendencies which we have noted from the beginning of 2009.

First, growing interest of international financial institutions in the market. EBRD is becoming increasingly active, providing loans to banks, industrial companies, and contemplating equity investment in various industries. Further expansion of activities is expected in connection with the Bank's possible revision of country strategy (EBRD may decide to extend its investment activities also to the public sector, while now it finances only private companies). Some financial institutions based in Nordic countries choose to co-invest in small and medium size enterprises together with a leading foreign or international investor from respective industry. Still, some international financial institutions are waiting for further political warming in the relations between Belarus and the West to start their operations in this country.

Second, privatization is getting into gear, beginning with smaller industrial enterprises. Targets are often picked not from the official privatization list. Privatization is more and more frequently initiated by the companies' management or municipal authorities. Superior authorities – ministries, state committees, government concerns, - seem to be slow and reluctant to give up control over enterprises subordinated to them from the time of the Soviet era. On the other hand, at the negotiation table every now and then we hear that privatization is seen as the only way to implement necessary modernization program at a given enterprise. Quite often, a target's long standing foreign trade partner is invited to invest equity.

Third, investment agreements with Belarusian state are becoming more and more popular. Under the Investment Code of Belarus of 2001, an investment agreement may be concluded by a domestic or foreign investor directly with the Republic of Belarus represented by a designated government body or organization. The investment

agreement may provide investor with additional privileges and exemptions (normally they concern taxes, customs duties), guarantees and protection against risks. Such agreement is used by the companies venturing in Belarus to achieve greater legal certainty and security for their investments.

Fourth, culture of relations with investors is changing for the better. Belarus Government already a while ago began to value very highly image of the country as investment destination, and a lot is being done to maintain and improve this image. Besides undertaking accelerated reform of legal environment and a massive privatization campaign, the Government is trying to play consistently a fair game with foreign investors under transparent and stable rules.

Of course there is still a lot of room for improvement. Local bureaucracy is sometimes very heavy and reminds of Soviet times, giving birth to many half-comic, half-dramatic stories. For example, it takes to exchange quite a few faxes (emails and calls are almost not acceptable) to appoint a first meeting to offer a privatization project to a ministry, and still the meeting may be missed due to necessary ministry people forgetting about the appointment, meeting other business partner, or whatever other reason. A ministry clerk responsible for reviewing and coordinating your investment proposal may leave for a one month vacation without notifying you or delegating the project to his colleague. The most difficult task is usually identifying the decision maker out of the dozens of people meeting you in the negotiation room. As if to make communications yet more difficult, very few government clerks speak foreign languages and use email.

Yet another major problem is a gap in expectations on the part of foreign investors and their potential Belarusian counterparts. This is often observed both in the deals with the government and the private business. The government expects that the investor, in exchange for an opportunity to enter an unexplored market and do business on Belarusian soil, will pay a high purchase price for an enterprise and in addition will undertake significant obligations related to modernization of manufacturing facilities, technology and know-how sharing, creating new jobs, increasing exports, maintaining social infrastructure. Private Belarusian businessmen, when making a joint venture with foreign partners or selling their business to them, commonly expect a considerable compensation for the „good will“, market reputation, brand, etc. Sometimes compromise may be found, sometimes not – deals fall through.

However, culture and mentality are changing too, and also there are ways to overcome bureaucratic obstacles. Prudent investors rely heavily on local partners (e. g. management of the target companies) and advisers (lawyers, investment bankers), whose expertise and connections may help to identify and approach decision makers within the Government, choose most suitable negotiation pattern, and avoid unnecessary time expenditures and efforts.

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The future challenges of agriculture in the Baltic Sea Region

By Mariann Fischer Boel

On 10th June this year, the European Commission adopted a proposal for an EU Strategy for the Baltic Sea Region. This proposal will be the subject of intense discussions during the Swedish Presidency of the EU, which began on 1st July. The Strategy covers a wide range of issues such as environment protection, sustainable economic growth, energy and transport networks and is built around four main objectives: to improve the environmental state of the region; to make it a more prosperous place by supporting balanced economic development; to make the region more accessible and attractive for its inhabitants, workers and tourists; and to improve safety and security.

The Strategy does not imply any new legislation or mobilisation of additional public support, but is based on the will of governments and citizens in the eight Member States and regions around the Baltic Sea to work more closely together to meet shared challenges.

It includes a comprehensive action plan with a list of 80 flagship projects, which can be coordinated either by public institutions or private bodies, for example NGOs.

Environment and agriculture in the region

Good environmental status was chosen to be primary goal of the Strategy. The Baltic Sea is the largest body of low-salinity water in the world and is very sensitive to pollution. The condition of the sea is deteriorating, mainly due to discharges of nitrates and phosphates. Agriculture is therefore at the centre of the debate when it comes to environmental protection. As such, the EU's Common Agricultural Policy should be considered as part of the solution in the Baltic Sea Region – not part of the problem. Recent reforms to the CAP have put a much greater emphasis on environmental protection, through linking payments to farmers directly to the respect of standards and through a greater emphasis on Rural Development policy.

As a contribution to the challenge, the farm organisations of Sweden, Denmark, Finland and Germany have proposed one of the flagship actions of the Strategy. The project is called "putting best practices in agriculture into work". Its aim is to improve national agri-environmental services and information activities targeting farmers and their advisors on how to have a nutrient-balanced agriculture. It provides advice on how to reduce the leaching from agriculture into the Baltic Sea through rivers without reducing the productivity or the competitiveness of the farming sector. It is based on the good experience of a project implemented in Sweden.

Another flagship project in the field of agriculture is the setting up of a forum for inventive and sustainable manure processing. Handling of manure is important in relation to leakage of nutrients. Two scientific research institutes from Denmark and Finland will be responsible for managing the project.

These types of projects can be enhanced through the EU's Rural Development policy. This includes agri-environmental schemes, which support actions going beyond minimum requirements. During the current programming period, over €1 billion per year of public money is being spent in the Baltic Sea Region on different agri-environmental measures, some of which aim specifically at preventing nutrient loss.

Development of rural areas and the countryside

In the Baltic Sea Region agriculture and forestry are important to the economy and sustainable development.

Keeping these sectors profitable and competitive is therefore vital. Policy needs to make them not only more environmentally sustainable, but also more competitive, and there is great potential for better cross-border cooperation.

A sustainable strategy for wood will be developed within the framework of the Sustainable Forest Management (SFM) and Research and Development programmes to develop a common Baltic Sea Region approach. This will have to balance renewable energy development, nature conservation strategies and wood mobilisation.

Efforts will be made to increase the use of renewable energies, including biomass, through better and more coordinated research. One flagship action of the Strategy is to create a network of sustainable cities and villages to exchange knowledge and good practices on environmentally friendly management practices, including local sustainable energy supplies. Such projects can both create more jobs and contribute to climate change mitigation.

High speed broadband connection for rural areas is another priority, so that rural areas are attractive places for people to live. Broadband projects can be supported under the Rural Development programmes using additional funds from the European Economic Recovery Plan.

Among other flagship actions are projects on rural tourism, to be coordinated by Polish and Swedish authorities, and the creation of a network on the implementation of EU food and feed legislation.

The way ahead

The Strategy for the Baltic Sea Region has been thoroughly discussed by all eight EU Member States around the Baltic, as well as a great number of non-governmental stakeholders. Many stakeholder structures already exist in the region and these have expressed the willingness to contribute to the implementation of the Strategy. The most successful of them has been the intergovernmental organisation HELCOM with its holistic Baltic Sea Action Plan, but all interested parties have a role to play in successful implementation of the Strategy.

The role of the European Commission will be to facilitate co-operation by taking part in the meetings, to monitor the progress of the Strategy and to report periodically back to the European Council. The Member States in the region have divided up the responsibility for co-ordinating 15 priority fields within the Strategy. Agricultural issues will be co-ordinated by Finland.

If the Strategy proves successful, it could serve as a model of regional co-operation where new ideas and approaches can be tested and developed over time as best practice examples. This is the first time that the EU has developed such a comprehensive strategy at the level of a "macro-region". If all goes well, it could inspire similar approaches in other areas in the EU, such as the Danube basin

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Aspects of sustainable development in education in the Baltic Sea Region

By Henna Virkkunen

Finland has committed itself to the promotion of welfare in the Baltic Sea region. The main idea behind this welfare building is sustainable development on a national level as well as through the European Union, the United Nations, and the cooperation between Nordic and Baltic states. The Finnish vision and strategic lines for education for sustainable development in the education system are based on national education policy documents, the Baltic 21E programme, the education for sustainable development strategy of the United Nations Economic Commission for Europe (UNECE), and the University Charters for Sustainable Development. The promotion of sustainable development is an integral part of the objectives of Finland's education policy.

UNESCO World Conference on Education for Sustainable Development (ESD) took place in Bonn this year. We participants stressed the importance of the ESD not only as an issue to be taught but as an issue which is relevant also in developing the teaching methods. Another observation was the importance of the values. That is to say not only knowledge but the values of people are crucial. We also gained an insight that everybody can learn. Here the different kind of partnerships, meetings and personal engagements play an important role. One more remarkable notice we made was the orientation to the future. Building for the future is what the education is about and what the education for sustainable development especially is about. Capacity building, co-operation and forums which promote global actions contribute to this forward looking stand.

We are now halfway through The UN-Decade for Education for Sustainable Development. Its focus is on improving access to quality education, reorienting and modifying existing education towards sustainable development, increasing the awareness and public understanding and providing education for sustainable development in all areas of society. These objectives and the Baltic 21E have been the background of the national strategy of education for sustainable development in Finland. According to the strategy the principles of sustainable development should be integrated in the activities of educational institutes of all levels. Institutes have projects of

their own to promote the idea of sustainable development and to carry out the principles into practices. As the awareness to bear a global responsibility grows this kind of activity will take place on a larger scale.

A recent Commission's document concerning the European Union Strategy for the Baltic Sea Region highlights the standpoints for making the Baltic Sea region a prosperous, attractive and accessible place and putting the objectives into wider perspective of creating the Baltic Sea area a model of regional co-operation where new ideas and approaches can be tested and developed. The expedients of making this happen just to mention a few are to establish a common Baltic Sea Region innovation strategy, to develop a Baltic Sea Region programme for innovation, clusters and SME-networks and to further increase student exchanges within the Baltic Sea Region. I very much support these ideas and see the link between the work done so far and the future challenges among Baltic Sea countries in these prospects.

I would like to stress once more the importance of forward looking. Today in a time of global recession there is a risk of looking future at short-term only. Building a common policy around the Baltic Sea area and investing in policy areas like education and research the sight has to be however farther. We have to see beyond the economic down-turn and give breeding ground for the future possibilities. In the Baltic Sea Region, the quality of life is linked to high education levels. We certainly want it to be the case also in future. It will require collaborative work and efforts. As aspects of sustainable development will characterize future education even more than nowadays the co-operative activities will have to take into account the principles of sustainable development to larger extent.

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Baltic Sea region security – a view from Lithuania

By Rasa Juknevičienė

Predicting future security situation is a very challenging task. In 1994, when Lithuania officially expressed its desire to join NATO, few believed that Lithuania will become a NATO member already in 2004. Although today the Baltic Sea region enjoys security never seen before, still it is not a reason to close our eyes to the security challenges we are facing today.

After NATO and EU enlargement in 2004 all countries of the Baltic Sea region, except Russia, became members of NATO and/or EU. We began to enjoy new opportunities to expand regional cooperation, develop working relationship with Russia and continue to build mutual confidence. A common work in the Council of the Baltic Sea states, the Nordic-Baltic cooperation, implementation of E-PINE initiative pushed us more close to a common approach in solving various problems. I believe that the EU's Baltic Sea strategy, which should be adopted during the Swedish presidency, will help intensify regional cooperation even more.

However our future look should not be overwhelmed with a rosy perception of the present status quo in the Baltic Sea region. It is upon us to identify the most important security challenges in the region, which require our common understanding and action. I would like to note that the Baltic membership of NATO and the EU has not brought an ultimate reconciliation in Russian-Baltic relations, as it was expected. Russia is still not able to come to terms with the loss of influence in the Baltic countries. The remaining Russian-Baltic tensions, starting from different interpretation of their historical past, Russia's anti-Baltic propaganda campaign, playing the Russian minority card, to Kaliningrad-related problems, and so on, do not contribute to the strengthening of regional security.

We recognize Russia's paramount role in building a secure and prosperous Baltic Sea region. However, development during last years in the Russian foreign policy invoked serious concerns about the impact of such a role. Military force used in the war with Georgia in 2008, unilateral moratorium on the CFE Treaty and threatening to remilitarize Kaliningrad district in response to the planned deployment of the U.S. missile defence elements in Czech Republic and Poland have undermined overall confidence in Russia's engagement in the Baltic Sea region. Power politics, which is increasingly reemerging in the Russian foreign policy, has not to be a reason to reconsider and reshape the European security architecture. All this gives grounds for a serious Baltic concern related to their hard security. Although the sovereignty and territorial integrity of the Baltic States are not at stake today, Russia's war with Georgia sent a clear signal – the Baltics should take a due care of their territorial defence arrangements. NATO also seems to understand to take Russia seriously. NATO Allies are now forced to return to the basics: the pledge of collective defence, as stated in Article 5 of the Washington Treaty, must be taken as seriously as before. In other words, NATO is expected to meet the Baltic demands to give NATO's collective defence guarantee a real substance – to prepare the Baltic defence plans.

In terms of soft security threats, there is more than enough evidence to believe that Russia seeks to retain its political, economic and cultural influence in the Baltic States. Russia will retain its various tools of influence, primarily by using economic levers and Baltic dependence upon Russia's energy supply. Therefore energy security is one of the main soft security challenges for the Baltic Sea region in the next decade. Overall European effort is directed to create a well-functioning and integrated EU internal energy market. Logically, the Baltic countries, being part of the Baltic Sea region, should be integrated into a common EU energy network. Free access to the energy networks and sustainability of its transit should help build trust between energy suppliers and consumers, thus fostering regional cooperation. Energy isolation of the Baltic states, named as 'energy island', is due to the Baltic overdependence on Russia's energy sources. In theory, measures to respond this challenge are obvious. Diversity of suppliers is a key issue of energy security. And this should be done in much broader – regional and

European context. However, in practice it is not so easy to achieve. First of all, we have to intensify implementation of energy interconnections of the Baltic states with the Nordic countries and Poland, and develop gas interconnections as well as underground gas storage facilities in the Baltic Sea region. Secondly, while all countries in the Baltic Sea region welcome initiation of the new energy projects, we still face a lack of coordination when agreements to launch them are reached. Thus, it has to be a consensus based common endeavour to implement regional energy projects. The North Stream pipeline project deserves criticism first of all for ignoring such a consensus. Further on, construction of this pipeline diminishes the strategic importance of the transit infrastructure of the Baltic countries and Poland. We have not heard reasonable arguments why possibilities to build this pipeline in the territory of the Baltic countries and Poland were not explored and discussed with interested partners.

As the energy infrastructure (gas, oil, electricity interconnections, new nuclear power plants) in the Baltic Sea region develops a risk to fall under terrorist attack is increasing. Moreover, massive cyber attacks may also be executed against operating energy networks. Therefore the countries of the Baltic Sea region have to enhance cooperation to protect expanding energy infrastructure.

A damaged ecological balance of the Baltic Sea is also a challenge for the region. It is already widely acknowledged that the Baltic Sea suffers from overfishing, pollution and increased ship traffic. In addition, chemical weapons, which were dumped in the Baltic Sea during the World War II, are negatively affecting the Baltic Sea environment. A climate change is also beginning to show its growing impact on the Baltic Sea. This complex challenge requires a consolidated response from all the countries in the Baltic Sea region. We think that the EU Strategy for the Baltic Sea region, which will also address environmental problems of the Baltic Sea, is an important tool in this regard. Engagement of Russia in this area is another major step we have to make if we look for a success.

To sum up, the Baltic Sea region is far from being safe from the security challenges. Of course, a list of them outlined above is not complete. We would like to see the future of the European security, including the Baltic Sea region, free from the disturbances caused by the demonstration of military force and threatening to use it. Still, we would like to expect that Russia will pursue an agenda, which promotes cooperation in the Baltic Sea region and reduces remaining mistrust and tensions between Russia and other countries of the region, especially the Baltic States. We have needed instruments in our hands – regional institutions and regional initiatives are yet to be fully explored. And we are ready to engage Russia in cooperation projects and initiatives aimed at mutual benefit, confidence building and, eventually, at strengthening security in the Baltic Sea region. For example, a joint work to ensure an effective Lithuanian/Polish – Russian border control (the Kaliningrad district) is one of the needed cooperation areas.

We do hope that the EU Strategy for the Baltic Sea region should help tackle many soft security issues, whereas NATO will be instrumental to handle any possible hard security issues. Also, we seek to strengthen our cooperation agenda with Russia. During our presidency of the Council of the Baltic Sea states, which has just started, we are prepared to work hard to enhance cooperation in the Baltic Sea region. In general, overall success in fighting these challenges will depend on joint endeavours and solidarity of all the countries of the region.

Rasa Juknevičienė

Minister of National Defence

Lithuania



Regional cooperation in the Baltic Sea area – the potential of Karelia

By Markku Laukkanen

The significance of the Baltic Sea region is rising strongly. The European Union's Baltic Sea region Strategy relies on four fundamental functions; environment, economy, accessibility and security. Also, the Finnish Government gave Parliament a report on Baltic Sea issues at the beginning of summer 2009 that focuses on environmental issues. The state of the environment in the Baltic Sea region requires comprehensive measures and a strong commitment by the Baltic Sea countries in order to solve the environmental problems. The load created by agriculture, industry, and population, as well as the quickly growing environmental risks of maritime require fast preventative measures.

The Baltic Sea has become an internal sea through the expansion of the European Union, with remarkable common interests of the Baltic Sea countries with regards to commerce, politics, maritime, environmental protection, security, and energy politics. The Baltic Sea should be considered as an entity requiring common multidisciplinary measures between the EU member states, but also co-operation with countries within the sphere of influence such as Russia.

The significance of the Baltic Sea region as a northern economic area with dynamic growth is rising. On this basis, Finland should actively exploit its knowledge and strengths in implementing EU policy programmes in our neighbouring areas. Although the integration continues, one of the forms of its deepening is the development of regional units within the EU. Finland has a lot of knowledge, and has contributed to the strategy work in the Baltic Sea region regarding many substantial issues such as innovation policy, education and research cooperation, internal and judicial matters, and the development of the constitutional state and civil society. Baltic Sea policies have strong connections with the EU's Northern Dimension programme.

The expansion of the common Nordic electricity market to a common Baltic area market is justifiable, as is then the construction of electricity transmission lines between the states of the Baltic Sea region. The importance of Russia as an energy supplier to Europe turns the Baltic Sea into an important region also from the point of view of energy security. Thus it is vital to ensure Russian cooperation in every field in order to guarantee successful Baltic sea region policies.

Neighbouring areas are in focus in the functional environment of Finland, and the perspectives of development in this region are the most interesting in all of Europe. Although the slow expansion of the EU continues, at the same time the future of Europe will be built on functional regional units. We can see the basis of the Baltic Sea region co-operation in this light. Finland should have an initiative and an active role in implementing the action plans in our neighbouring areas, and use its strengths in this respect.

We need also new openings in Baltic Sea policies. In this time frame, it is easy to have a look a few centuries back and we see the flourishing era of the Hanseatic cities. Multicultural life, trade, and a flourishing maritime culture were characteristic of that era; why not then for the future as well? The cities of the Baltic Sea region have still similarities; the history and the sea are still in common. The overall development of the cooperation between them is a part of the new flourishing era of the Baltic Sea.

Karelia in the middle of the Baltic Sea region is a part of Russia's north-west economic region that could have a remarkable role in neighbouring area co-operation between the EU and Russia. Already now a reasonable number of goods belonging to the EU-Russia trade moves through Karelia from Finland to Russia. The development of ports in the area that Finland lost during World War II as well as sustainable exploitation of natural resources would increase the social and economical stability of this border zone, and in this way support a permanent change towards democracy and civil society.

Non-governmental organizations could play a remarkable role in developing and strengthening cooperation in the Baltic Sea region. They could act with official organizations and the businesses supporting them, and with their own activities enhance the social and economic stability in the region. The Carelian League has good experience of the activities of non-governmental organizations on bases of good knowledge of Karelia and the cultural and social projects that it carried out in Karelia. The non-governmental organizations could create their own co-operation forum and spread the best practises and improve the function of civil society.

The Karelian League has succeeded in creating an active network in the region and in restoring the graveyards, churches, and memorials in different parts in Karelia. One of their aims is to open all of Karelia to tourism, including the outer islands of the Gulf of Finland as well as Lake Ladoga. This could turn into a remarkable way of improving the economic bases of the region. Russians have bought a remarkable amount of real estate in Finland, especially by the lakes and sea, as well as summer cottages in the eastern parts of Finland. This has created some critical discussion, which says that land purchasing should be based on mutual rights. Especially those Finns having Karelian roots may have a great interest in buying back land belonging to their families for centuries that was lost after World War II to the Soviet Union.

New openings should be made within the sphere of education and research. An international high quality knowledge centre for education and research could be created in the Baltic Sea area that would concentrate on teaching and studying comprehensively topics within Baltic Sea regional cooperation. The aim would be internal cooperation in the spirit of Nordic dimension to increase the needed knowledge capital for the development of the Baltic region and the improvement of cultural unity. In the spirit of modern times, the centre could be founded as a network university between already existing universities and research centres, where the best knowledge in each discipline of each of the bordering countries could be incorporated.

Markku Laukkanen

Member of Parliament

Chairman of the Karelian League

Finland



Storm over the Baltic Sea – is innovation a safe haven?

By Mats Hellström

At the present time the worldwide financial and economic crisis is striking hard at the Baltic Sea Region. Extra hard hit are the high growth Baltic States, that now have to take drastic cuts in the living standard.

With this background – how will it be possible, and how should we act, so that the commitment to make the Sea itself cleaner and healthier and the region more cohesive will not become impaired and suppressed in the face of economic turmoil.

I think it is good to go back to the discussions during the boom years. A slogan for the region is “innovation”. We have presented ourselves to the outside world as more innovative than other regions.

The old democracies in the west are leading most benchmarkings and scoreboards on innovation. And the new democracies in the east and south have shown a very innovative and flexible streak in changing extremely rapidly a whole economic system.

Some people might see the concept of an “innovative region” as merely a cosmetic form of advertising the region. However in my mind it is now in the midst of the crisis that the innovative character of much of the Baltic Sea Region is more relevant and needed than ever. The brilliant exhibitions of young people in the Innovation Park in the centre of Riga some years ago show a spirit that is dearly required now.

In the economic field new cost saving solutions must be found and our enterprises can take a lead in areas that have future market prospects and require new research and innovative solutions not least in the area of *sustainability*. Because ecological, social and economical sustainable solutions are more and more demanded worldwide in this extremely deep recession.

And here of course the proposed EU Strategy for the Baltic Sea Region to be decided during the Swedish EU Presidency will be of utmost importance as it has in one of its four pillars “A prosperous region” “Foster innovation” as a main issue.

The proposals around this in the Action Plan are all relevant and valid but I somewhat miss an important dimension:

First; Many measures are of a national character. That is of course often self-evident and rational given the structure of the government bodies that foster for example Research and Development in our respective countries.

But interregional clusters are also important. One example: In Sweden the innovative internet based IP-telephony company Skype is seen as Swedish company. But ask people in Tallinn and they will tell you Skype is Estonian.

And in reality Skype has come out of a Nordic advanced ICT environment with founders in Sweden, Estonia and Denmark. So Skype should really be seen as a Baltic Sea based innovation success story!

To make it possible for more such success stories to come true I think one has to consider a weakness in the proposal for the EU Strategy for the Baltic Sea Region.

It centers around green technology for the Baltic Sea with measures for more research and new funds and cooperation between clusters. All this is good. But it lacks something vital and necessary:

And that is *Effective Demand* for new solutions. New technologies and innovative services basically come about only when there is a demand drive.

And when it concerns green technologies - those requires *public procurement*. And this is something almost totally absent from the strategy. It is mentioned only in passing as something where more information is needed.

But here of course Governments and Regional Authorities must act with operative purchasing procurement and tenders for competitive bidding so that innovative companies will be motivated to participate and work on new solutions to environmental or other tasks that concern our Sea.

And here governments could cooperate. Tasks are certainly provided for by for example Helcom. And there is a Government structure; and that is the Council of Baltic Sea States, CBSS which is now looking a new role and which comprises all Baltic Sea Region Governments;. And of course the EU Commission could play a helpful role. Joint Governmental public procurement would be possible and important.

Green public procurement is by the way something that is nowadays propagated by the EU Commission. And in US similar initiatives are taken. So why not make the Baltic Sea Region a green pilot!

Another aspect of innovation is *culture*. Too long culture has been seen and treated as something separate from other spheres of society. Nowadays there are cultural incubators as part of an entrepreneurial spirit in development of enterprises.

Baltic Turntable is one such endeavour; the goal being to raise awareness and engagement for people - who are not environmental experts - about the condition of the Baltic Sea, using artistic expression and easily understandable modern communication technology.

The Baltic Sea needs a new *story*. With impulses from the past - new ideas for the future can be created.

Baltic Turntable's partners are in Sweden, Finland and Estonia with good contacts also in Russia, Latvia, Germany and Denmark. Through exhibitions, workstations and seminars around the Sea discussions will be held about identity and belonging. How do we create connections between different disciplines, areas, nationalities and groups to really make things change around and in the Sea itself?

This is a formidable task that comprises not only economic, social and environmental sustainability - motivation comes as much from cultural and artistic expression!

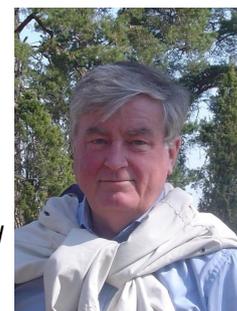
Mats Hellström

Former Governor of the
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Former Ambassador to
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Former Minister of Nordic and
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Sweden



Global financial crisis and the Russian banking system

By Raimo Valo

Global financial Crisis hit Russian Federation in September 2008. The starting point was actually rather good, State finances were in excellent shape, RUB liquidity was better than ever before and the business had been booming for the last eight years. The only problems were inflation which nobody seemed to be too interested in and the limited or almost non existing Money Markets. The private sector debt had also risen to almost dangerous levels, but since the business was growing, there were no doubts the system could not handle it.

When the crisis hit, the Russian markets reacted as they always do in times of trouble. The market was closed down. Banks cut the interbank limit to each other which stopped trading practically immediately at or a few days after the Lehman Brothers collapse. Only a few State owned Banks and some foreign owned Russian Banks remained as "market makers". The longest available funding period, for anybody, was one week, during the worst times in the autumn.

Ruble was devalued at a fast pace starting from early November and, coinciding the Oil price movements, until February 2009. The market was thin, but Banks were liquid. One should use the word Cash Rich, rather than liquid, since the money did not circulate in or into the system. Interest rates were sky high mainly due to short positions against RUB.

The Government and the CBR tried to do their best to feed liquidity to the markets and to keep the Ruble steady. Large size scandals were avoided and Ruble finally became stable, but due to Oil price strengthening rather than CBR actions. Only two middle sized Banks have been "saved" by the authorities, so far.

Since we are still in the middle of the crisis, what is to be expected? What have we learned from the past? The main concerns from the Bankers point-of-view, are the following:

- Liquidity of the system does not improve only by adding money in the system. The trust can only be recovered by time. Banks need time to evaluate the financials of the competitors.
- RUB strength or weakness is based on Oil price, CBR is almost helpless when crisis hits the market. All Russians are professional FX-traders and have been through this before.
- Everybody is talking about the "Second wave" which means that it will come. Most likely it has already started when this article is being printed.

- The Real Estate bubble has not yet busted. When it does, the Banks will face enormous trouble, since it will be almost impossible to get rid of sour assets.
- The difference in Russian Accounting Standards and IFRS-accounting systems applied in Western Europe leads to very strange problems.

Let me write a few words about the last point above, since it is the cause for most of the other problems. The provisioning system controlled by the CBR is too rigid in times of trouble. CBR-system is based on five categories and assumes that the Banks give a "rating" to all counter parts, based on their economic wellbeing. When the whole market is "sick", this means that the provisioning levels sky rocket and cause multiple problems for already ailing Banks. In IFRS system, despite the worsening financials of customers, main concern is the collateral. If the Bank knows that it will get its money back, provisions should not nor could not be made. In RAS-system, collateral is not even considered a factor in this respect.

The provisions basically eat up the Capital and destroy the P&L and result of all Banks. Since the owners have problems in their other businesses as well and the Capital Markets do not function normally, the Capital cannot always be raised, which means that the Banks need to shrink dramatically to be able to meet the CBR ratios. If they don't, they will lose their licenses.

This means that the Banks cannot lend money to customers, not even the healthy ones. Banks will maintain a huge cash position which is placed in the CBR, as a cushion. But the money does not improve the liquidity in the system and thus does not help the economy to recover.

It seems that the control measures only work in the good days. I am afraid we need to wait for a long time to see them, unless the authorities change the control measures rapidly.

Raimo Valo

CEO

OAQ Swedbank

Russia



Future international challenges of Latvenergo Group

By Ingrida Lace

In spite of the economic crisis this is the time of challenges and possibilities. Only those who can be flexible and maximum efficient will survive. It refers to energy industry as well. Industry leaders and decision makers have to look beyond the current crisis to prepare for the time when growth will pick up again. The cornerstones of European Union power sector policy of today are the development of energy markets, energy security and energy efficiency together with CO₂ emission reduction. All these priorities are interlinked and have to be viewed and coordinated regionally. Hence, efficient regional international cooperation becomes of utmost importance for the development of competitive EU energy market.

The public limited company Latvenergo AS is an energy power supply enterprise engaged in production and sale of electrical power and heat, electricity trade, as well as provision of IT and telecommunication services. Latvenergo AS is one of the largest corporate entities in Latvia. Already for five years Latvenergo AS is heading a corporate group. Latvenergo group includes five subsidiaries: Transmission System Operator Augstsprieguma tīkls AS, Distribution System Operator Sadales tīkls AS, Latvenergo Kaubandus OU, Latvenergo Prekyba UAB and Liepājas Enerģija SIA.

One of the biggest challenges will be the implementation of the EU energy-climate legislative package and the 3rd energy package after the final adoption at the European Parliament. The Baltic Region is comparatively small but the situation in the electricity sector is quite different. Latvia is the only of the three Baltic countries where there is free market with Latvenergo AS market share of 95%. Estonian market is closed up to 2016, but Lithuanian market, though open de facto, but does not function and is strictly regulated.

EU has defined the integration of Baltic States into EU energy networks as one of its main objectives. High Level Group (HLG) on a Baltic Interconnection Plan was set up in late 2008 by European Commission President Jose Manuel Barroso under the 2nd Strategic Energy Review. In late April Prime ministers of Latvia, Lithuania and Estonia signed an agreement to start implementation of a Baltic-Swedish electricity link. A joint declaration was also signed on principles for the development of single Baltic energy market. The limited degree of electricity market opening in the Baltic region would make it difficult to derive the full benefits from the construction of the new cable and other interconnections.

The High Level Group, represented by Sweden, Finland, Denmark, Norway, Germany, and the Baltic States, has set the objective to achieve the common Baltic electricity market start functioning from 1 January 2010. HLG has taken a decision that this year Lithuania and Estonia have to incorporate in their legislation the same market liberalisation principles as in Latvia. Baltic Electricity market will be modelled after the Nordic market, having Nord Pool as the basis of the market integration and trading. Today it is the most advanced market model with its joint vision of the system, information, openness, information analysis that ensures flexible and quick trading.

Liberalised regional energy market will also promote trading activities of Latvenergo AS subsidiaries - in Estonia Latvenergo Kaubandus OU and Latvenergo Prekyba UAB in Lithuania to the benefit of our customers in the whole region.

A carefully considered strategy and clearly formulated aims lie at the basis of any efficient company work. Latest changes in the EU power sector, market development, the significance of the environment issues and growing customer demands - all these factors had an impact when developing the updated Latvenergo group strategy last year. Being aware that the next years will be significant for the Latvian power sector as important decisions will

have to be made about the new base load development, more extensive use of renewable resources, Latvenergo AS being the leading Latvian electricity generating company, is even in greater need of a clear-cut strategy that is understandable to consumers and environment friendly. Latvenergo group new updated strategy embraces all the aims and objectives meeting the needs of the situation in the energy sector in Europe and together with renewed brand serve as the basis of the group identity. The renewed Latvenergo group values are responsibility, efficiency, openness. The three key objectives include efficiency raising, focusing on customer needs and the company growth by restoring and increasing the generating capacity, entering new markets and participation in the Baltic projects, including Ignalina NPP project. The updated strategy focuses on the environment issues by paying a special attention to upgrading the technological equipment, making it more environment friendly, and planning new options for operating in the renewable resources business.

To reach the set goals, much effort is invested in researching new generating possibilities. Riga thermoelectric power plant TEC-2, reconstructed last year, has been the biggest industrial project in Latvia – now TEC-2 generating capacity has increased almost twice and is a considerable contribution for the future development of the power sector when electricity deficit becomes the issue of the day.

Every new reconstructed facility makes us more efficient and environment friendly. If in the past both Riga energy facilities were oil-fuelled thermoelectric power plants, then now environment more friendly gas is used for generating electricity. Moreover, taking into account that about 60% of the total electricity volume in Latvia is generated by the hydroelectric power plants it may be assumed that Latvenergo AS is one of the greenest electricity producers in Europe. And it is important, because when thinking about the future it is not only finances that matter, but ecological awareness as well.

The technological upgrading plan in Latvenergo group will be continued, as the current market situation does not allow being inefficient. It implies that we have to focus on using state-of-the-art technologies so as to have the maximum return from all the available resources, irrespective whether it is gas, water, woodchips, biomass, coal or maybe nuclear. It is vital to use these resources as efficiently as possible. And free energy market is the only reasonable development for ensuring improvement and safety of energy supply.

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Industrial-innovative networks as an opportunity to raise productivity of the Russian North-west

By Igor Maksimtsev and Sofia Rekord

In the context of current economic crisis companies and countries are facing the challenge of searching opportunities for economic survival and growth. One of the basic problems in this field is to define criteria of successful economic development. It is hard to argue with the point that one of the most sound measurement both for businesses and states is productivity, taken as the basis for the study "Lean Russia: sustaining economic growth through improved productivity", conducted by the McKinsey Global Institute. There were pointed out the main problems of Russian economy and initiatives which could improve the situation. It is worth noting that those initiatives perfectly match with main goals of creating industrial-innovative clusters:

- *Increase of competitive intensity*: one of the basic features of any industrial-innovative cluster is a balanced combination of co-operation and competition, that means a competition not only by products, but also (and mostly) of business models. Nowadays in Russian economy such competition is possible between small and medium fast growing "gazelle" companies.
- *Improvements in business processes*: they are inevitable when formal or informal network of companies and supporting institutions is created. Its horizontal orientation (heterarchy) means more flexible structure, but at the same time – more sophisticated management systems. Thus, managerial innovation may work faster, than the technological one, and clusters could facilitate better information circulation and adaptation of the whole production system to external changes.
- *Improvement of professional education and training*: lack of professional training is a problem for the majority of Russian processing industries, so, clusters make it possible to organize special, "tailor-made" educational centres, and, as a result – local labor market which is extremely important during the time of economic crisis.
- *Launching labor mobility and social protection programs, minimization of the expected decline in workforce*: during the "lean" years of economic crisis this is one of the toughest problems, which also may be partly solved by the creation of local cluster labor market with collective responsibilities of businessmen and mobility of employees within the network.
- *Implementation of the integrated approach to urban and regional planning*: industrial clustering implies better organization of the space – territory itself, and infrastructure, both "hard" and "soft". As a result it is possible to create effective system of planning, involving urban and rural areas.
- *Development of a viable financial system*: though it should involve efforts of state monetary authorities, creation of the local system of financing is feasible for the mature cluster network.

Thus, three basic problems of Russian economy, pointed out in the above mentioned survey (inefficient business processes, obsolete capacity and production methods, structural differences) may be partly resolved by developing geographically concentrated industrial-innovative networks, i.e., clusters.

At the same time the point that many Russian industries are rather consolidated, with the small amount of large players, which may hurt their flexibility, is widely discussed. Still, it should be noted that there are opportunities to create clusters even in rather monopolized sectors, involving such models, as:

- *core-ring with lead-firm* (a cluster in which the lead firm is substantially independent);
- *all cores* (the vertically integrated firm).

So, it may be assumed that in oil and gas industry it is possible to build up effective industrial-innovative networks, moreover – it could have a great positive impact on the whole traditional energy sector. The main problems of this sector are: high costs, narrow competition and over-maturity. The last point is the most crucial: through joining together supporting and related industries, medium-size service companies, and scientific institutions it becomes possible to move companies of the sector to the more "young", growth phase.

Cluster concept also includes an opportunity to create trans-border networks. It is a crucial point for the North-western Russia with common EU border. As mentioned in the Government of Finland resolution "Russia Action Plan" from 16.04.2009, "considering the size of the Russian economy, the number of internationally active companies in the country is rather low".

Conducting a survey of opportunities to develop cross-border clusters between Leningrad region, Saint-Petersburg and Baltic countries, the author of the current article took for the consideration not only the concentration of industries in the region (turnover, employment, number of companies), but also – attitudes of key persons and business circles to determine the level of their awareness of the cluster paradigm. The survey showed that such sectors as wood-working, metal-working, chemical industry and hospitality have the most appropriate balance between quantity (concentration in the region) and quality (acceptance by potential cluster members).

Concerning the principle opportunity to create trans-border production chains: Saint-Petersburg and Leningrad region could provide Baltic countries with: still large market capacity, infant industries with high potential (for example, ICT), educated producers and educated consumers (playing the role of a "testing market" for the whole Europe), higher risk acceptance, developing innovators (creative elites of Saint-Petersburg), and serve as a transportation hub. On the other hand, Russian North-west needs such precious assets, as business knowledge of different type (industrial, ecological, managerial), investments and an ability of networking as one of the most important skills to be implemented on the Russian economic "soil".

It may be concluded that Saint-Petersburg, Leningrad region and the Baltic Sea states possess complementary structure of needs for regional cooperation and clusters formation. At the same time cooperation may be less formal and based on common platforms to improve business processes, such as: IT, science and education, design culture, etc.

Thus, in the Russian case clusters seem to be neither a dogma, nor a panacea, but one of the ways to increase productivity by synergies and fertile environment inside such industrial-innovative communities.

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From the red star to the double-headed eagle

By Kari Kaunismaa

A history textbook is a very fruitful method to acquaint oneself with a way of thinking and impressions of themselves and others of a nation other than our own. It is the most important teaching instrument and the only literary genre about history that every member of a society is obligated to study, furthermore at an age susceptible to influence. In a research it is important to ask, what is taught, who has chosen the material, why these particular issues have been chosen and how the teaching can be best arranged with the help of these matters. Nearly all states have also wanted to control teaching of history in some way. In my dissertation, accepted in the University of Turku at May the 9th this year, I have aspired to evaluate in an ideology-critical way the influence of a machine of a totalitarian state, the Soviet Union, on history textbooks and seek for what Russia used to replace the previous material after the system changed.

In various seminars, after hearing my subject, Russian researchers have stated: "There are always two truths in Russia: what is written and what is taught in a classroom." In my opinion, it is exactly the duty of the Russians themselves to study the occurred teaching. As a foreigner, I must limit myself to the printed word. Thence, I am able to interpret the sources from my own starting points, striving to understand their context and purpose. Germans have had to, both among the researchers and in their textbooks, deal with the Nazi atrocities many times, which has been a painful but also a cleansing process. By contrast, in Russia, a liberating discussion of a similar extent on the terror and prison camps of the Stalinist regime or the post-World War II Soviet dictatorship in the Eastern European countries has not taken place. The government has in the 2000's even tried to limit the criticism waving freely even in textbooks in the previous decade. According to the material I have studied, however, this has not succeeded.

The authority in the Soviet state and the central committee of CPSU controlled strictly the curricula and textbooks. This led to a one-sided view of a historical process which did not include understanding of a whole versatile life of people and the society. Teaching and education were tied to the principles of collectivism and carried out by authoritarian forms and methods in which a student acted solely as an object of a teacher's work. The idea of legitimacy excluded the handling of people's problems in a historical development. The list of inevitably learned historical events deviated remarkably of Western curricula and served the Marxist-Leninist view of the legitimate development of history. Missing from the list were, for instance, the Renaissance, great inventions, The Reformation in Europe and true, ground-breaking ideas of the French bourgeois revolution. Instead the feeling of hate was upheld: "The children must be taught to hate the enemies of the Communist society."

In a Soviet school, history teaching was at the same time training children to be Marxist-Leninist communists, whose job, after coming of age, is to develop the society in accordance with the ideology. From the eighth grade onwards the pupils had to perform political announcements and reports in front of a school audience. From the ninth grade on the audience consisted also of adults. A pupil's "political announcement" in a totalitarian system can only be based on "rote learning", freeze the pupil's own learning and represents an enormous waste of energy. As a result of this, the sublime goal of a "Soviet human" flagged to a

passive "Homo sovieticus" who could mostly just receive orders given to him. Executing them was not necessarily successful. On the part of the Second World War I have only dealt with what kind of picture is given of the wars against Poland and Finland in 1939–40 (fulfilling the orders of the Secret Protocol of the Molotov-Ribbentrop Pact) and 1941–44. Intentionally, I left out the rest of the "Great Patriotic War", because the number of pages dealing with it is, even in the new Russian history textbooks, extremely great.

The chapter dealing with the leader's position shows that in Russia, the czar, the secretary general and the president all have more power than any Western leaders. No leader has actually been openly responsible to anybody and the name of the next leader has always been secured behind the scenes. It is still unimaginable in Russia that presidential candidates would debate on television in front of the public and that they could be compared with each other. – The matter of gender is invisible too: The books do not introduce a single known woman in the field of physics, chemistry, mathematics, biology, medicine, agricultural studies or social sciences, although Russian women have in different times achieved notable results in these sectors, too. A woman is still a humanist, a poet, a singer, a dancer, an actress and most of all an ornament of a man. In no way is a woman a social or political leader or a decision-maker. Nevertheless, at all times the most essential figure of the Russian everyday life has been a grandmother, *babushka*, who has kept the whole country on its feet.

Based on my study I state that where the Germans have thrown light on their whole history, the Russians have just barely begun. It was of course painful for the Communist Party to admit acting like the worst imperialists, which it had condemned throughout its entire existence. Moreover, only after the Soviet state had collapsed could the textbooks confess that the occupation of the Eastern Central Europe (1945–91) was not only "liberation from the Fascist power" but also coercion of these countries and peoples under Communist command.

Although every state defines itself the goals of their national history teaching, it is not possible to return to the Stalinist censorship due to present expanding communication and improving language skills of the people. With regard to the historiography and history teaching, the period of the Russian Federation is much more open than that of the Soviet Union ever was. Marxist-Leninist historiography is not recovering. In the international seminars of historians, the results of Russian researchers are nowadays evaluated on the same criteria as those of the others. Although the Russian troika flies free and the Steppes suffice, Russia has to be understood with common sense.

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Republic of Belarus – ways of economic stabilization in the context of the world financial and economic crisis

By Vladimir Shimov

Financial problems that arose in the USA in the summer of 2007 were pretty quick and consistent to transform into a global economic crisis which influences adversely on economic processes practically in every country of the world. Belarus is none an exception; its economy has been sensing negative external impacts since the autumn of 2008. These revealed in decreased exports of goods and services, bigger foreign trade red ink, accelerated inflation processes, wider credit restrictions, faster devaluation of the national currency, grown foreign debt, more acute problems in the population employment and social security, and decreased competitiveness of the real economy in the world markets.

To overcome these problems, we need to develop a systematic anti-crisis mechanism based on joint arrangements of operative, tactic and strategic nature. Meanwhile, the state economic policy should be aimed at supporting the most prospective innovative sectors in science, education, technology and production, and not at preserving the existing economic structure.

Reaching this target pre-supposes implementation of common system steps, on the one hand, that will create necessary conditions and background for stabilization actions, and arrangements in the most affected segments of the real economy and finance. These common system steps include:

- establishing lower limits for the principal social development indicators that are impossible to break without endangering the society;
- limiting intervention by the state authorities into the economic activities of enterprises leading to bigger stockholding of finished produce;
- liberalizing the economic life in the country; and
- implementing a package of arrangements to create a favourable investment climate based on the modernization of economic institutes and management mechanisms.

The most important elements of the anti-crisis mechanism in the real economy should be:

- development of a long-term program for the economy's sanitation, modernization, and basic reconstruction on the innovative basis;
- increase in export volumes and optimization of import flows, concrete priorities in export and import activities upon defining industries and businesses with the largest potential;
- creation of the state-supported export system; and

- optimization of the custom regulation to provide favourable conditions for science intensive and high-tech businesses, and high priority R&D programmes.

To support the Belarusian real economy in the context of the crisis, we ought to employ the potentials of the national monetary and credit, and budget and fiscal systems. These are enormous and diverse, here in a short abstract we shall but mention some of their components that are the most important, in our eye. They are:

- establishing a state specialized nonbank financial intermediary (NBFI), whose primary tasks shall be, on the one hand, concessional lending and financing of priority investment projects and social programmes, and acquisition of distressed assets of the largest national banks, on the other hand. This will allow eliminating the causes of worsening the financial performance and, consequently, ratings of the largest Belarusian banks, enlarging their possibilities to draw foreign credits;
- limiting the banks margin;
- eliminating, for the period the banks require to stabilize, the indicative index of the bank assets share used to credit entities in the real economy;
- accelerated development of the insurance market, creation of favourable conditions to attract here private insurance companies from abroad to provide all kinds of services, etc.

The system of arrangements suggested does not imply to be the absolute truth or a final coverage of the tools required; yet we believe it's quite consecutive.

These are the minimum steps necessary to stabilize the national economy and create prerequisites for overcoming the crisis.

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Belarusian anticrisis program – pragmatic conservatism or market reforms

By Kiryl Apanasevich

Belarus without any exaggeration can be called a unique country for Europe. There is no other state which is situated so fortunately in the center of Europe and which plays the role of a peculiar bridge between the Russian Federation and the EU. It is the state where the remains of the Soviet culture are still preserved and where even in the 3rd millennium the command economy remains effective and tolerates only certain kinds of market mechanisms. It is also the only state on the modern European territory which is lead by the first and the single President, a charismatic person widely recognized over the world due to different reasons, – Alexander Lukashenko. All of the abovementioned facts have caused a peculiar development of the crisis phenomena in the country's economy.

At the times of the Soviet Union Belarus was considered to be an "industrial assembly" of USSR. Large-scale machinery, chemical and petroleum refinery USSR plants were centered on the Belarusian territory. Thus, after the collapse of the USSR Belarus gained a serious heritage which has actually predetermined the further export trade of the Republic of Belarus. At the same time Belarusian export potential appeared to surpass the internal consumption so dramatically that Belarus eventually becomes a country with utmost export-oriented and even export-dependent economy. Even remaining a closed administrative system with a low level of foreign investments and an overwhelming part of the state property (more than 70%), Belarusian model proved to be surprisingly stiff to external crisis phenomena. Therefore Belarusian planned economy, being "manually guided" by the state, felt the pressure of the world economic crisis only at the end of November 2008 while Europe and Russia had been suffering the strongest shocks for a several months already.

Indeed, downfalls of a number of international financial markets destructive for Europe did not influence Belarus so gravely, as there are no shares of Belarusian companies at the international foreign exchanges markets, and Belarusian internal financial market had been insignificantly integrated into an international one. Flight of the foreign capital, being so injurious for Russia, had affected Belarus to a little degree, because the amount of foreign capital in Belarus was negligible. Such specific character allowed Belarus to hold out longer than the others and, in the judgment of many experts, may allow the country to come out of the crisis earlier as far as export flows will be restored together with the activity on the external markets which are the main Belarusian trade partners. In addition to that, the isolated economy did not manage to avoid the strike which was delayed but at the same time so swift and powerful that within two months it revealed the disadvantages of this model and made the Government immediately to review the principles of working schemes and to level originated gaps. So, here are measures being undertaken by the Belarusian Government in order to level the crisis effects that by the World Bank assessment in 2008-2009 allowed Belarus to become one of the world leaders among states-reformers.

1. Approval of a massive program of privatization of state property which embraces hundreds of medium and major enterprises. It's fair to note that the program was developed and approved before the crises, therefore the common decay in economy will probably slow down privatization processes in Belarus because the state government does not consider the world stagnation to be a sufficient reason for a decrease of enterprises selling prices. Alexander Lukashenko always underlines that the common rule is to sell the companies at the prices as they were before the crisis. However, such prices can hardly attract a lot of investors. But Alexander Lukashenko believes that if there are no potential buyers, it is better to wait rather than to decrease the prices. Initial plan of privatization was meant for the years 2009-2011 and it is already obvious that it can be best realized within 2010-2013. Such a pragmatic approach of the Belarusian government can justify itself to a certain extent especially if to take into account an opposite example of the mass and chaotic privatization in a number of Eastern European countries (especially in Russia and the Ukraine) in early 90-ies.

2. Simplification of taxation system of Belarus (which is traditionally considered one of the most complicated in the world)

and a gradual descent of a tax levy on the commercial companies. Particularly, it is necessary to mention the establishment of the territories with a special (preferential) tax treatment, for instance: the Park of High Technologies; six free economic zones, one per each region; providing the tax preferences to the most substantial investment projects or to the spheres of economy by the President's decision; conclusion of investment contracts between foreign investors and the Republic of Belarus; abolition of some insignificant republican and local taxes during last years; reduction of the tax rates (particularly, VAT from 20% to 18%, introduction of a fixed rate of an income tax in the amount of 12% instead of progressive rates from 9% up to 30%); introduction of an alternative simplified taxation system; entering into new bilateral agreements with other states on elimination of double taxation and mutual support of investments, and etc.

3. Systematic legislative reforms aimed at liberalization of market relations, introduction of modern legal and financial instruments and mobilization of foreign investments. Bright examples of the positive changes in Belarusian legislation for the last year and a half could be abolition of so called "golden share"; gradual cancellation of moratorium on circulation of companies' shares acquired by the citizens in the process of privatization; reduction of licensable types of activities; systematization of separate legal rules into integrated legal acts which regulate the significant legal institutes; and etc.

4. Active borrowings on external markets, including international financial organizations. Within less than a year Belarus attracted loans from the IMF, Russia, the World Bank and other donors in order to maintain international reserves on a before-crisis level. At the same time the total amount of the Belarusian external debt does not exceed 8% which is considered by the IMF's experts to be secure for the economy.

5. Renewal of the dialog with the USA and the EU. Belarus had been in partial political and economic isolation for almost 15 years; a considerable step forward was the development of the dialog between the Belarusian high authorities and the EU. As a result of this dialog, Belarus joined the EU policy of neighborhood "Eastern Partnership" and adopted the multi-vector policy of the state.

6. Strengthening of the national currency authority. After a prompt devaluation in the beginning of the year under the IMF recommendation (in one night the Belarusian rouble became down 15-20% against the main currencies – U.S. dollar and euro) the citizens' confidence in the national currency was lost and as a result demand for foreign currency inside the country started growing constantly. It lead to the deficit of the foreign currency on the internal foreign exchange market. The main action undertaken by the Belarusian National Bank to overcome the negative consequences was the introduction of guarantees of citizens bank deposits in national, as well as in commercial Byelorussian banks; reduction of the refinancing rate of the National Bank; restriction of payments in foreign currency inside the country; limitation on advance payments on imports; the last step, according to the declaration of the head of the National Bank, was the prohibition to provide credits in foreign currency to natural persons until January 1st, 2011.

Obviously described above measures are of a progressive nature for such a specific emerging market as Belarus and since the implementation of the new rules just has been started it is still questionable if all those liberal declarations will be gradually reflected in actual steps of the Belarusian authorities. In the end of the day the effectiveness of the program, and the whole economy, will depend on acceptance of new challenges and proper consequences of the government which has never been open to such changes before. The time will show.

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NATO in Finland – Finland in NATO?

By Terhi Suominen

Finland has not been neutral nor alone since she joined European Union (EU) in 1995. However, a number of arguments have been raised in Finland on the assumption that being neutral or at least dismantling the alliance commitments – especially what comes to North Atlantic Treaty Organization (NATO) – would be good for the image of Finland. It has been argued from the Finnish Government that neutrality would also be of special value in the branding of Finland.

The lust for neutrality rests on assumption that avoiding alliance commitments would distract Finland from international tensions. The argument derives from the post-war political history of Finland. It is claimed that neutrality would promote national interests of Finland even today. There are also arguments which underline the importance Finland being outside all the alliances to be able to mediate as a neutral arbiter in international conflicts.

Finland is known for her longstanding policy of military non-alignment. However, Finland wants to "keep all doors open" and preserve "an option to NATO". In line with this, Finland has not pursued NATO membership but has been systematically aimed at getting as close to NATO as possible. She joined for instance the Partnership for Peace (PfP) in 1994 to work alongside NATO Allies in areas where bilateral aims converge and she supports NATO-led operations. Finland has worked alongside the Allies in security and peacekeeping operations in Bosnia and Herzegovina, Kosovo and Afghanistan.

Finland is politically aligned but militarily non-aligned. While military non-alignment is technically possible it is more complicated in practice. Since Finland joined EU, the political link through the EU to NATO emerged. Yet EU and NATO are often considered as two entirely separate organisations.

However, the memberships in NATO and in the EU are not alternatives. NATO and EU are intimately linked and overlapped organisations at large. Today 21 out of 27 EU member states are members to NATO.

EU and NATO share common strategic interests and cooperate in a spirit of partnership and complementarity. Close cooperation between these two organisations is an important element in the development of an international comprehensive approach to crisis management and operations which requires the effective application of both military and civilian means. It is important to avoid unnecessary duplication of effort in the framework of the EU and NATO.

Institutionalised relations between EU and NATO were launched in 2001. The structure was built on the steps taken during the 1990s to promote greater European responsibility in defence matters. The political principles

underlying the relationship were set out in the December 2002 EU-NATO Declaration on ESDP.

In its foreign policy, Finland has to be an active contributor, not a bystander, the current Finnish Foreign Minister Alexander Stubb has emphasised recently. Minister Stubb also reminded that according to the official definition Finland is a militarily non-aligned state, not a neutral state. He completed that Finland is a country which is not a member of military alliance.

The question of Finland's NATO membership is not a simple yes or no issue. It does entail several arguments both for and against but no decisive conclusion either way. Roughly 30% of Finns are in favour of Finland's NATO membership. The figures have stayed more or less unchanged since the first NATO opinion polls.

Public opinion on NATO has been divided into two groups: NATO-enthusiasts and NATO-sceptics. Finnish NATO discussion has been coloured black and white. The issue is whether Finland should join NATO or not. In order to improve the public understanding on NATO there is a demand on more detailed, extensive and profound information.

The Atlantic Council of Finland (ACF) has provided for ten years time a forum for open debate on transatlantic foreign and defence policy related issues. ACF has brought citizens and decision-makers together. It has succeeded to promote more open NATO discussion in Finland and has done the best to improve the knowledge of Finnish public on transatlantic relations at large.

The challenge is that NATO debate is far too often seen as a political battle behind the scenes. This deadlock can only be broken by political activity and commitment. A key to open the public debate is to get the politicians involved frankly in the debate. Probably there will not occur any change in the public opinion before the Finnish political elite will publicly come out with their concrete arguments on NATO. Similar situation emerged beginning of 1990's before Finland joined EU.

NATO is in the first place a security policy instrument. NATO membership entails both costs and benefits. The real question is whether the benefits outweigh the costs. That is the question.

Terhi Suominen

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Russia's Arctic strategy – challenge to Western energy security

By Marcel de Haas

On 27 March 2009 the Security Council of the Russian Federation (SCRF) announced in a press-release the 'Foundations of the Russian Federation national policy in the Arctic until 2020 and beyond' (further: 'Arctic Strategy').¹ On 18 September 2008 the Arctic Strategy had already been approved by President Medvedev, but for unclear reasons publication was postponed until March 2009. The Arctic Strategy comprises the main goals, basic objectives, strategic priorities and mechanisms for implementing Russian policy in the Arctic region.²

Contents

The Arctic Strategy contains the following main viewpoints. The document asserts that the Russian Federation (RF) Arctic Zone is a strategic resource base for resolving Russia's social-economic development problems. The Arctic region with its hydrocarbon resources and other types of strategic raw materials widens Russia's energy reserves and thus these deposits must be explored. Furthermore, the Northern Sea Route, as the exclusive RF transport route in the Arctic, also supports Russia's economic development. To achieve this, this resource base has to be protected, by securing RF national borders through the Arctic Zone. This will be accomplished by sustaining an adequate military potential of Defence Forces as well as of other troops of the power ministries (e.g. federal security service FSB Troops, Border Troops, Internal Troops), of which a dedicated (Arctic) group of forces and troops will be formed. Also a system of coastal protection by the FSB will be established. Moreover, RF interests will be legally secured by delineating maritime space and the use of Arctic sea-routes for international maritime traffic. This will be done by preparing a regulatory act to specify the geographical boundaries of the RF Arctic Zone. By 2020 the RF Arctic Zone should be a main strategic resource base for Russia, which will allow Russia to preserve its role as the leading Arctic power.

Background

Estimates are that the Arctic region may contain up to 30 percent of the world's gas reserves and 13 percent of the oil reserves, which explains that Medvedev's Arctic Strategy did not come fully unexpected. The interest of Moscow in the Arctic as the new strategic base of energy resources was previously made clear under Putin. Already in 2001 Russia forwarded its territorial claims for the Arctic to the UN. Next, SCRF Secretary Nikolai Patrushev, at the time Director of the FSB, created in 2004 a special Arctic Directorate at the FSB. Furthermore, in 2005 and 2007 Moscow sent expeditions to the Arctic. The expedition of August 2007 planted a Russian flag on the seabed of the North Pole.³ At a SCRF meeting of September 2008 Medvedev mentioned that some 20 percent of Russia's GDP and 22 percent of its export were produced in the

Arctic.⁴ The other Arctic littoral states – the USA, Canada, Denmark and Norway – challenge Russia's claims of sovereignty over parts of the region. Disagreements between Russia and the West have already occurred. For example in March 2009, when Russia's Minister of Foreign Affairs Lavrov complained about Norwegian military exercises as aimed for getting access to resources. And the RF ambassador to NATO, Dmitry Rogozin, in reply to NATO's desire of an increased role in the Arctic, replied that NATO had nothing to do with or in the Arctic. Conversely, Norway's Minister of Foreign Affairs noticed in the Arctic an expansion of RF military operations, involving warships, aircraft and submarines. Likewise, Canada's Premier warned that Russia could act outside international law to secure its claims in the Arctic. In June 2009 Russia further emphasized the military aspects of the Arctic region, when the RF General Staff demanded that a restructured European security architecture should include the Arctic region.⁵

Assessment

Taking into account that the climate change opens up the accessibility of oil and gas in the Arctic region, the Arctic Strategy expresses that the Kremlin is well aware of the value of this area. In their view the Arctic is a new ground of energy resources which can promote economic but also political leverage of Russia, which will reinforce Moscow's position in the international arena. Russia takes a proactive stance to be ahead of any Western initiatives, by determining the boundaries of its aspired area, by claiming the Northern Sea route under its national control – possibly denying access to others – and by forming a military force in the Arctic region which can enforce Russia's objectives.

The current Russian leadership is likely to stay in power in the years ahead; therefore an assertive security policy will be continued. The West is confronted with a resurgent Russia, in which 'Georgia 2008' type of Russian military action could be repeated. Considering that energy is a primary instrument of Russia's power, clashes are most likely to occur in regions where energy is to be won or lost. The Arctic is such a region. Grounds for a confrontation are the launching of a dedicated RF Arctic strategy, that Russia is already conducting a military build-up in this area, the unsolved territorial disputes with Western stakeholders, as well as frequent statements by Moscow that NATO / the West should keep out of this region. However, the most essential factors are the enormous amount of oil and gas in the Arctic, and, simultaneously, further growth of global scarcity of energy.

Political and economic cooperation between the West and Russia is inevitable and often mutual beneficial and should therefore be continued and intensified, in spite of Moscow's assertive stance. However, this does not mean that the West should except infringes of its legitimate interests, such as in the Arctic region. In this and other cases the West should demonstrate a policy of a tough stance. By pointing out to Russia what is acceptable, and by taking the initiative in stead of reacting to Moscow's endeavours. This will demand first of all a united Western

¹ Press-reliz no Osnovam gosudarstvennoy politiki Rossiyskoy Federatsii v Arktike na period do 2020 i dal'neyshuyu perspektivu', 27 March 2009, <<http://www.scrf.gov.ru/news/421.html>> (accessed 4 June 2009).

² *Osnovy gosudarstvennoy politiki Rossiyskoy Federatsii v Arktike na period do 2020 i dal'neyshuyu perspektivu*, 18 September 2008, <<http://www.scrf.gov.ru/documents/98.html>> (accessed 4 June 2009).

³ T. Halpin, 'Russia warns of war within decade over hunt for oil and gas', *The Times*, 14 May 2009.

⁴ M. Sieff, 'Russia's growing Arctic power play', 6 April 2009, <www.spacewar.com/reports/Russias_Growing_Arctic_Power_Pla_y_999.html> (accessed 4 June 2009).

⁵ T. Halpin, 'Russia sends army to frozen north in bid to claim Arctic's wealth of resources', *The Times*, 28 March 2009; 'Arktiku podvedut pod dogovor', *Nezavisimoye Voyennoye Obozreniye*, 19 June 2009.

stance towards Russia. Considering that a number of EU member states are currently involved in constructing new Russian pipeline networks, there is still a lot of work to be done to reach a united EU stance on energy policy. The West should also prepare its expeditionary military capabilities for a show-of-force towards Moscow if Western interests are threatened by assertive Russian actions. In stead of being taken by (a Russian) surprise, the West should already assess what its interests are in the Arctic and how to respond to Moscow's contrary actions, by political and military means.

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A new pan-European security regime?

By Margarete Klein

In June 2008, Russian President Dmitry Medvedev presented his major foreign policy initiative – his idea for a new pan-European security architecture. At its core lies the demand for a summit meeting of either all states “from Vancouver to Vladivostok” or of the “key international organisations” in Europe – OSCE, NATO, EU, CIS, CSTO – , which would produce a security treaty that is binding under international law.

The Russian president has justified his plan by pointing out that the existing security architecture in Europe has failed to achieve the goal of the Paris Charta from 1990 – namely, to create a Europe that is united, free, and secure. To remedy this situation, he proposes that the security treaty should be based on five principles. First of all, the “basic principles of security and cooperation” in the Euro-Atlantic space must be affirmed. Second, all participating states should pledge neither to use violence against one another, nor to threaten the use of violence. Third, the treaty must guarantee “equal security” for all. Fourth, no state or international organization would have the “exclusive rights” to protect peace and stability in Europe. As a fifth principle, the treaty should stipulate “basic parameters for arms control” and establish new cooperation mechanisms for combating proliferation of weapons of mass destruction, international terrorism, and drug trafficking.

When considering Medvedev’s proposal, one can only agree with his fundamental diagnosis – that the goals of the Paris Charta have not been realized completely and that Europe suffers from security deficits:

- “(un)frozen conflicts” in Abkhazia, South Ossetia, Nagorno-Karabakh, Crimea, Transdnestrer,
- crisis of conventional arms control in view of high armament growth rates, especially in the Post-Soviet space,
- a general crisis of confidence between Russia and NATO which hinders a cooperative resolution of common security challenges and
- unresolved disputes concerning the arctic region.

To a differing degree, all these problems affect the security of the northern European countries.

In view of these problems, there is a definite need for discussion on the shortcomings of the European security system. The idea of doing so within the framework of a pan-European summit conference seems, in principle, to be a reasonable one. Whether such a meeting produces an informal agreement or a legally-binding security treaty is of secondary importance. The decisive factors will be the contents of the discussions. Here, Russia’s proposal should not serve as the sole basis for such a debate. First of all, the proposal is still quite vague. Second, with regard to contents, there are some crucial problems connected with the Russian idea. The European states would, therefore, do better to develop proposals and demands on their own.

The first problem concerns the institutional prospects of Europe’s security architecture. Initially, the Russian proposal envisaged no special role for OSCE. This was in line with the traditional Russian criticism that the OSCE was concentrating too much on the “human dimension”. On May 23rd, 2009, Foreign Minister Sergey Lavrov modified the Russian position by demanding to strengthen the security dimension of the OSCE. This change reflects

“lessons learned” from the sceptical European reaction to Russia’s plans. Strengthening the security dimension of the OSCE is reasonable. After all, the OSCE is the only real pan-European institution that includes all states as members with equal rights and thus represents a quasi-natural forum for discussing matters of European security.

However, strengthening the OSCE should not be conditioned to weaken the role of NATO. This seems to be one of the main aims of the Russian proposal as becomes obvious from a closer analysis of Medvedev’s statement on the principle of “equal security” which he linked with three “No’s”: First of all, nobody should be permitted to guarantee their own security at the expense of others. Second, military alliances or coalitions should not conduct any operations that undermine the unity of the common security space. Third, military alliances should not develop in such a way as to threaten the security of the other treaty partners. These principles are formulated in a highly subjective manner and ultimately amount to a Russian veto against almost all NATO operations. They would thus not serve “equal security”, but primarily lead to an unilateral improvement of Russia’s security.

Insisting on preserving NATO does not mean that there should not be a debate over ways of improving cooperation between the alliance and Moscow. In addition to a revitalization of the OSCE in terms of security policy, an enhancement of institutionalized cooperation between Moscow and Brussels would be a major step forward for European security. Furthermore, Russia’s legitimate security interests with respect to the alliance’s enlargement to the east should be discussed as part of a negotiating process.

However, security guarantees must be mutual ones. Russia has to acknowledge the right of all European states including those in Eastern Europe to choose their foreign policy orientation and alliances freely. In order to avoid mere lip services, it would imply that Russia gives up the idea of an own, exclusive “zone of influence”. This very point could serve as a test bed for the earnestness of Russian proposals.

In summary, Medvedev’s proposal pursues two aims. The first is to address Russia’s security concerns and make Europe to listen to them. The second is to strengthen Russia’s position in European security policy and to weaken the influence of NATO. Therefore, to avoid a policy of wedge driving, the Europeans should develop an agenda of their own for joint discussions with Russia. This would require a debate over legitimate Russian security interests as well as the formulation of clear demands towards Moscow. In light of unresolved security issues in Europe, it is worth testing Russia’s interest and willingness to compromise.

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The Baltic Sea gas pipeline – can we manage it sustainably?

By Timo Koivurova and Ismo Pölonen

The Baltic Sea Gas Pipeline has evoked strong feelings and emotions from the general public, politicians and the media. The project has been perceived as an environmental risk, as a wrong choice for the region's energy policy and even as security threat. These fears have been exacerbated by the fact that the project developer is Nord Stream AG, a joint venture company that is registered in Switzerland but whose majority shareholder is the state-owned Russian energy company Gazprom.

While it is interesting to think about the various political factors related to the pipeline project, such speculation often seems to yield conspiracy theories sooner than realistic explanations. A more interesting pursuit is to examine how the project is actually intended to operate and how its risks are being managed in the complex international policy setting in the Baltic Sea. There is clearly cause for concern. After all, the project consists of laying two parallel natural gas pipelines on the sea bed, part of an ecosystem already under considerable stress. Plans call for the pipelines to run from Vyborg/St. Petersburg in Russia to Lubmin in the Greifswald region of Germany, a route spanning some 1200 kilometers and traversing the maritime areas of Finland, Sweden and Denmark.

From a pragmatic perspective, the crux of the project is managing the risks to the vulnerable environment of the Baltic Sea. Because Nord Stream AG proposed in 2006 that the pipeline was to run through regions under the maritime jurisdictions of five countries, it was known that the company would need to carry out environmental impact assessments (EIA) and to obtain permits from each of the five states in keeping with their national legislation. Yet, the project entails many possible transboundary impacts on other coastal states of the Baltic Sea and the Baltic Sea in general. The key question became not only how to assess the specific environmental impacts of each sector of the pipeline project, but also how to examine the environmental impacts of the project as a whole. The ability to examine all of the impacts was made possible by the innovative application of the Espoo Convention, which regulates environmental impact assessment in a transboundary context. The Convention is an international treaty to which all the Baltic Sea coastal states other than Russia are parties.

The challenge that confronted the civil servants in charge of applying the Espoo Convention to the pipeline project was that there was no previous experience on how to apply the Convention to such a large-scale multi-jurisdictional planned activity. Typically, the situations that are managed under the Convention are ones in which a proposed activity in a state (the origin state) is likely to cause a significant adverse transboundary impact in a neighboring state (the affected state). The Convention enables the affected state and its public to participate in the national EIA procedure of the origin state and thereby makes it possible to have all the impacts of the proposed activity examined. Characteristic of these situations is that the main benefits of the activity accrue to the origin state while the negative impacts are concentrated in the affected state.

Contrast these typical situations with the gas pipeline project, where a private company with Swiss headquarters proposes to build a pipeline traversing the maritime areas under the jurisdiction of five states and the activity may have environmental consequences for all the littoral states of the Baltic Sea. The benefits of the proposed activity would comprise profits for the company's shareholders and the diversification of the natural gas supply to Western Europe.

The responsible civil servants succeeded in applying the Espoo Convention to the pipeline project in a pioneering manner. In a meeting on April 2006, they defined Finland, Sweden, Denmark and Germany – parties to the Convention – and Russia

as origin states under the Convention, and all the coastal states of the Baltic Sea as affected states. Even though it is not a party to the Convention, Russia agreed to the Convention being applied to the pipeline project, noting, however, that it would do so only to the extent permitted by its national legislation. With this initial decision, the four origin states and Russia committed themselves to opening up their national EIA procedures to all the Baltic Sea coastal states. They also asked Nord Stream AG to assess the impacts of the entire pipeline project, thereby ensuring that the assessments would not be confined to the individual sectors of the project.

Overall, the transboundary EIA of the project has been organized in a sound manner. The responsible officials have made innovative use of the Convention and been able to focus the studies of the project on its environmental consequences and risks. This has mitigated some of the unnecessary fears related to the plan, which, at times, seem more like storylines of thrillers. On the other hand, the Espoo Convention procedure has succeeded in raising relevant concerns over the environmental impacts of the project. Recently, on 8 June 2008, the Finnish Ministry of the Environment sent its comments on the Espoo Report to the other origin states and Russia, and conveyed various concerns that Finland has regarding the quality of how some of the assessments in the Report were conducted.

The Espoo process has thus been able to produce relevant information for the five national EIA procedures, as well as for the actual decision-making on the future of the pipeline project, which will soon begin in each of the four origin states and Russia. It is those permit authorities that will decide how the environmental consequences of the project can be controlled and mitigated or, if they cannot, will reject the company permit application.

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EU kicks the ball to ScanBalt BioRegion – The green valley, the health region

By Hans-Robert Metelmann and Peter Frank

The 10th of June the EU Baltic Sea Region strategy was released – the very first EU strategy for a metaregion. The 25th of June ScanBalt BioRegion published a set of recommendations on how to improve cross-border collaboration between academic institutions and SMEs based on smart growth and sustainability principles - as this is the key challenge for the success of the Baltic Sea Region as a “green valley” and “health region” based on solutions provided by Life sciences and biotechnology. The recommendations are thus a first step towards realizing some of the ambitious goals set by the EU Baltic Sea Region strategy. They form part of the EU FP 7 co-funded project Bridge-BSR.

The recommendations are presented in the report “Smart growth – Bridging Academia and SMEs in the Baltic Sea Region” and constitute a set of actions that ScanBalt BioRegion will act upon. The report also declares strong support to the intentions of the EU strategy to establish a flagship project for innovation in health and life sciences. The ambition is to promote the region as a globally leading “health region”. ScanBalt BioRegion is ready to take a key role in such a project, an issue which was discussed in Klaipeda, 25 June.

The Baltic Sea Region has an urgent need for a cross-border financial support infrastructure for research, development, innovation and education. The EU structural funds, the CIP-programme and EU FP 7 are very valuable; however they should and cannot stand alone if we have ambitious goals for the region. The Nordic countries have well established financial support tools in the Nordic Council of Ministers and its institutions, the Nordic Innovation Center and NordForsk. However they only encompass the Nordic and Baltic countries, while Poland, Northern Germany and (to some extent) North West Russia are not included. In addition they lack the financial power to fully exploit the potentials for cross-border collaboration.

The need for a Baltic Sea Region financial support infrastructure is in fact mentioned in the EU Baltic Sea Region strategy. ScanBalt BioRegion finds this very positive and is looking forward to interact with regional, national and supra-national decision makers to realize this ambitious and important goal.

A key recommendation for the ScanBalt BioRegion community to put into motion is the establishment of Shared Modular Business Support and Services between Clusters (SMS-BSS). These are needed to support the development from ideas to high-growth SMEs, to improve effectiveness of regional support and services and to strengthen the meta-regional value chain. The SMS-BSS should be delivered and marketed as a virtual portfolio with different modules to be initiated depending on customer demand or based on priorities set by the ScanBalt BioRegion community. The total portfolio would rely upon the regional competencies of the SMS-BSS partner organisations and each module partnership should include competence hubs and satellites. SMS-BSS constitutes a flexible way of organizing shared support and services between clusters which can be extended according to needs, competencies and priorities and quickly be adapted to a rapidly changing market.

The idea of competence hubs and satellites as a basic model for cluster collaboration in ScanBalt BioRegion was developed in the EU FP 6 co-funded project “ScanBalt CompetenceRegion”. It means to develop strategies for targeted networking in selected areas where scientifically strong regions can be regarded as “competence hubs” while other regions would then be regarded as “competence satellites”. Nearly any region has a leading competence which qualifies it for being a competence hub and thus hubs can be distributed over the region.

Other recommendations for ScanBalt BioRegion to act upon are the issues of human resources or “talents”. Talents are crucial for the collaboration between Academia and SME’s as knowledge

is located in the heads of people. Since Life sciences and biotechnology operates with a very high degree of specialization it is often a necessity and advantage to collaborate with neighbouring regions on talents. It is a question of utilizing the available local/regional talents; increase the mobility in order to supplement local/regional talent, maintain talents and attract talents from outside ScanBalt BioRegion. Talent is a key parameter in order to stay competitive and collaboration on talents need to be performed in a way which ensures mutual benefits, and prevents brain drain from individual countries. One important issue is that collaboration based on competence hubs and satellites may also promote distribution of tasks to where the talents are – instead of moving the talents.

Another important issue for ScanBalt BioRegion is the Northern Dimension and collaboration with Russia. The highlight of research in ScanBalt BioRegion gathered in ScanBalt Academy has taken steps to strengthen links with Russia with a focus on the major future challenges in health, ecology and climate. Coping with the enormous dimensions and complexity of these challenges requires advanced research based on state of the art combined with a strong political backing. At a ScanBalt Academy meeting 10 June in Oslo these issues were discussed with decision makers in order to bolster collaborative research in the Nordic region.

One main reason to collaborate around the Baltic Sea is the Baltic Sea itself. Therefore the annual ScanBalt Forum, this year taking place 7-9 October in Kalmar, Sweden, focus on restoration of the Baltic Sea. The objective to gather scientist, managers and government officials is to disseminate experiences made and discuss the possibilities and limitations of active restoration approaches within the Baltic Sea Region. It is our hope that the Forum will stimulate collaborations at the local, regional, national and international level on projects dealing with restoration. ScanBalt Forum 2009 is organised by Kalmar University. In parallel the annual ScanBalt Biomaterial Days will be running, likewise in Kalmar, organised by Tampere University and Kalmar University.

The Baltic Sea Region seems more vibrant than ever but it is necessary to remember that all stakeholders should strongly push forward to utilize this window of opportunities we have right now. If we loose momentum at this critical point the drawback can be severe, however we are indeed optimistic this will not happen.

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Chairman

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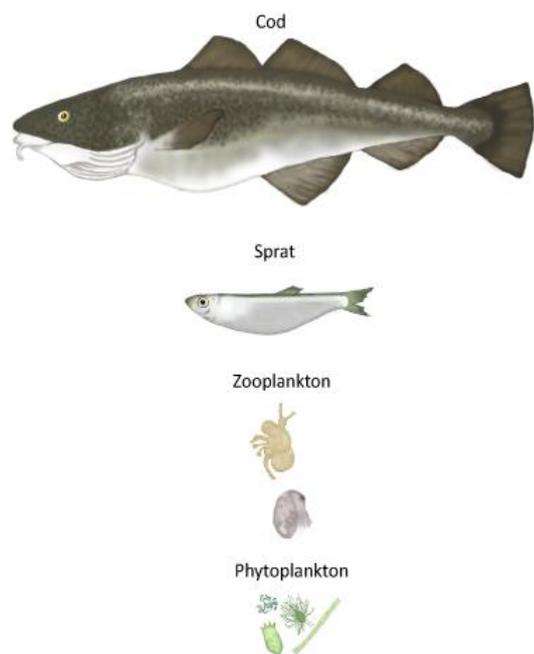


Sustainable management of the Baltic Sea

By Conrad Stralka and Katarina Veem

Did you know that the best and quickest way to combat algal blooms in the Baltic Sea is to ensure a large cod stock? This fact might make the lack of cod in the Baltic Sea into the single most important environmental issue today – An issue that we can influence in just a few years.

The lack of cod in the Baltic Sea is an environmental problem. It is beyond question that fish are an integral part of the Baltic marine environment and that fishing impacts directly on that environment. Since too much fish has been extracted from the sea the intricate relationship of species in the food web has been altered, putting the balance of the marine ecosystem at risk. Cod, which is at the top of the food chain, has decreased in number, while sprat has increased, zooplankton decreased and phytoplankton and algae increased. **Strengthening Baltic cod stocks therefore offers an opportunity to improve the recovery of the Baltic Sea environment and contain widespread algal blooms.**



In recent years a good hand has been dealt the region – management measures in combination with nature have contributed to improving the eastern Baltic cod stock. At this specific juncture it is more important than ever that management applies stringent and bold measures which allow the eastern stock to recover and grow to a size which balances the ecosystem. A sufficiently large cod stock will provide the maximum sustainable yield and will be economically profitable to the fishermen.

The Baltic Sea has been overfished and as a consequence, the environment is seriously degraded. It is time that the biological and environmental objectives which can deliver sustainability need to become a priority. Endless overfishing has hampered the socio-economic significance of Baltic Sea fisheries and the time has come to ascribe greater significance to negative environmental impacts. A well-balanced and healthy marine environment is the precondition for ample and rich yield from the resource. The fish that fisheries depend upon require a healthy marine environment. If a healthy marine environment cannot be safeguarded and ensured the

socioeconomics of fisheries are automatically rendered irrelevant.

Regional governance

A regional approach to the Baltic Sea could more effectively take account of the issues above and enable the application of an ecosystem approach. This is best done on a regional basis which corresponds to the ecosystem found in the area. Marine ecosystems are not about individual species of fish, instead it is about the interaction between the various species and the environment in which they all live – it is a whole, with a multitude of individual parts. In our governance structures we have created artificial boundaries which counteract the healthy interaction between species. The marine environment is governed by Ministers of environment, fish and fisheries governed by Ministers of Fisheries. These artificial boundaries need to be broken down in order for the Baltic Sea to be managed sustainably. **The ecosystem approach contributes to integrating fisheries with marine environment policy and makes it possible to effectively implement policy developments such as the Baltic Sea Strategy, the Marine Strategy and the Maritime policy.**

Measures to be taken

To accomplish true integration and with sustainability as the main objective a regional management organisation should be established where national governments formalize, improve and strengthen their dialogue with various stakeholders. Dialogue fosters trust and openness which is needed in the entire process. The subsidiary principle needs to be applied so that decisions are taken as close to the citizens as possible. This can be achieved by delegating decision power from the central EU level to where action is most likely to have an impact – on regional, national or local level.

An appropriate regional management organisation has to be given the appropriate decision making power. This can be established by joint collaboration between Baltic Sea Member State governments, through the “enhanced cooperation mechanism” where they jointly request the delegation of competence to the Baltic Sea Member States. Such collaboration can be established immediately. Further, sufficient funding needs to be provided to ensure proper organisation and buy in. The regional management organisation should include broad representation from governments, industry, NGOs, scientists and other interest groups.

A new courage is needed by the politicians in the Baltic Sea region. Fisheries and environment are victims of institutional inertia with little or few horizontal connecting points. **Let's be bold and encourage a comprehensive approach which will show everyone that the Baltic Sea region is capable to agree and manage the common sea resources so that it benefits the fishery - through increased revenues, the sea – through reduced algal blooms and the citizens who will be able to swim in clean water and buy and eat locally caught fish. Always resting assured that is it responsibly managed and that has been fished on environmentally safe levels.**



If you want to learn more about what measures could be taken, please read more about our work at www.Balticsea2020.org

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Russia and climate – on the road to Copenhagen

By Anna Korppoo

The Copenhagen climate negotiations in December 2009 will be a crucial moment in the history of the mankind; according to the Inter-governmental Panel on Climate Change, global warming must be limited to 2°C in order to avoid dangerous climate change. Even though the commitments of the United States and China alone can make or break the Copenhagen deal, the actions of other major emitters including Russia can also derail the process. The lack of Russian participation would break the industrialised country group 'Annex I' and discourage developing countries to join the common effort. The latter group's main argument against commitments is that it is the industrialised countries which created the problem of climate change should fix it.

Russia's emissions collapsed in the early 1990s due to the economic recession following the systemic change. As the year of comparison for the Kyoto Protocol commitments is 1990 and the Russian commitment is to limit emissions to the 1990 level, the country was left with a sizable surplus of emitting allowances. This so called 'hot air' could be sold under the Kyoto emissions trading mechanism. Due to such benefits, the Russian government remained interested in the Kyoto Protocol regardless of the skeptical approaches to climate science by Russian scientists and benefits expected from climate change according to them. Due to the withdrawal of the US from the Kyoto Protocol in 2001 Moscow found itself in an important role of bringing the Kyoto pact into force. This critical role gave Russia more leeway to successfully demand more benefits against ratification; Putin famously settled with the EU's support for Russian WTO membership in 2004.

Since the ratification in 2004, there was hardly any discussion on climate policy in Russia until April 2009 when the Russian Cabinet debated a draft Climate Doctrine. This document establishes the official approach of the Russian government to the problem of climate change. Even though the role of the Doctrine is hardly central to the Russian negotiation position in the Copenhagen climate talks, it reintroduced the climate topic to the national agenda.

The Russian greenhouse gas emissions remained 34% below its Kyoto target in 2006; emissions have been growing since the late 1990s, but significantly slower than the economy. Based on these numbers it looks like a commitment to generate fairly deep emission cuts under a Copenhagen pact would be a possibility for Russia. But the Russian emission models-based analyses provide a mixed message. The model produced by the Center for Energy Efficiency suggests that a reduction of only 35% of 1990 level by 2050 would be possible. According to the Moscow Higher School of Economics model a reduction of 20-30% of the 1990 level by 2020-2030 should be possible. Given that the current economic crisis must have further cut the Russian emissions somewhat, and that the economy is unlikely to continue its growth indefinitely afterwards without energy efficiency improvements which would further reduce emissions, these estimates sound conservative.

President Dimitri Medvedev announced that a domestic target of 10% to 15% reduction in comparison with 1990 would be possible to achieve by 2020. Given the current

level of emissions, this would translate into a growth of emissions by some 29-36% of the 2006 level by 2020. Further, in the July meeting of G8 in Italy president Medvedev originally joined the front of the leading industrialised countries to cut emissions by 80% by 2050. However, his economic advisor Arkady Dvorkovich soon corrected that a reduction of 20-60% could be considered for Russia while the mentioned 80% cut was the position of the European Union only. In his final statement, Medvedev outlined a reduction target of 50% by 2050 for Russia. This may suggest that an internal debate on Russia's Copenhagen target is underway in the Kremlin.

It seems that the economic crisis could have further cut Russian emissions down to some 40% below 1990 level as industrial production had declined by over 17% between the first halves of 2008 and 2009. Based on these numbers Medvedev's announcement on the 2020 target of 10-15% cut sounds conservative. If in addition to this the planned policies to improve energy efficiency by 40% during 2007-2020 will be implemented, the 50% cut by 2050 may be quite possible to achieve without negative impacts on the economy.

Other issues relevant to the Russian commitment in Copenhagen include the treatment of the remaining surplus emitting allowances and forest carbon sinks. Both of them could in theory provide Russia with additional help to achieve deeper emission reductions. However, these elements are likely to be seen as additional 'buffers' against any international commitments. It is felt in Russia that the country has done its fair share already under the Kyoto Protocol due to the massive emission reduction generated by the economic collapse of the early 1990s as well as bringing the Protocol into force. International attention has also recently focused on the US and China, and some Russian experts argue that their country is needed less this time around than under the Kyoto Protocol.

Given the history of the Russian approach to international climate negotiations, it seems likely that Copenhagen will be more important for Moscow as an arena of foreign policy-making than that of an environmental debate. What probably supports the Russian cooperation in Copenhagen is the participation of the country in the G8, which both provides evidence of the country's role as an important global power as well as facilitates political agreement on emission reduction commitments. Also other for instance bilateral partnerships could encourage Russia to participate in the climate regime. Then again, Moscow blocking a consensus in Copenhagen in order to demonstrate political muscle would be hardly surprising.

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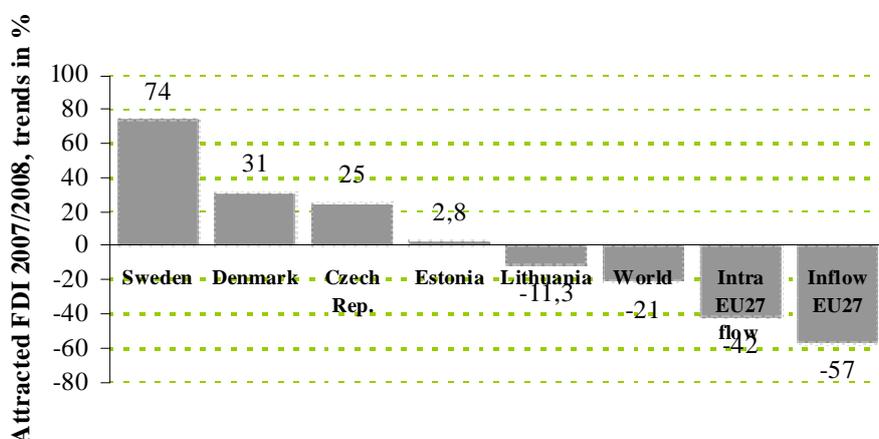


Lithuania – demanded synergy between economic promotion and development

By Sigitas Brazinskas

Recent economic trends in the Northern European region have been monitored by international analysts and institutions with a higher focus to overall situation in the Baltic countries. Looking from region's perspective these countries have to respond to challenges which are met obviously for the first time since last decade. Despite the growing economy since middle 90's and several declines in the meantime, the current situation is more actual and has to be analyzed more wider: the Baltic countries are EU members, more integrated into global economy and impacted by world crisis on the other hand, they rely much more on export and foreign direct investments (FDI) as it was before and recession impact might be more visible.

According to the latest statistics of 2008, internal EU27 FDI flows dropped by 42% compared with 2007 while FDI into the EU27 from the rest of the world (inflows) decreased by 57%¹. However, several Northern European countries have managed to attract significant investments (chart 1)².



Sweden and Denmark had achieved mostly to attract FDI in the current situation. Despite the fact that the economic slowdown is obvious in traditional industries as manufacturing sectors (e.g. automotive) other sectors have accumulated significant FDI. Looking from the region's perspectives the Baltic countries remain under challenging economic situation. Foreign direct investments, international trade and inward tourism remain among the key engines for economy growth.

The current article focuses more on Lithuania and its tendencies however they are similar across three Baltic countries. Lithuania's FDI inflow has decreased by 11% in 2008 compared with 2007. Exports has dropped by 30% within the first five months of 2009, GDP decreased by 22.4% within the 2nd quarter of 2009 (both compared to the same period of 2008)³. The Lithuanian government has taken further measures where the corporate profit tax became 20% since 1st January 2009 (previously it was 15%), VAT will be 21% from the 1st September 2009. Traditional competitive advantages such as overall costs along with energy are not among the key advantages. Thus there is an essential need to identify new and explore current measures to stabilize recession and assure competitive growth under attracted FDI and stable volumes in international trade.

As governmental institutions play one of the key roles in economic development, until recently Lithuania had focused more on promotion of its business opportunities, industry, free economic zones, unique geographic location to bridge EU with East region,

new tourism destinations, cultural events and many other advantages which seemed needed from internal view of the country. Development agencies and other Lithuanian business support structures, which focus more on promotion of the country and business opportunities, made a number of international events, matching sessions which led to exploring business opportunities and integrating Lithuania's economy into global value chains. But it is obvious now this was not enough in a long run.

Now it is the time to put emphasis on total development and keep investing in Lithuania in a wide range of areas such as infrastructure, clusters, education, service that should lead to maintain competitiveness of the country. However it might become a hardly implemented task under economic decline.

On the other hand the current situation is a good precondition to start implementing reforms and launching new measures. New initiative of public presenting about ongoing monitoring of

economic situation and its development support was started. This initiative is led by the Ministry of Economy of Lithuania and is named "Promotion plan" (www.skatinimoplanas.lt).

Lithuanian Development Agency is being restructured according to a similar model which was carried out in a number of world countries some years ago. It is expected that new measures will narrow the gap between policy making and policy implementing actions. It will include focus on development measures to improve business environment, energy efficiency, available financing tools and EU structural support.

As Lithuania's economy is mostly placed in middle position of entire value chain with dominating subcontracting and geographic proximity to leading economies to manufacture products, there is a precondition for further growth and regional expansion. Other industries as business processes, cleantech aim to enlarge existing business opportunities too. A number of successful cases have proven that Nordic and European companies have established themselves in Lithuania, made clusters of subsidiaries of different business lines and now distribute manufactured products both in EU and Eastern countries. Other companies have established regional centers for business services.

Lithuania and the region becomes a linkage in logistics through developing infrastructure. Integrated transport cargo links and growing trade volumes (as operating shuttle train "Viking" between Ukraine and Lithuania) enhance goods flow between EU, Northern Europe and Central Asian and CIS countries.

Finally innovation, creativity, service export, decrease of transaction costs remain as other key areas with the higher attention which are defined by education. This includes large number of development measures such as education, clusters, talents, life quality, medical services and others.

Consolidation of growing economic development initiatives with promotion activities will enhance Lithuania's competitiveness and attractiveness. This synergy will bring significant impact to soften consequences of the current economic slowdown. New measures will build preconditions for sustain growth afterwards economic decline ends.

¹ Source: Eurostat, "EU27 Foreign Direct Investment", http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-14052009-AP/EN/2-14052009-AP-EN.PDF

² Source: Reuters, "FDI flows fell 21 pct in 2008, to keep dropping – UN", <http://in.reuters.com/article/businessNews/idINIndia-37542820090120?pageNumber=2&virtualBrandChannel=0&pageNumber=2&virtualBrandChannel=0>

³ Source: Department of Statistics of Lithuania, <http://www.stat.gov.lt/en/>

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Opportunities for foreign companies in Kola Peninsula

By Petri Leino

The North-West Russia has not received very much attention since the collapse of Soviet Union. Kola Peninsula area has traditionally been living on fishing and mining industries. The biggest city in the area, Murmansk, had a population over 500 000 in 1989, today only 320 000, partly due to decrease in military force personnel.

Things are changing now. The Shtokman gas fields were discovered already in late 80's but nothing really happened until 2008 when Shtokman development AG was founded by Russian Gazprom, French Total and Norwegian Statoil. These gas fields are located in Barents Sea some 600 km North of Murmansk. Circumstances are very demanding and this type of operating environment is new to Russian operators so foreign partners are needed.

At this moment the development consortium is asking companies interested in this gas project to participate in prequalification. The project is divided into four main parts:

- 1) The under water constructions in the bottom of the Sea
- 2) Drilling equipment floating on the Sea
- 3) Pipelines from the field to the onshore (Teriberka village)
- 4) LNG plant

It is very likely that the main contractors are going to be the big international construction companies together with Russian, French and Norwegian builders. Possibilities for smaller foreign enterprises are in sub contracting and active follow up who is doing what in the project. So far the biggest Finnish contract has been made by Steeldone group who delivered demanding steel structures for test drilling rig which was assembled in Vyborg ship Yard. Also French companies have shown their interest to test the suitability of some of their equipment in cold environment in Finnish Lapland. The final decision to go ahead with Shtokman gas field project is going to be made during the second quarter 2010. Many "outsiders" specially on the finance sector are sceptical about the possibility to get finance for the project but the fact is that the existing gas fields in Russia have received their peak in production (Russian gas exports have decreased over 20 % on year to year basis and Norway has become as big supplier of natural gas as Russia to EU. Despite of this still the fact remains; both Russia and EU needs Russian gas in the future as well.

Besides offshore technology this type of project needs a lot of "traditional" construction work like roads, warehouses, power plants, modern houses,

telecommunication ect. Also a great variety of services are needed. As far as sea transportation is concerned Norway has a clear geographical advantage. Road transportation (including containers) is most effective via Finland even though the roads on Russian side are in bad condition (especially during the spring time.)

Besides the gas project there are a lot of other opportunities coming up as well. The northern coast line of Kola Peninsula has good circumstances for wind power electricity production. Kola is becoming the leader of renewable energy production in Russian territory. Russian government has also big plans to improve the whole logistic chain in the arctic including new cargo terminals, railroad connections and road transportation.

However, when it comes to practical work in Kola area there are many (constantly changing) rules and laws affecting the business. It is very difficult to get working permissions for foreign employers. Nowadays the coast line is considered as boarder area which in practise demands a special permission to enter (affecting above all the tourism business). Compared to EU countries Russia has very different approach how react to global financial crises. Free trade is not on the top of the list. Domestic production is favoured as much as possible (at least on political level). We are likely to see a lot of balancing between supporting domestic production and import of goods to Russia in the near future.

Despite these negative trends caused mainly by today's global crises the fact remains that Russia needs and is dependent on foreign imports and technology even more than before. Companies with experience in arctic who actively offer their services to Shtokman Development AG and to main constructors have a good change of winning contracts in the years to come.

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Time for the next level of cooperation around the Baltic Sea

By Thomas Johansson

In June 2009 the European Commission presented its proposal for a EU Strategy for the Baltic Sea Region, a Strategy that is designed to deliver a more prosperous, environmentally sound, accessible and safe region.

Hopes are generally high regarding the possibilities that the Strategy will pave the way for. The Baltic Sea region has seen a remarkable transition in recent decades. Who could imagine 20 years ago independent Baltic States and eight of the nine states around the Baltic Sea being EU members in the near future? In view of this we at the Sida Baltic Sea Unit look forward to new advances in the years to come.

Meanwhile, it is obvious that contacts across this new *Mare Nostrum* of the EU are not yet intense enough. During recent years several opinion polls have shown that neighbours around the Baltic Sea still do not know each other very well. Out of date images and prejudices still loom. This is worrisome because contacts are key to generating awareness and fencing off ignorance. Awareness is a prerequisite for reaching a stage in which we intuitively see ourselves as a macro region.

This means that the countries around the Baltic Sea rarely make each other a natural first choice when faced with a need or when a possibility for cooperation arises. Clearly, if thinking and acting regionally is to become the rule rather than the exception, continued attention must be paid to the role of contacts and unprejudiced awareness of the opportunities available in the region.

When the proposal for the EU Strategy for the Baltic Sea Region was finally made public it had been preceded by some 18 months of preparations, led and coordinated by the Directorate General for Regional Policy (DG Regio).

A vital instrument in this work was a series of stakeholder conferences and public consultations, meetings that are a good foundation to build upon. During the stakeholder conferences 80 actions have been identified and are now part of the Action Plan accompanying the Strategy. It will now be easier to initiate joint projects in the Baltic Sea Region with the Action Plan as a starting point.

With political commitment at the highest level within the EU we stand a great chance of meeting global challenges and opportunities – and being a strong global competitor. It will be easier to influence EU policies and to ensure that they, when needed, are adapted to the specific circumstances of the Baltic Sea Region.

This transnational Strategy marks the first Macro Region within the EU. It will make it easier for the region to prosper, and it will help the region handle its cross-border challenges and opportunities effectively. I am convinced that the Strategy is the next step for EU cooperation around the Baltic Sea, and that it will serve as a model for regional cooperation in Europe.

Another important actor is Russia, the only nation bordering the Baltic Sea that is not a member of the EU. The Strategy also marks the next step for cooperation with this nation. I believe that Russia, after a period of hesitation towards the Strategy, will come to appreciate the new structure and the fact that it will be easier to cooperate with the members of a Macro Region rather than with eight different countries.

The adoption of the Strategy thus only marks the beginning! The Strategy will help to identify our common priorities and channel our cooperation in the same direction, and to identify the priorities that are most suited to being handled on a transnational level. It is of the essence that the political will in each country around the Baltic Sea signals to all institutions that we need to think regionally when we plan ahead.

The Sida Baltic Sea Unit was formed by the Swedish Government in 2005 to develop relations between diverse actors in the Baltic Sea Region so as to facilitate the implementation of the EU Strategy for the Baltic Sea Region.

During 2008-2009 the Unit has supported 180 projects with seed money involving 100 Swedish actors and more than 300 actors in the neighbouring countries. The Strategy now marks a new phase, where these initiating projects can develop even further.

All countries across the region have pledged to take lead responsibilities for certain issues in the Action Plan, thus demonstrating a broad ownership in the implementing phase of the Strategy. We need to build relations to solve common problems – problems that actually can be described as possibilities for development and cooperation.

There is no lack of funding to realise the Action Plan. There are for example billions of Euros in the EU structural funds that can be combined with national sources. What we now need is an institution that can link and inspire cooperation between different actors in different countries. The Sida Baltic Sea Unit has had this kind of function in Sweden, and we would very much like to see similar institutions in the neighbouring countries. Even better would be a common institution – a brokerage function with satellite offices in all eight countries – that would effectively promote networking and support new ideas and partnerships.

Approximately 100 million people live around our sea, will the Baltic Sea Strategy lead to any tangible changes in our everyday lives? Well, by reaching towards the four goals of the Strategy – a more prosperous, environmentally sound, accessible and safe region – noticeable changes are bound to take place.

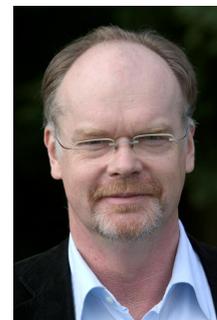
Connecting the Baltic Sea Region thus remains a high priority issue also in the years to come.

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Opportunities of Finland in Russian innovation environment

By Timo Koponen

Finnish innovation system is regarded as one of the most effective in Europe. To improve its innovative development Finland has integrated with European and US innovation systems and now is starting cooperation with fast developing innovation environments of Russia, China, and India. In Finland we understand that in order to improve our competitive positions in global economy we have to work more and more globally, recognizing that the best innovations may be born "borderless".

Russian innovation environment is developing very fast. The Government is promoting the innovation policy on all levels of education and economy. The Russian Government is building a system for monitoring potential innovations in leading Russian regions using the capabilities of Rosnano. Rosnano is probably the biggest profiled venture investment fund in the world and it is aimed to invest only into productions based on nanotechnologies in Russia.

Nanotechnologies are the most advanced and prospective area of sciences in Russia. On the other hand, in Finland there has been created a cluster of nanotechnology business which includes 200 companies and R&D laboratories. More than 60 of them already have cash flow from business. That is why the nanotechnologies are one of the most lucrative areas of the future Finnish – Russian cooperation in research and business. To support this development Ministry of Employment and Economy of Finland and Rosnano has signed a Memorandum, targeted to give a strong support to operators in the both countries in this business. Finnish technology agency Tekes has already been cooperating with Kurchatov Institute, being the main coordinator of nano research in Russia, for three years.

In Finland there has been created 13 industrial or service clusters "OSKE" (The Center of Expertise). More than 8000 firms are connected with programs of the clusters. To achieve the most advanced technological solutions for the global competition, leading Finnish companies and research organizations have established 6 development companies in which the best national skills and capabilities are to be combined – "SHOK" (The Strategic Top Competence centers).

If we in this framework look at potential areas of science, research and technology in Russia, we can identify a few prospective areas not only in nano, but also in such businesses as ICT- software, biotechnologies, bioenergy, sun energy, and new technological solutions in energy efficiency and environmental issues. R & D in energy efficient technology is one of the main topics in the Strategy of Innovative Industry Development Program of the Russian Government and it paves way for cooperation between Finnish Clean Tech companies and Russian enterprises in machinery.

In order to better understand processes happening in global innovation environment, especially in BRIC countries, the Ministry of Employment and Economy of Finland has established a new Finnish innovation center

network concept – Finnnode, which combine major Finnish innovation organizations. Finnnode innovation centers are working in 4 countries by now, in Russia (St Petersburg), China (Sanghai), Japan (Tokio), and USA Santa Clara, CA). The next center is scheduled to be opened in India (Mombai).

Finnnode Russia, inspite it is located in St.Petersburg, is working to set up a network with leading Russian innovation organizations, not depending of their location in Russia. To be able to understand and react to the developments in innovation business in the country, Finnnode Russia now works with respective partners in Moscow, St.Petersburg, Ekaterinburg, Kazan etc. About 30 % of scientific potential and 70% of financial resources of Russia are located in Moscow, that's why Finnnode Russia is planning to expand its permanent presence there in 2010.

Finnnode Russia started its activities in February of 2008. During the year of 2008 Finnnode Russia identified and selected main areas of operations in Russia for 2009. These areas cover networking with leading operators in nanotechnology in Moscow, St.Petersburg, and Ekaterinburg. Because Finland in one of the leading countries in Europe in energy efficiency and ecological construction, of course these capabilities open a wide variety of options for cooperation with Russians in this field, especially in North-West Russia. The fact, that one of the biggest clusters of automobile assembling in the world is located in St.Petersburg area, allows to expect future business opportunities for Finnish technology and service companies.

A number of factors, such as developing legislation system, governmental support to regional innovation development agencies, increasing availability of financial resources (such as public funds, private venture companies, business angels, and growing interest of global venture capital towards Russia) is turning Russian economy to more innovative direction. Despite of the problems in commercialization of Russian innovations because of weakness of IPR - transparency, lack of financing of innovation developments and start-ups, low level of English proficiency and international communication, bureaucracy and corruption, the new generation of modern and internationally oriented young Russians guarantees stable movement of Russia towards innovative society. Finland will be a reliable partner of Russia in this movement.

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Director

Finnnode Russia

The Finnish Innovation Center in Russia

The global crisis and FDI in new Europe

By Kalman Kalotay and Sergey Filippov

The economic crisis which started to affect the world economy in 2008 has affected the sustainability and future course of all global phenomena, including foreign direct investment (FDI) carried out by multinational enterprises (MNE). In world FDI flows, the year 2008 marked the end of a cycle: As the crisis unfolded and corporate and project finance was weakening, all kinds of equity investment including FDI came under pressure. At the "epicentre" of the crisis, developed countries suffered from a fall of FDI by 25% in 2008, compared to a decline of 15% globally. In contrast, FDI increased by 7% in developing countries and 24% in South-East Europe and the Commonwealth of Independent States. Evidence for the new EU member states remained mixed: FDI inflows continued to grow by 34% in Romania, 8% in Hungary and 3% in the Czech Republic, but fell in Poland (-28%).

The current new members of the European Union (EU) relied heavily on FDI inflows for economic restructuring during the 1990s; presently, their development strategies still depend on foreign investors, but focusing more on upgrading FDI to higher value-added industries and functions. In these countries MNE subsidiaries with higher-value added, such as R&D laboratories (which are mostly immune to the crisis) are relatively rare, although growing in number. Market-seeking subsidiaries are probably the most common. They were born out of privatisation, under which large local market-oriented units became foreign-owned without necessarily being deeply integrated in the corporate network of the new owners. These subsidiaries might suffer in the crisis, especially in societies where the local consumer purchasing power declines (e.g. in the Baltic States and Hungary). Efficiency-seeking ("export platform") subsidiaries are also frequent, present not only in manufacturing industries (automotive, electronics and garments) but also in export-oriented services (such as shared service centres). Some types of these subsidiaries again can suffer from the crisis if the international demand for their output is declining, and if the impact of the crisis is coupled with the existences of excessive productive capacities (e.g. in the automotive industry). In turn, the crisis can provide new business opportunities for the cost-efficient locations of the new EU in export-oriented services.

How export platforms have been affected by the crisis can be detected from output statistics available for industries in which foreign subsidiaries dominate, or are the sole producers. The former is true for the manufacturing output and exports of new EU member countries; the latter to most of their transport machinery and equipment exports (table): Bulgaria, the Czech Republic, Estonia, Hungary and Latvia, Slovakia and Slovenia, all show very similar decline in industrial output (over 20%), in exports (over 20%) and in the exports of the transport industry (over 40%).

In Hungary, used as an example of the social effects of the crisis, various major job cuts affected the subsidiaries of foreign MNEs over the six-month period of November 2008–April 2009. The export-oriented subsidiaries of the car, electronics and garment industries (e.g. Suzuki, Foxconn, Jabil Circuit, Linamar, Sanmina SCI, Levi's and Bosch), as well as the local market-oriented subsidiaries of foreign banks (Raiffeisen, Intesa Sanpaolo) were the most affected by downsizing. Compared to foreign subsidiaries, local firms engaged less in job cuts. Despite this generally negative picture, it is notable that the total size of

downsizing by subsidiaries remained relatively limited, especially compared to the generalized hike in unemployment, caused by layoffs in small and medium-sized enterprises. It does not mean, however, that the impact of plant closures would be negligible in terms of lost demand for local suppliers and lost purchasing power for employees, especially in smaller localities where the foreign subsidiary used to be a major source of employment.

As mentioned above, while FDI inflows are in general contracting, some subsidiaries are expanding their activities. By capitalising on their relative labour cost and tax advantages, as well as their proximity to consumer markets, certain new EU members have strengthened their attractiveness for such FDI. A case in point is the Czech subsidiary of Honeywell, which in December 2008 announced the expansion of its production of aircraft-engine components and the hiring of 400 additional engineers for its Czech R&D lab. As for shared services, new centres were opened in Hungary in 2009 (Vodafone, 3M, Alstom, Christian Dior). Similar developments can be observed in Poland: in February 2009, Unilever (Netherlands/United Kingdom) opened a global product development centre in Poznan, a first one of its kind in the region.

The FDI downturn has provoked a major policy challenge for governments worldwide, and in new EU members in particular. As FDI inflows are declining, some foreign MNEs are even divesting, people are losing their jobs at foreign subsidiaries, and fiscal revenues are dwindling, there is a pressure on host country governments to compete more efficiently and more aggressively for their part of a shrinking cake. All this has had to be done against the backdrop of a need for a macroeconomic "quick fix", adding to a temptation of recourse to protectionism and economic nationalism. However, effective and sustainable FDI policies require measures that avoid "beggar-thy-neighbour" solutions. In the context of investment promotion, the challenges are to find new sectoral priorities (for example, replacing the automotive industry), and new measures (including a rethinking of the system of subsidies which in the current form has been to little avail in stopping job losses). In the countries in transition in particular questions are raised if policies to attract FDI and benefit from it have been sufficient and the right ones from the point of view of desirable outcomes and resistance to crises. The uneven record of FDI and the negative effects of the crisis indicate that there is a need for a stronger link better investment promotion and industrial policy. The relationship between the quantity and the quality of FDI needs to be better understood, especially in the context of the crisis.

Focus on the existing subsidiaries in the time of global economic downturn may be a winning strategy. If in the current conditions it will become even harder to compete for new FDI projects, new investment may come from subsidiaries' reinvested earnings and expansion of operations, leading to investment multiplier and spillover effects in the national economy. In new EU member states in particular, the crisis should accelerate policies aimed at upgrading their production base to higher value-added activities, especially in the form of investment in knowledge and innovation, and support to R&D function of foreign subsidiaries.

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Note: The views in this analysis are those of the author and do not necessarily reflect the opinion of the United Nations.

**Table: Year-to-year changes in manufacturing output and exports, selected countries,
February 2009**

Country	Change in manufacturing output (%)	Change in manufacturing exports (%)	Change in the exports of transport equipment (%)
Bulgaria	-24.3	-39.2	-41.0 ^a
Czech Republic	-23.4	-22.2	...
Estonia	-32.7	-26.0	-54.0
Hungary	-26.1	-30.4	-48.1
Latvia	-24.3	-29.3	...
Lithuania	-17.9	-21.8	-31.9
Poland	...	-24.8	-25.7
Romania	-14.5	-15.9	...
Slovakia	-28.2	-31.0	...
Slovenia	-24.1	-25.1	-42.3 ^b

Source: Authors' calculation, based on national statistics.

^a Machinery and transport equipment.

^b January 2009.

Acquisition opportunities in adversity – but don't be late

By Risto Venermo

Under these days of significant financial uncertainty it is essential to balance the short-term, mostly operational goals and actions with the longer term, strategic objectives and activities. Entering into the emerging markets like Russia, or expanding the current operations, is much more attractive now than last year.

In Russia, the last quarter 2008 and two first quarters this year have been very weak, and GDP shows a significant drop. Despite of the strongly increased price of oil, the impact to real economy has been almost non-existing so far. Stock market, however, has had great performance in the last 6 months, with RTS almost the double from the beginning of this year, although still being at some 40 % of the last year peak. Some stocks, such as retail and oil&gas, are even pretty close to the pre-crisis level. Based on the stock market valuations, stock prices include very strong positive expectation for the next years, and seem to be somewhat optimistic considering the real economy right now, especially in the manufacturing industry and construction sector.

There has been rapid erosion in the Russian mergers and acquisitions (M&A) market since November 2008, even though 2008 and 2007 were exceptional years in many ways. The beginning of 2009 has seen a reduction of one third in the deal activity. This reduction is, however, significantly less than the comparative reduction at the mature markets in the Nordic countries or Western Europe. Clearly, transactions take place even in this crisis, but something has also changed.

First of all, now there are enterprises available for acquisitions. During the overheated M&A market, especially 2007-2008 when demand was well in excess of supply, this was not always the case, or asking prices for enterprises were very far from the buyers' views.

Secondly, the enterprise values have come down, as a consequence of two primary reasons. Sellers' expectations for future growth are now more realistic and reflect current real economy better than before. Companies' earnings have taken downturn, something sellers' had difficult to foresee in the overheated M&A market. Also the multiples have come down, although not aggressively in general, reflecting more targets for sale and fewer buyers. This equation makes the current situation commercially much more attractive than a year ago.

One of the primary questions is the recovery of the overall market. Given the nature of Russian industry and vast energy and commodity resources I believe this is more of a timing issue than "will recover/will not recover" – issue. Considering the long term supply/demand balance of key energy and mining commodities it is very likely that we will see higher prices already in the nearby months.

Current oil prices, well above 60 USD per barrel, implicate fast upswing of the Russian economy, and if sustained, accelerate growth over the longer period of time. These developments towards higher price levels are supported by long-term megatrends. Consequently, the price rises will generate wealth to Russian marketplace, to business and people.

The timing issue is essential since year 2009 seems to represent an unparalleled opportunity in some markets to

make acquisitions at modest enterprise valuations and to win market share ahead of weaker competitors. History shows that downturn mergers generate more value than boom-time mergers, and as the first half of the year has already passed by, you may want to look at the autumn period very carefully. Most probably we will see buying of undervalued assets by industrial groups. Also private equity houses have returned to the marketplace, although in the non-leveraged manner due to high cost of borrowed capital. Most likely there are going to be disposals of distressed assets, and transfers of debtors' assets under the creditors' management. All in all, being in the transaction deal flow right now is critical in order to succeed in the M&A –driven strategy and tactics. And yes, successful integration does take time.

Geographically, and important to Finns, the close proximity of Finland provides a strategic advantage for Finnish enterprises, especially in those sectors where products need to be physically transported (such as heavy industries). For those rapidly scaling businesses like software or internet services faster-growing Asian markets may be more attractive to enter in the first place.

The risks of the emerging markets are higher than in the mature markets. Russia is nowadays more dependent of the overall recovery of the global economy, and this will even more highlight the importance of the right timing. Western companies are reporting an improving environment; at least a more predictable one and macroeconomic indicators are gradually getting better.

These higher risks will require prudent business management and tight corporate control. Unfortunately bad times have also a tendency to increase corporate fraud and dishonesty, demanding even higher quality controlling activities.

Such crisis we are facing now can be also a great opportunity to implement new rules and procedures. Given the scope of protectionist actions taken by the governments, it was expected that also Russia will join the pack, and that the general burden of bureaucracy will remain. This combined with the higher risk and the cost of controlling must be compensated by the higher returns from an investment to the Russian marketplace.

The timing issue culminates to the question - can you make acquisitions when the enterprises are priced at the lowest? As a business strategy, I do not think so. Therefore, those of you pursuing expansion at the Russian marketplace don't be late.

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Reliable intelligence and due diligence are keys to success in turbulent M&A market in Russia

By Ville Korpela

The Russian mergers and acquisitions (M&A) market was valued at US\$120 billion in 2008, just 9% below the figure for 2007, according to Ernst & Young's sixth annual overview of the Russian M&A market. The financial crisis which developed in the fall of 2008 brought drastic change to the M&A market. However, thanks to a very active market in the first six months of the year, the value of total transactions did not fall significantly.

The crisis in the Russian economy resulted in reduced general activity in the Russian M&A market: since the last quarter of 2008 many companies have revised and cut back their investment programs; the number of uncompleted deals has grown and the government has played an increased role in the Russian M&A market.

With the financial crisis raging, many Russian companies are also facing financial crises internally. For some, finding a strategic investor might be the only way to stay afloat. For those who have avoided the worst of the crisis and have the means, however, now can be a great time to become a strategic investor or even purchase competing companies while market prices are down. In either case, properly evaluating the target company for purchase or investment with a financial due diligence investigation is an obvious and crucial first step to make. The bookkeeping and administrative information must be checked against reality, starting with the company's financials and paying close attention to the tax load and potential tax risks.

Due Diligence is a thorough procedure for inspecting company and business activities. The goal of such is to verify that the information provided by the company is clear, accurate, and complete; it is a comprehensive assessment of the information's reliability. Although such a professional investigation cannot eliminate all risks associated with business and investment, it can help significantly reduce them.

A typical due diligence check includes the research of criminal records, civil-court judgments, law-enforcement investigations, business reputation, relations with partners and litigation. Usually buyers and strategic investors are keen to ensure that there is nothing in the target company's history which, if uncovered at a later date, might affect their reputation and consequent valuation.

Special attention should be also paid to understanding the characteristics of Russian companies and how they differ from their Western counterparts. One should however still bear in mind that Russia remains a nation with high levels of fraud and corruption, despite recent efforts to increase transparency. It pays to know the right people, especially in Russia.

Characteristics of Russian companies help one to understand the corporate and emerging market environment compared to more developed markets. One difference compared to Western economies is that many companies are owned and managed by the same people. Another difference is that the legal environment is not yet fully developed and is often inconsistently applied, contributing to instability and lack of transparency in the market.

Precautions are all the more important where there is a lack of transparency. For the growing number of foreign companies and investors operating in the region, unfamiliarity with the business environment makes it much harder to even identify the threats, let alone evade them. The key to success in Russian M&A process is to know the right people and have the right partners. Russia is still largely a market in which personal networks of contacts matter and where it is sometimes necessary to resort to this informal network to get valuable as well as reliable information and intelligence on potential business partners, as well as on potential future clients. Referrals and social capital are important, as they are the key tools, which can help to minimize risks related to uncertainty of the Russian market.

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Role of young people from Baltic Sea Region in rising its potential

By Joanna Grudzińska

Nowadays, all European citizens have to know that only stronger regions, nations and macro regions can guarantee more powerful position of the whole European Union. As the latest news regarding the condition of global economy and demographic trends are quite alarming, we all should think of closer cooperation, starting at a very local level. Seeking for factors, values, things that we have in common is in these hard times absolutely relevant.

European Union is facing many difficulties that were caused by the economic crisis. There is only one way to win—policies concentrated on a close cooperation within the regions. Estonia, Latvia, Lithuania, Sweden, Denmark, Finland, Germany, Poland and western part of Russia have something in common—obviously it is Baltic Sea. This fact is believed to be a factor, which binds all these countries and develops relations between them. But who is going to implement all the ideas in the future? Of course this is a challenge for young people. There is a huge potential in citizens from Baltic Sea Region that needs further development, providing relevant educational possibilities and equal chances for all of them.

Using creativity, cross-cultural approach, international experiences, multilingual skills and knowledge of young people from mentioned region can significantly increase the importance of Baltic countries in European Union. The activities should be concentrated on different fields. The main one is: focus on environmental issues, this should be a first step in all what we will entrepreneur. To live, work and develop ourselves in a clean place should be our priority. We need to be convinced that minimizing pollution, increasing the popularity of alternative sources of energy and making sure all eco-friendly ideas are treated by the governments and the citizens with the highest attention. Young representatives from Baltic Sea Region countries should first of all exchange experiences among each other and implement most successful solutions in their own countries.

Another issue which is enormously important is active participation of youth in each Baltic country public life. Young people have a very important advantage: their way of thinking is just fresh, in most of the cases they do not have any barriers in their minds. They are not involved in some years lasting conflicts. Such an open minded behavior enables crossing so many borders. There is a really significant number of things which need to be improved, so many standards which need to be fulfilled. Still big discrepancies in economic growth, employment, standard of living are observed between countries from the Baltic Sea Region. Here is the challenge for youth—minimizing those discrepancies and maximizing all the possible positive changes. Countries which are less developed have some very good examples in Scandinavia and Germany. Exchanging information and solidarity between countries is always a good way to achieve success. The mobility which was given to countries that joined EU, provided them with the better mobility. It enabled them traveling for jobs, studying and tourism in an easier way. Now learning from others is much less complicated and young generation should definitely take advantage from it. Things that were totally not possible even for their parents are now normal for them.

The Baltic Sea Region is a quite differentiated macro region in European Union. The variety of languages, habits, landscapes may sometimes cause problems. But especially young people with their spirit and creative approach should focus on turning this threat into an opportunity. It is worth remembering that power of this region is hidden in its differentiation.

This way of thinking has a brilliant future ahead. Young people from Baltic Sea Countries need to know that promoting this variety in and outside European Union will bring them enormous

outcomes in the coming time. It is a task for youth to transform a critical economic situation into a chance and something positive for the future. Our region needs constant improvement. If we want to be competitive we need to think and act twice faster than the others. This approach will enhance the position of the region but also whole EU. There is an outstanding potential in the citizens from Baltic countries, we have good researchers, scientists, businessmen. Their knowledge should be used as often as possible to attract and encourage people from all over the world to invest and spend their time in our region.

However, the idea of cooperation between young people from all Baltic countries is not possible without their interest and will to do something additional. Nowadays, youth not always is really involved in ongoing processes between countries. There is no doubt that our region needs their participation in them. It is an obvious thing all over the world, that without involvement of new generations further development in all the areas is stopped. That is why our aim should be to motivate youth to take active part in public life. How to do it? This is a question that needs to be answered in all Baltic Sea countries. Young people from that region have different past, often different standard of living and different views. But it is believed that the way to achieve consensus is much easier than in case of more mature generations. In many cases also the situation in their country is the factor that shapes their plans and perspectives for the future. This is something which should not take place. All children, teenagers should have equal chances to build their lives how they want it. This should be the aim of European Union and also our region, where as mentioned the discrepancies between the countries in standard of living are still quite high. Young people should know that by participating in public life will have a positive influence on their life, they can decide about the important issues in their country and in whole Europe.

At the beginning of June we had elections to European Parliament. The attendance of the citizens was in most of the countries below the expectations (in Poland: 24,53 %). This is something that we should be embarrassed about. As a candidate of the Democratic Party (in the last elections to the EP), a representative of the young generation, I was observing the awareness of people around my age. Unfortunately I have to say that it is too low. Still a significant part of youth doesn't know the competences and meaning of European Parliament. They do not see the point in voting and to run for Parliament themselves. This situation definitely needs improvement. More education and information on EU issues and more evidences that we all can create our common wealth are required. Actions are necessary especially in these of the Baltic Sea countries, which joined EU 5 years ago. If our citizens are more aware of their rights and influence that their choices may have, then the development of the whole region will be more possible.

Once again, do not forget about these who really are the future of our region. Baltic Sea Region young citizens need just more attention and encouragement to be a part of the current public life. They can work a better future for all of us!

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So far (away), so good – when peripheral communities lead the way

By Silvia Magnoni

Energy security issues have become increasingly important in national and international political agendas and energy concerns have been significantly shaping policy efforts in the Baltic Sea Region-BSR. Not only because the intrinsic nature of energy and environmental problems requires these to be tackled with effective regional collaborations, but also because in the field of cleantech many companies in the region can play a top role in international competitive markets. The stability of energy supply is certainly of utmost concern for large urban centres, where the density of industrial, commercial and residential agglomerates requires constant energetic procurement. It is also of particular significance for peripheral and rural communities, which are by nature located at a certain distance from the main energy sources of national supply. There are many of these remote communities in the BSR, which are currently facing various challenges posed by a more globalised world: distance from main economic activities, low employment rates, emigration, and the need for reliable access to national energy sources.

These socio-economic and environmental challenges have induced many peripheral communities to activate themselves to work on the development of sustainable strategies for generating long-term prosperity in the local context. A discreet number of EU-financed projects and Baltic Sea regional collaborations focusing on sustainability in peripheral areas show the overall direction certain BSR rural communities have taken in their political agendas, with energy issues being a gradually more important topic of discussion. Through the creation of Sustainable Energy Action Plans and the effective employment of local natural resources as a basis for the production of renewable energy, peripheral areas are trying the road of revitalisation and are positioning themselves as re-born localities with a newly discovered “good and green” quality of life.

Among these rural communities stands the Danish isle of Lolland, a 1243 sq. km island in the southern part of Denmark. Due to its historical heritage –Lolland was for centuries the retreat of aristocratic families who here owned vast agricultural properties- the island is commonly perceived as a peripheral and rural community, even if its distance from the capital Copenhagen is just 150 km, and bridges and tunnels guarantee for constant transport connections. With 70.000 people living on the island and the absence of any substantial towns, Lolland has nonetheless a remarkable track record: it has one of the world’s highest figures of renewable energy production per capita. The island produces 50% more renewable energy than the local power consumption, with wind, agricultural waste and other biomass products accounting for the total electricity production. The total consumption of electricity on the island of Lolland is therefore CO2 neutral and more than 70% of heat generation is from renewable energy sources, mainly biomass and biogas. These astonishing numbers assume ever more significance if put in the context of the specific socio-economic development achieved by Lolland in the past decades. Twenty years ago the island suffered from a strong economic recession that caused the closure of many businesses on Lolland, including the main shipyard that was responsible for the employment of a good number of the local active population. This event provoked a distort vicious circle of poverty, brain drain and unemployment (17%!). In an area where there were no high-value local resources, but abundant availability of agricultural land, the recovery strategy identified by the municipalities on Lolland was precisely based on this important local asset - land. Land availability meant the possibility of planning and developing infrastructure without constant restrictions, and this could be used to attract private companies on the area, to whom Lolland would

offer appropriate logistics and land management in line with their business requirements. Lolland wanted specifically to focus on “green business”, those that would guarantee a more sustainable economic and social growth at local level. Over the years, this strategy has proved to be a winning solution to social poverty with the favouring of local business development.

In 2007 Lolland Municipality revised its goals with a more specific political approach: Lolland CTF- Community Testing Facilities. This represents the Municipality’s leading industrial commitment and entails the transformation of the island into an international platform for full-scale testing and demonstration of renewable energy technologies/products in real communities. Under this public framework, Lolland has now a notable number of energy demonstration sites (wind, biomass, hydrogen, water management, biotechnology), each of them being developed according to the EU-appraised Triple Helix spiral of innovation, which requires the involvement of close synergies between academic, industrial and public actors. To turn around Lolland’s rural position without a university, such a hands-on research platform can also be used for various training and research programmes as an alternative (and complementation) to traditional classrooms. As a consequence of such a strategy, Lolland has not only been able to experience economic regeneration at local level and notably reduce its unemployment rate (now 4%), but with its remarkable achievements in terms of advanced research for renewable energy generation, Lolland has also contributed to the development of a specific model of national and regional energy relations, where rural and peripheral communities become the “green lungs” for the generation of important renewable energy amounts that are then distributed to urban areas. This approach, called “Growth beyond Metropolises” is based on the assumption that remote areas generally have an availability of land and natural resources, which represent critical elements for the infrastructure and the basis for a local renewable energy sector. With an appropriate integration of the energy grid at both national and regional level, peripheral communities can therefore become the clean energy providers of urban areas, transferring their surplus renewable energy to those areas and cities where the creation of a renewable energy cluster would require much a more substantial structural change. This concept can be of mutual benefit to metropolis and peripheral areas, and represents an important factor in the effort to find satisfactory BSR cross-border collaborations in energy markets. Lolland is already working in this direction, and facts (and numbers) have proven that the interaction of urban and rural areas can be sustainably fruitful. So far (away), so good.

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Human migration to and in the Baltic Rim – past, present and future

By Arno Tanner

Past: the Baltic Rim transformed from emigration to immigration region

From the early 1800s until the 1960s, the Baltic Rim was more an area of origin than of destination for human migration. Particularly in the late 19th century and early 20th century, a proportionally large amount (2-10%) of the entire Baltic Rim population left for the United States, Canada, Australia and New Zealand.

Slowly after the Second World War, however, the tide began to turn. The first Baltic Rim countries to become net immigration countries were Germany and Sweden, which started to admit guest workers, particularly from Turkey and Yugoslavia. Slightly later, Norway and Denmark increased their intake of guest workers, with Finland joining in as a clear-cut net immigration country only in the 1990s. The eastern part of the Baltic Rim (a swath from Poland to Russia) have been sending migrants up to the present day while at the same time receiving refugees, particularly from the east and southeast.

Pre-recession, early 2000s

In the early 2000s, prior to the global economic downturn, the situation was such that the western part of the Baltic Rim (Nordic countries and Germany) was receiving refugees to a moderate degree. There was a demand for even more economic migrants, but stiff labour immigration legislation meant that there was no major peak in the number of labour immigrants. The eastern part of the Baltic Rim (Poland to Russia) was also receiving refugees and illegal migrants, while skilled economic migration to these countries has from the outset been less, and these countries have rather encountered an enlarged return of their brain drain.

Present: Global parameters of the economic recession and Baltic Rim migration

The economic downturn has caused a drop in the need for certain kinds of labour, particularly on the skilled side of the labour spectrum. Unskilled labour has also been less in demand, due to the shrinking labour market and a more available domestic labour force.

In general, economic migration has decreased and is expected to further decrease, due to the economic downturn. However, certain service sectors, such as nursing and elderly care, are less affected around the Baltic Rim, where the population is growing older. In addition to these sectors, illegal migration might increase, as an indication of poverty and misery escapism.

As concerns forced migration, whether economic or humanitarian, this will presumably continue in the form of illegal migration and refugees. There may even be an increase, due to the turbulent political and human rights situation that ensues in the world presently, due to less resources and work.

In all, labour migration is today decreasing, due to lack of demand and probably also due to a tightening of national labour policies, which reflects the decreased demand. Simultaneously, forced economic and humanitarian migration is increasing, and causing further refugee and illegal migrant streams.

Present: Where does Baltic Rim migration originate?

Let us first look at the source countries for Baltic Rim migration, both from without and from within the region. The main streams of migration **from without** the Baltic

Rim are the following: To Russia, the main immigrant flows come from the former USSR republics, particularly from the Caucasus and Central Asia. Migrants are typically unskilled or semi-skilled irregular migrants. To the Baltic States, the migrant streams are small, either remnants of the migrant streams to Russia, or then Russians or Ukrainians, with some Belarusians to Lithuania. Very small refugee flows come from other parts of the world. Migration to Poland is similar to that to the Baltic States, though in a somewhat more populated fashion. There are both labor and humanitarian immigrants in Poland, from further Eastern Europe.

Germany receives family-related Turkish and ex-Yugoslavian migration, whereas labor immigration to Germany has decreased, as has asylum-seeking, due to the rather strict norms. Denmark and Sweden get labor immigrants and refugees from all over the world, but admit very few. Finland gets refugees particularly from Iraq, Somalia and Afghanistan, and there are still, even amidst the economic downturn, many Estonian seasonal laborers in the country.

As for **internal flows of migration** within the Baltic Rim, most go from Russia, the Baltic States and Poland to Germany. For decades there has been a strong flow of Poles into Sweden and, during the past 10 years, Estonian seasonal workers into Finland. Within the Baltic Rim, the east has generally been the sending region, and the north and west the receiving regions.

Present: How do the Baltic Rim countries react to this supply of migrants?

As for the policies forming and reacting to this migrant pool, the Baltic Rim countries can be categorized into three basic clusters:

The tight controllers: Sweden, Denmark and Germany have tighter immigration criteria, and their immigration volumes continue to be relatively suspended compared to their situation 20 years ago, although there is constant labour supply for these countries.

The aging humanitarians: Finland, although the least traditional "immigration country", is receiving relatively more humanitarian immigrant applicants due to temporarily lighter asylum practices. Finland also has the most rapidly aging population, which will probably maintain the need for some foreign labour in care and certain services.

The capitalist binge survivors: Russia, the Baltic States and Poland have lived through their first modern capitalist saga, which after 20 years has now come to a temporary end. During this phase, immigrants cannot be said to have been deliberately, systematically recruited nor integrated into these societies. Although immigration policies have been brought up to European standards, the true conditions of both labour immigrants and refugees are not on par with those of the best integrated immigrants in the Western Rim. Illegal migration continues to exist, and the living conditions of such migrants are typically harsh.

The future?

What will migration to and within the Baltic Rim look like if the economic downturn deepens? What about the situation

afterwards? If there is a deeper dive, legal labor immigration will shrink further while the volume of humanitarian migration will continue unabated due to the humanitarian and political crises caused by the global slump. Refugees may apply to Russia or continue to the European Union. In the EU, Poland and Finland will then be the first in line. It will then be up to the moral values of these countries to decide which applicants will be admitted.

In time, the economic downturn will come to an end. Presumably the healthy businesses will be the ones still standing, particularly those that have to do with nursing the elderly. Immigration to these sectors will be the first to recover. Other labor immigration will take longer to re-emerge, as there will be public reservations about further immigration. Even after the recession, humanitarian immigration levels to the Baltic Rim will remain high, on account of new international conflicts triggered by the economic downturn

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Poland's trade in the BSR after the EU enlargement

By Anna B. Kisiel-Łowczyc

The rapid growth of Polish trade since the 1990s has been the effect of the economic and political transition, preparations for EU accession and the globalising activities of TNCs. The growing openness of Polish economy, measured as trade-to-GDP relation (51.8% in 2001 and 81.5% in 2006), has contributed to higher pace of transition, more FDIs and a narrower gap between Poland and the EU-15. Trade grew rapidly in value terms (Table 2), although this growth was uneven – periodically and geographically.

The rapid growth of exports (mostly to EU) in 2001-2003 was coupled with gradual decrease in the balance of payments deficit. This positive trend was reversed in 2006, due to a significant rise in the trade deficit with China and Russia. Between 1992 and 2008, there was a continual decrease in the share of BSR countries in Polish total exports, from 56% in 1992 to 45% in 2004, and to 40 per cent in 2008. This is partly due to the changing trade streams and partly to globalisation (in-coming FDIs, among others).

Polish imports from BSR countries between 1992 and 2008, partly stimulated by FDIs, increased in absolute value terms in line with the growth in total imports, and faster than exports. The aggregated long-term net effect, i.e., the difference between exports generated by a given investment and the imports it requires, amounts to 0.8 bn euro per each billion euro invested, according to the National Bank of Poland (NBP). The relative share of Poland's Baltic imports showed a downward trend throughout the period (52% of Polish imports in 1992 came from the BSR, 40% in 2004 and 37% in 2008, respectively).

Germany has been our largest trade partner, not only within the BSR, both for exports and imports (25% of the total). Another important partner in the BSR is Sweden, with whom the trade is balanced. The role of Russia has been growing since 2005, in our imports (expensive energy resources) and exports (food). Denmark ranks fourth, with balanced trade. Polish trade with Finland is at the same level as with Norway, with much higher imports than exports. Trade with Lithuania, Latvia and Estonia accounts for less than 1 per cent of Polish foreign trade.

The following trade clusters, showing the strongest bilateral economic and trade ties, can be observed in the BSR: Finland – Estonia, Poland – Germany, Denmark – Sweden. Trade is most balanced in the central part of the BSR, between Germany, Poland and Sweden.

The commodity pattern of Polish trade in the BSR is marked by complementarity in bilateral relations and the adjustment of the import demand structure (including the TNCs) to the pace at which Poland's export supply is adjusted. This is a long and difficult process in view of the changes in the highly competitive Nordic economies and their parallel capital ties with the Baltic transition economies. This is how the pattern of trade has been changing as the growing demand for consumer goods in the more affluent Baltic societies is diversified and supplemented with complementary services.

A characteristic feature of Poland's commodity pattern in its trade with BSR countries is the nearly balanced proportion of electroengineering: ca. 38% in export and 31% in import, which is higher than the global figure for Poland. There are, however, geographical variations within the BSR; bilaterally, Polish trade in this commodity type is most balanced with Sweden, Denmark, Finland and Germany, while the imbalance is the greatest with Russia (36% in export and 1.2% in import). Another important item on Poland's trade list with the BSR are minerals (mostly fuels). Here, the geographical asymmetry is greater in the BSR than globally (22% in imports and ca. 4% in exports). 75 per cent of our imports come from Russia, while our exports to Russia are only 0.6%; the respective figures for Norway are 26.1% and 5.5%, and for Lithuania 24.2% and 3%.

Another commodity group for which exports are nearly balanced with imports are chemicals – 11.2% in export to the BSR and ca. 15% in import. In this case, there are also significant bilateral differences. Our exports to Russia stand at 21%, while imports at 3.3% only. Similarly, chemicals account for 19.9% of our exports to Latvia, but only for 3.3% of imports; the respective figures in Polish trade with Estonia are 21.7% and 5%. Polish imports are higher than exports in bilateral trade with Germany

(10% in export and 19.2% in import), Sweden (6.7% vs. 16%) and Denmark (7% vs. 16.2%), respectively.

Light industry articles have a minor share in trade between Poland and the BSR – 5-7 per cent, with exports slightly higher than imports.

The general description of trade between Poland and BSR nations would be incomplete if the special role of Denmark in Polish trade in food articles (meat and meat products) were not mentioned. This commodity group accounts for 13.2% of Polish exports to Denmark and 24.1% of Danish imports from Poland. The same applies to the trade in wood, pulp and paper between Poland and Finland, with Polish imports accounting for 21.2% of the total, and exports for 5.4% respectively.

Five years after the latest EU enlargement, we see increase in trade and economic analyses of liberalisation of trade between Poland and the EU countries of the BSR show moderate integration effects at the time of the economic slow-down in EU member states and the global crisis.

Conditions (external and internal) affecting Polish foreign trade had seriously deteriorated by the end of 2007, especially in export. Externally, the most relevant is the economic growth rate, which in the developed world went down from 5.0% in 2006 to 4.9% in 2007 (the USA have experienced a 6.1% drop in their GDP and a 3.9% rise in inflation for the 1st quarter of 2009).

The optimism of Polish economic forecasts, speaking about "the resistance of the economy based on solid growth foundations" to the negative impact of the recession shock in the global economy (USA, EU, energy markets), seems inconsistent with Poland's economic performance and macro-indicators for the 1st quarter of 2009. The latter suggest that the crisis will come to Poland, but with a time lag of 12-18 months. Because of this, the defence mechanisms will be activated later and economic policy decisions will be more difficult.

Anna B. Kisiel-Łowczyc

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Table 1: Share of BSR countries in Polish trade between 2000 and 2008 (%)

Country		2000	2008
Denmark	imports	1,6	1,4
	exports	2,7	2,0
Estonia	imports	0,1	0,05
	exports	0,3	0,4
Finland	imports	1,8	1,5
	exports	0,7	0,8
Lithuania	imports	0,6	0,4
	exports	1,8	1,4
Latvia	imports	0,1	0,1
	exports	0,7	0,6
Germany	imports	23,7	27,0
	exports	34,9	21,0
Norway	imports	0,8	0,6
	exports	1,1	1,7
Russia	imports	9,4	10,5
	exports	2,7	3,5
Sweden	imports	2,9	2,05
	exports	2,7	3,1
Σ BSR	imports	41	37
	exports	47	40

Source: GUS yearbook, Warsaw, 2009

Table 2: Baltic trade as percentage of Poland's total in 1992 – 2008 (USD million, %)

Year	EXPORTs			IMPORTs		
	Global (USD million)	Baltic exports (USD million)	Baltic exports % of the total	Global (USD million)	Baltic imports (USD million)	Baltic imports % of the total
1	2	3	4	5	6	7
1992	13 186	7 346	56	15 204	7 969	52
1993	14 143	7 460	53	18 834	8 872	47
1994	17 239	8 861	51	21 569	9 668	45
1995	22 895	9 517	41	29 050	13 111	45
1996	24 440	11 505	47	37 137	13 575	37
1997	25 751	13 062	51	42 307	16 271	38
1998	28 228	14 448	51	47 053	18 461	39
1999	27 407	13 469	49	45 911	18 065	39
2000	31 644	15 046	47	48 940	20 150	41
2001	36 050	17 187	48	50 268	20 392	41
2002	40 986	18 195	44	55 069	22 020	40
2003	53 565	25 333	47	67 958	27 220	40
2004	73 792	33 057	45	87 909	35 297	40
2005	89 347	38 549	43	100 904	46 996	47
2006	110 180	46 307	42	126 121	57 551	46
2007	139 055	57 144	41	163 031	72 912	45
2008	169 536	67 814	40	206 075	76 248	37

Source: IMF Directions of Trade Statistics for 1992–2008

Table 3: Polish trade within BSR by commodity type in 2000 – 2007 (%)

No.	Section (SITC Rev. 4)	2000		2005		2006		2007	
		Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
1	Food and live animals	5.2	7.5	5.3	8.8	5.0	8.5	5.3	8.4
2	Beverages and tobacco	0.4	0.4	0.5	0.6	0.5	0.7	0.6	0.8
3	Crude materials, inedible, except fuels	3.3	2.8	3.0	2.2	3.0	2.3	3.0	2.4
4	Mineral fuels, lubricants and related materials	10.8	5.1	11.5	5.3	10.4	4.5	10.0	3.8
5	Animal and vegetable oils, fats and waxes	0.7	0.1	0.4	0.2	0.3	0.3	0.3	0.2
6	Chemicals and related products	14.0	6.8	14.2	6.8	13.5	7.1	14.1	7.3
7	Manufactured goods classified chiefly by material	20.0	24.8	20.7	22.6	20.8	23.2	22.2	23.3
8	Machinery and transport equipment	37.0	34.2	35.9	39.0	35.9	40.2	35.7	40.8
9	Miscellaneous manufactured articles	8.6	18.3	8.5	14.5	10.6	13.4	8.6	13.0
		100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: GUS yearbook, Warsaw, 2009

The benefit of library and information services to the competitiveness of a university

By Ulla Nygrén

Library and information services play an important role in the support of the core processes of their framework organisations. As far as university libraries are concerned, this means that they should invest in promoting the highest education and research, and assist universities in the implementation of their societal function. This is a fascinating and challenging mission! The challenges will increase when, on 1 January 2010, a new Universities Act comes into force in Finland, which will change the legal and financial position of universities. The new legal position will give universities greater financial independence than before. It may well be expected that, as a result of these changes, the assessment of activities that support the basic function of universities will in future be approached using models employed in the world of business: in addition to financial starting points, the benefit gained from a unit or function will be emphasised in order to achieve the objectives of the organisation.

In this new situation, the library must also be able to justify its significance in the success of the framework organisation. Why is a library needed? Why should a university direct resources towards its operation? In order to be able to answer these questions, a library must find the means to assess and adapt to the university's key objectives in relation to its activities. One such way is the use of a customer satisfaction survey.

From a point of view of interest groups, a library is primarily a service department: its significance is born of the service it provides. In order to succeed as a service provider, the same principles apply to a library as to other service sectors, be it a question of a company or a non-profit organisation: the services must be produced in a customer-friendly and cost-efficient manner. In the world of business, different customer surveys have long been used as tools in the development of customer-friendly services, and these surveys have also been useful in the overall examination of activities. Customer surveys have also become more common in libraries: The use of LibQUAL, developed in the USA, has now spread internationally. The library information service of the Turku School of Economics carried out a LibQUAL customer satisfaction survey in spring 2008. The survey was part of the library's own quality evaluation aimed at improving functions. Its aim was to investigate which areas of service show significant differences between the service level that the customer experiences and that which he/she would wish for. The results are analysed in a forthcoming Master's thesis written for the Department of Marketing at the Turku School of Economics. This thesis also compares customer satisfaction amongst other Nordic business schools that had carried out the same survey. The result of the comparison was pleasing for the Turku School

of Economics: the customers of its library are the most satisfied in the Nordic countries! This good result does not, however, obscure the fact that customer satisfaction is sensitive to change and must be monitored and developed as a continuous process.

The strengths of a customer satisfaction survey are that it shows which library services and activities require improvement from a customer point of view. When applying the results of the survey to the development of activities, it is important, however, to take into account the analysis of targets of development from a point of view of the objectives of the framework organisation. If the objective of the university is internationally significant research in selected fields, the library must find the best ways to support it through its own services. In the development of the library, there must also be readiness for proactive reaction: services should be flexibly adaptable to the needs of a developing research environment.

The universities of the future will stress the attractiveness and competitiveness of the scientific and student communities. As far as the future of library and information services is concerned, the key question is to what extent they can demonstrate that they really are promoting the strategic objectives of the university. Libraries have always been and remain treasure troves of information: they acquire and bring for their customers, either electronically or in printed form, most of the scientific information available in our country. In an information-intensive society, this, if anything, is a competitive advantage. If a library has the means strategically to distinguish what is fundamental, the ability to concentrate on it and the skill to take care of the economic efficiency of its operations, it also has every chance to be a key factor in a university moving towards something new.

Ulla Nygrén

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A strategic partnership with Russia remains our goal

By Jan Fischer

One need not spend a long time proving that the history of Europe inseparably blends with the history of Russia. The economic and cultural interconnectedness of both great civilizations is no less intensive and close now than it has been in the past. Due to factors of common history and mutual economic-security reliance, there is no reasonable alternative to the building of a strategic partnership between the European Union and the Russian Federation. It must, of course, be founded on mutual respect, common interests and an acknowledgement of universal values and the norms of international law. Various EU countries may have various bilateral experiences with Russia – just as they have them among each other – but the EU as a whole must not allow its talks to be controlled by historic resentments or the particular interests of individual members. Russia's territorial expanse, geographic proximity and international importance are simply too large for Europe to ignore. It is therefore only natural to jointly endeavour for strong, mutually advantageous and well-structured relations.

Of course all 27 EU member states are endeavouring for such relations with Russia in the framework of numerous international organisations: The UN, OSCE and Council of Europe. Their bilateral cooperation with the Russian Federation may also be more or less fruitful. But the political weight of even the largest European players will always be only a fraction of the total weight of the European Union – one of the most important and largest communities in the world. Perhaps in no other place has the need for a common European foreign, security and energy policy been shown as urgently and visibly as in the search for a *modus vivendi* with Russia. Recent experiences also suggest that in talks with the Russian Federation, the EU can be successful only insofar as it speaks with one voice. Any fragmenting of the EU-27's position worsens chances for a permanently good and correct relationship with Russia, and consequently decreases the chances of positively influencing its direction.

The EU has long endeavoured for a united position toward the Russian Federation. In 1994, the then EU-15 signed the Partnership and Co-operation Agreement (PCA), which created the basic legal framework for relations with Russia. After its ratification in 1997, its validity was set for 10 years with an automatic one-year extension every year unless one of the parties withdraws. On the basis of this agreement, an EU-Russia summit is held twice a year, and the Permanent Co-operation Council also functions. The agreement includes political dialogue, cooperation in economic areas, justice, interior and culture, and also in financial-technical cooperation. At the present time, the Agreement is the subject of renegotiations that are far from easy. In negotiations on new forms of strategic partnership, decreasing the frequency of summits and other incremental changes are being considered, which should correspond better to the situation on the continent today. Both sides of the partnership find themselves in a completely different situation than in the period from 1992 to 1994 when the agreement was signed. At that time, Russia was going through the initial phases of a deep systemic transformation. Its economic, societal and constitutional rebirth objectively influenced its economic and political potential. At that time, the EU only had 15 member states. Enlargement to include the states of Central and Eastern Europe not only brought it territorially closer to Russia, but also brought a new dimension to relations. The prepared agreement should bring these relations to a corresponding level.

In the past, the EU and the Russian Federation have successfully found common denominators which enabled them to utilise the enormous potential of bilaterally advantageous cooperation. The concept of building the Four Common Spaces for cooperation was approved at the St. Petersburg summit in 2003:

- a/ The common economic space
- b/ The common space of freedom, security and justice
- c/ The common space of external security
- d/ The common space of science and research, education and culture.

The gas crisis in January 2009 showed the foresight of signing additional sector agreements on establishing a so-called "energy dialogue." In accordance with an agreement from 2000, an expert panel meets for regular talks to assess new investments into infrastructure, trade issues and energy efficiency. Energy raw materials policy is a very important part of Russian foreign policy, and issues of energy security are again a vitally important interest of the EU. EU member states import a total of 30 % of their oil needs from Russia. Half of all European natural gas imports come from Russia. January's interruption in natural gas deliveries demonstrated with all clarity the degree to which certain EU members are dependent on imports of this raw material from Russia. On the other hand, the European common market is the largest in the world, and it is therefore in the interest of the Russian Federation to maintain good business relations, part of which also includes strict adherence to the supplier commitments that have been negotiated.

Today, Russia is the EU's third-largest partner. On the other hand, the EU is the main source of foreign investment – making up three-quarters of all foreign investment in Russia. This mutual economic reliance and interconnectedness is complemented by no less important common interests in the area of global security, the fight against terrorism, alleviating climate change and migration.

Improving relations with Europe also has a truly crucial importance for Russia, and not only because it can learn about the functioning of social mechanisms and the technologies of state administration. The European Union is made up of a large number of subjects with an unequal level of economic development, and it has decent experience in levelling out regional differences under conditions of stiff international competition. A European orientation not only does not threaten Russia's civilisational independence, but is on the contrary its guarantee and insurance policy. The Judeo-Christian values which lie at the foundations of European civilisation are also markedly organic for Russia. Despite all of its integration, the continent remains a Europe of homelands, a Europe of civil societies that are markedly tolerant of every independence. Many events on a global scale call directly for Euro-Atlantic/Russian cooperation for reasons that do not need to be expanded upon here. A clearly declared European orientation for Russia, confirmed by practice, would take the wind out of the sails of those who would like to dig a ditch between Russia and Europe, making an intentional line marking Europe's edge on the eastern borders of the Baltic states and Ukraine. History itself is the last instance in the resolution of issues of civilisational borders. It is also worth it for the West to fight for the European component of Russia's identity. It will require a wide and structured dialogue which includes both the aforementioned areas of common interest, as well as potential points of dispute. The goal remains to reach a permanent strategic partnership founded on mutual respect. The road to this goal may be thorny, but the Czech EU presidency is of the opinion that it is the only reasonable road worth taking.

Jan Fischer

Prime Minister

The Czech Republic



The Baltic Sea is to remain a safe and attractive place

By Astrid Thors

On the World Environment Day, the 5th of June, the Government of Finland introduced a white paper on our policy on the Baltic Sea. The aim of our white paper is to ensure that the Baltic Sea is a safe and attractive place. – Ahead of us is a huge challenge – knowing that the Baltic Sea is the most polluted sea in Europe, but also taking into account the implications of the financial crisis in the Baltic Sea states.

Not long ago the countries in this area were considered to be Europe's economic tigers and our economic growth and competitiveness was one of the best on the continent. Open economies with a well-educated population were magnets for foreign direct investment.

Unfortunately the picture is not the same at the moment; but that must not make us lose sight of what must be the long term perspective. That must be, among other things, to improve our innovation capacity. Competitiveness through lower wages is not a long-term solution.

Increased use of the Internal Market and of other European instruments will also in the future be paramount to the prosperity of the Baltic Sea region.

This double crisis – economic and financial turmoil at the same time as the climate challenge lies ahead – will create new opportunities, however. There are many studies around giving indications of what the greening of the economy will mean for the growth of jobs and opportunities. One made on behalf of the European Commission is pointing to big opportunities in biomass production for many of Baltic Sea states, not to talk about hydro power and wind energy opportunities. Or as a Danish consortium put it: We here in the north can be the green energy valley of Europe.

However, one of the prerequisites is that the energy markets around the Baltic Sea would be both better integrated and really functioning as a market. The first steps have been taken and further engagement is to be agreed in the margins of the European Council this summer. More capacity for transmissions is needed in order to stop isolation of several countries.

The transportation of energy is related to the new Baltic Energy Market Interconnection Plan – and it poses one of the biggest challenges to our aquatic environment today. Transport of oil has increased tremendously since early

1990s and it is not excluded that the transported amounts soon will reach over 200 million tons.

We cannot exclude the risk of an accident, no matter how well we succeed in developing surveillance and monitoring systems. We need increased cooperation between maritime authorities and better reporting and identification of vessels. Finland is ready to take the lead role for the actions in this area in the soon to be adopted EU Strategy for the Baltic Sea Region.

The European Maritime Safety Agency monitors the accident response capacity in member states. A quick look at the capacity in the Baltic shows that many parts of the region fall short. Therefore work under both the auspices of Helcom and the Council of the Baltic Sea States must lead to concrete plans to have efficient response plans in case of an accident.

As all readers of this paper know, the dire situation of the Baltic cannot be blamed on a lack of institutions and papers – all trying to improve the state of the sea. The problem is, on the one hand, that some regulations are not binding, just representing a good will, and, on the other hand, that we have situations where one country is to bear the costs of the actions while it is another country benefiting from them.

But in some respects the situation has changed for the better. With the EU enlargement in 2004 the Baltic Sea became an inner water of the EU, and through this, the parameters for development of measures and instruments are the binding regulations of the EU. The Water Framework Directive for example requires at least a good state of the waters by the year 2015. During 2009 Finland will approve plans in this respect. Another tool is the Marine Strategy Directive, in which the Baltic Sea could become a pilot area, using the Helcom Baltic Sea Action Plan as the framework.

So there is reason to remain hopeful; we can still save the Baltic.

Astrid Thors

*Minister of Migration and
European Affairs*

Finland



The Baltic Sea Region – A bridge between EU and Russia? – EU energy strategy and the Nord Stream gas pipeline

By Henrik Lax

It is in the clear interest of the European Union to create a functioning internal energy market. The EU should not be dependant on energy from the outside but should be self sufficient in that area. The ongoing gas crisis between Ukraine and Russia has highlighted and reminded the Union of the fragility of its energy supply. The ones who believe that the Nord Stream pipeline is the solution are utterly wrong.

The current state of the EU policy and strategies on energy are reflected primarily in the following proposals and decisions: the initial proposal from the commission in 2007, the decision in the Energy Council in October 2008 and the vote in the European Parliament in April 2009.

A European single market for electricity and gas allowing free exchange of energy within the Union would make it much less vulnerable to disruptions in energy supply from external sources and to political pressure. Such a market would depoliticize the trade in favour of commercial considerations.. Russian gas counts in fact for only 6,5 per cent of the Union's consumption of primary energy.

One of the very key issues in the negotiations on a new cooperation agreement between EU and Russia is what rules shall govern the energy trade. The negotiations have hardly begun and results are only expected to materialize slowly. It is still an open question what the ultimate intentions of Russia are. Deep lack of trust is hampering progress on many issues to be dealt with.

During his recent visit to Finland the Russian president Dmitri Medvedev clearly stated that Russia, albeit a signatory of the European Energy Charter, does not regard itself bound by it, and he reiterated this during the EU-Russia summit in Habarovsk a short time later. Ironically Prime Minister Vladimir Putin urged Ukraine to respect the same charter during the crisis early this year. – Common rules for the energy market and the trade of gas and electricity between EU and Russia are lacking.

Moreover the Member States of the EU are divided on the energy policy. Had it not been for the gas crisis between Russia and Ukraine in 2006, the new Article 176A would never have been included in the Lisbon Treaty. This article envisages a common energy policy for the EU. The aim is to harmonize EU's energy policy and to allow the Union to establish new measures.

Member states would be allowed to adopt legislation only if the Union has not already done so. In other words, national governments would only be able to legislate on policy areas on which the EU has decided not to. Currently creating a common single energy market has proved difficult since there are 27 different regulatory frameworks.

The policy of the European Union in regard to energy is to ensure both the functioning of the energy market and the security of the energy supply. The policy also endeavours to promote energy efficiency and energy saving as well as to develop new and renewable forms of energy. The European Parliament has continuously expressed its worry regarding Europe's energy supplies and has examined different ways in which to ensure that there will be no threat of discontinued access to energy by utility companies.

In 2007 a *third country clause* was proposed by the European Commission in order to protect the EU's energy market from third countries. This clause requires any company from a third country to comply with the same rules as any EU company. In practise this means that a company that

produces energy may not transmit energy or own companies that do so.

This clause, sometimes referred to as the Gazprom clause, because some consider it to be directly aimed at the Russian energy giant Gazprom, is intended to function as a reciprocity clause, but was eventually watered down by the Council of Ministers in October 2008. The current version only requires the member state and third country to bilaterally agree in order to allow a third country to invest in EU's energy infrastructure. However the main ratio of the clause, demanding companies from third countries to comply unequivocally with the same requirements as EU companies, remains fully valid. The third energy package, including the third country clause, got its final approval by the European Parliament in a vote in plenary in April 2009.

Will this clause be sufficient to prevent third country actors playing according to their own rules from blocking the establishment of a single energy market for the EU? It is evident that Gazprom is a tool of the Kremlin for fulfilling Russian foreign policy. Indeed, it was prime minister Putin who ordered the gas deliveries to be stopped to Ukraine and was negotiating the pricing of the gas with his Ukrainian counterpart. Ex-Chancellor Gerhard Schröder was wrong in asserting that Gazprom is a purely commercial company.

Having said this it is questionable whether it is in the interest of the EU to have the Nord Stream pipeline constructed before common rules for the gas market have been agreed upon with Russia. This question is even more pertinent as it seems to be highly unlikely that Gazprom will have any possibilities to increase its gas deliveries to Europe within a foreseeable future.

The outcome of the discussion in the European Parliament early this year concerning the Second strategic energy review, that is one of the main strategies within the European Energy Policy, was a call for a greater cooperation between member states regarding the energy market and for a greater diversification of supply routes. EU need to "speak with a single voice" and work towards energy solidarity.

It is in this context, I would like to raise the role of the Baltic Sea Region. In June, the Commission will officially make public a first version of the much longed-for strategy for this region. This Strategy, if properly implemented, will give the region a new role and impact,. but this will happen only as long as key political figures are deeply committed to the strategy. Therefore, I would welcome a Summit during the Swedish presidency of the EU, with the presence of all political leaders who have proved their interest in developing the Baltic Sea Region into a strong actor. A political and economic consolidation is the only way the Baltic Sea Region can have a say in the future, and it is the only way the region can enhance its position as a bridge between the EU and Russia. Solving the question marks relating to the Nord Stream pipeline has a high priority in this respect.

Henrik Lax

Member of the European Parliament

Finland

The Baltic Sea needs reform of European Union agricultural subsidies

By Janina Andersson

The Baltic Sea is a unique marine ecosystem. There are nine coastal countries and millions of people who consider it as their own sea. But Baltic Sea is now one of the most threatened marine ecosystems on the planet due to overfishing, unsustainable shipping practices, industrial and urban wastewater and agricultural run-off.

One of the most serious difficulty is the eutrophication. Eutrophication is a process where water receives excess nutrients that stimulate excessive plant growth. This enhanced plant growth, often called an algal bloom, reduces dissolved oxygen in the water. This affects the whole ecosystem. About 80% of all nutrients in the sea come from land-based activities, including sewage, industrial and municipal waste and agricultural run-off.

According to the recent study by Fredrik Wulff, professor in Marine Systems Ecology in Stockholm University, the pollution to the Baltic Sea has been diminished for the first time. The pollution has been diminishing in almost every country. There was only one exception: the pollution from Finland hasn't been decreasing. On the contrary, it has increased.

European Union is preparing a strategy for the Baltic Sea Region. Agricultural subsidies should be included into this strategy. EU agricultural subsidies were launched for two reasons. They aimed to work as an income subsidies and as an environmental subsidies. Nowadays they are ineffective as an environmental subsidies. System is also bureaucratic and expensive. The administration of the system takes over the half of the whole costs of the agricultural supervision, almost 30 million euros per year.

We need to differentiate the drainage basin area of the Baltic Sea from the agricultural subsidies. The subsidies for the drainage basin of the Baltic Sea should be addressed especially for sloping seacoast fields. It is known that the biggest problems are the fields of gradient level more than 6 %.

It is essential to address the agricultural subsidies to specific operations. A good example of this kind of actions is the Finnish TEHO project (2008-2010). TEHO project is focused on agricultural water protection issues in southwest Finland. The primary sources of the project funding are the Ministry of Agriculture and Forestry, and the Ministry of the Environment. Southwest Finland Regional Environment Centre and two regional unions of the Central Union of Agricultural Producers and Forest Owners are taking care of the implementation. The project takes place in Southwest Finland with around 12 000 farms

and 20 % of Finnish arable land. The project is concentrated in four more defined areas characterized by intensive crop production agriculture and/or animal husbandry.

The farmers' knowledge and skills are vital and they will be utilized in the project as well as local environmental conditions, farm resources and prevailing practices are taken into account. The aim is to find farm-specific, the most suitable water protection measures, in close co-operation with farmers and to develop environmental protection handbook for the use of the farm.

As well known, changes in agricultural practices is reflected to the water quality with a delay, which complicates environmental impact assessment. Automatic water quality sensor stations are established in order to monitor effects on waters. Moreover, effectiveness of measures will be estimated using modeling. The results, conclusions and experience will be utilized in the preparation of the third Agri-Environmental Program in Finland (2014 -).

And finally.

We don't have much time to wait for these changes in the agricultural subsidies from EU. Especially the new member states as Poland should be able to minimize the run-off from their fields before their agriculture has been changed into intensive and massive farming systems instead of smaller family farming.

The climate change may shorten period of frozen soil and increase precipitation during winters, which leads to more run-off waters from the fields also in the winter time. This is probably the reason why the Finnish figures look bad in the recent research. Because of this it is even more important than earlier to have something growing on the fields all year around near the rivers. For example energy plants would be a good solution for these difficult areas. So we need a quick change in the financial subsidies to the agriculture in the Baltic Sea area if we want to save our sea.

Janina Andersson

Member of the Finnish Parliament (the Greens)

Finland



International sea surveillance co-operation in the Baltic Sea Region

By Juhani Kaskeala

Maritime traffic on the Baltic Sea

Increased co-operation within the Baltic Sea region, the expansion in trade and higher living standards have led to a significant swell in maritime traffic. This rise in maritime traffic is currently the biggest in the world. The amount of oil transportations in the Gulf of Finland has grown seven-fold in the past ten years. In 2008, nearly 150 million tonnes of various oil products were transported via the Gulf of Finland. On average 10 fully loaded tankers set off from the Gulf of Finland daily, and this trend is expected to continue in the foreseeable future. Experts predict that once the new oil terminals will have been completed the amount of oil transportations in the Gulf of Finland will surpass the 200 million tonne benchmark already in 2015.

Picture (see end of article): The main task of the Finnish Navy is to secure sea routes

The fact of the matter is that Finland has always been — and still is — like an island in the remote waters of the Baltic Sea. Eighty-three per cent of Finland's imports and exports rely on maritime routes.

The main task of the Finnish Navy is to secure these maritime routes. Changed threat scenarios and the significance of maritime connections to the national economy have determined the Navy's priorities: everything the Navy does must support this task which is paramount.

Finland's dependency on unobstructed maritime traffic set the conditions for sea surveillance both in normal and exceptional circumstances. The maritime picture is a result of seamless co-operation between different authorities and highly automatised data processing.

Whereas earlier all sea surveillance could muster was a limited maritime picture from a single surveillance station, radar and vessel, today maritime pictures provide a comprehensive report on the areas that are of particular interest to Finland using an array of sensors. Since the beginning of 1994, maritime authorities (the Defence Forces, the Border Guard and the Finnish Maritime Administration) have combined their resources to improve the maritime picture and to save resources. This co-operation has generated a smoothly operating sea surveillance system. Fifteen years of co-operation between authorities has been a success in Finland, and this has not gone unnoticed internationally.

Sea surveillance is becoming more international, focused and it combines data from different sensors and authorities. We are shifting from a national maritime situation report to an international situational awareness of the events and circumstances out at sea.

Expanding the maritime picture

Finland has actively developed a maritime picture based on international exchange*. In the early 2000's, Finland and Sweden initiated the Sea Surveillance Co-operation Finland Sweden (SUCFIS) Project. The aim was to merge two independent national sea surveillance systems electronically. In addition to the automatised exchange of information, another significant step was the adoption of common practices and establishing points of contact between the sea surveillance centres. SUCFIS has been operational since the summer of 2006.



Picture: SUCFIS has been in operational use since the summer of 2006.

In September 2008, Finland and Sweden proposed the exchange of sea surveillance information to cover the entire Baltic Sea region. The proposition was put forward to all the littoral states of the Baltic Sea, Norway and various organisations operating in the area. The idea was met with considerable interest. The Sea Surveillance Co-operation Baltic Sea (SUCBAS) was initiated with a Letter of Intent at a meeting held in Finland in spring 2009. SUCBAS co-operation is based on the principle that each state decides for itself what parts of its recognised maritime picture (RMP) it wants to share with other states. The exchange of information between the contracting parties' (Finland, Estonia, Lithuania, Sweden, Denmark, Germany) sea surveillance operators began already on 2 April 2009, as planned. In future SUCBAS can be merged into a European-wide RMP exchange programme.

Within the European Union, the Finnish Navy leads a working group called Project Team Sea Surveillance Working Group 1. The group designs solutions and methods for the exchange of sea surveillance information between 15 EU member states and maritime authorities and stakeholders operating within Europe. So far, the project has agreed on what the aims of cooperation are. At this stage the group is putting forward for approval the first technical requirements for the exchange of information. The European Defence Agency (EDA) is responsible for this project.

In addition, Finland, together with several stakeholders and countries, such as the United States of America, Sweden, Spain, Singapore, Poland, Germany and NATO, develops technology and processing models related to the exchange of sea surveillance information and analysis. The main focus is on technology and the work is part of a series of multi-national experiments that the Finnish Navy has been involved in since 2006.

Finland's aims in international sea surveillance

Finland supports the goal of the EU maritime policy to create an EU-wide recognised maritime picture. Finland actively participates in ongoing projects and seeks to steer things in such a direction that they enhance co-operation between Finnish sea surveillance authorities. Finland supports the initiative to produce technical and practical solutions that enable European navies (MARSUR/EDA),

border guard authorities (EUROSUR/FRONTEX), and maritime authorities (SAFESEANET/EMSA) to exchange maritime pictures.

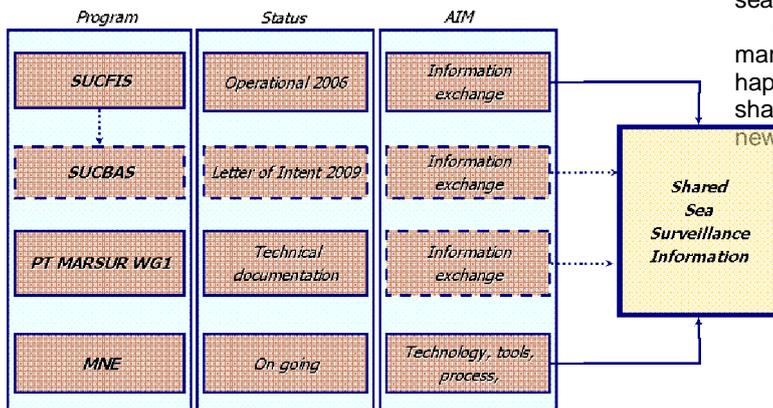
International RMP projects further Finnish interests and provide more opportunities to increase maritime safety. An expanding situational awareness enhances international and national co-operation between authorities in repelling large-scale security threats. An integrated effort in RMP co-operation strengthens national crisis management capabilities and lays the foundations for international exercises.

Picture: International sea surveillance co-operation the Finnish Navy is involved in.

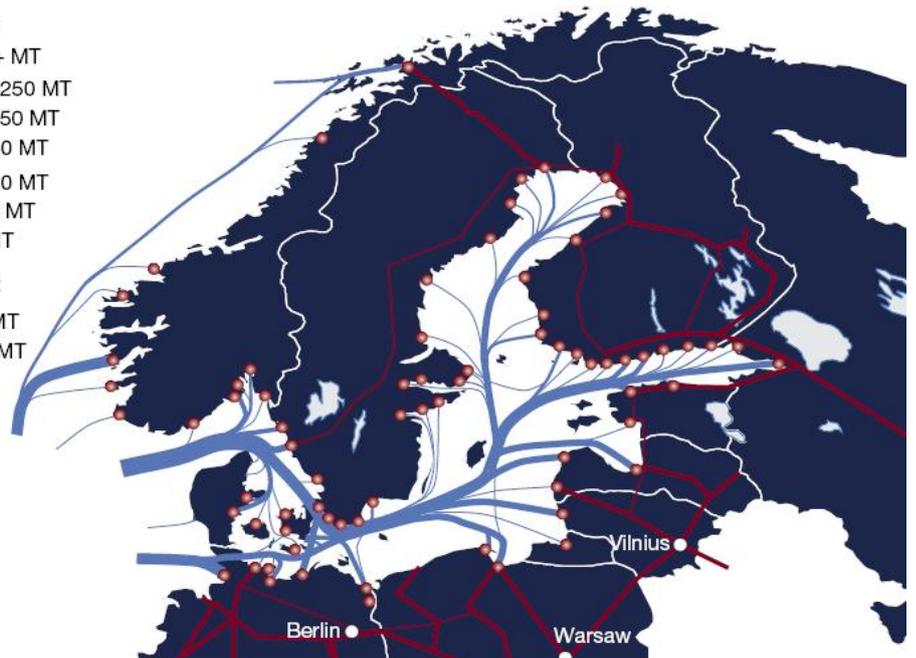
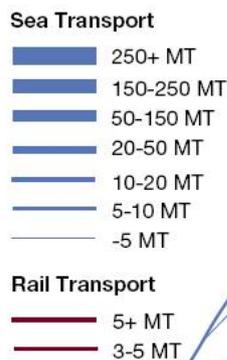
We currently know exactly who are in or close to our territorial waters. The increased maritime traffic and information puts our systems and surveillance personnel under considerable strain.

Finland participates in international sea surveillance co-operation to exchange sea surveillance information with other countries and stakeholders and to develop national sea surveillance capabilities.

Our aim is that we not only see the recognised maritime picture but that we also understand what is happening out at sea. This can only be achieved by sharing sea surveillance information and by developing new technology and methods.



Juhani Kaskeala
 Commander of the Finnish Defence Forces
 Finland



Picture: The main task of the Finnish Navy is to secure sea routes

The future of Russia-US relations

By Stephen Blank

Once the Obama Administration metaphorically pushed the reset button on US-Russia relations it generated numerous comments at home and abroad. Moscow and Europe as a whole have openly welcomed the changed atmosphere of bilateral relations while American conservatives have launched a media blitz decrying them as a sellout of US policies or allies. In fact, a closer look suggests that the Administration has merely cleared the air so that a genuine dialogue on the bilateral agenda can begin.¹ It also has launched an ambitious attempt to expand that agenda to find more avenues where cooperation might be possible. This ambition is clearly reflected in the bilateral communique from the Obama-Medvedev meeting in London on April 1.² Nevertheless improved atmospherics, though valuable, hardly denote harmony or détente.

Actually, close examination of what this writer has called the agenda of discord, suggests that cooperation will be limited to issues pertaining to strategic nuclear weapons, namely a treaty to reduce strategic nuclear weapons and proliferation questions.³ This treaty is itself part of that agenda of discord but evidently progress is occurring as serious negotiations are underway. Admittedly Washington decided to postpone discussion of the issue of tactical or non-strategic nuclear weapons in Europe and will count both warheads and launchers in a gesture to Russia.⁴ But following President Obama's speech in Prague the US will not surrender missile defenses and Russia's insistence upon tying offensive reductions to terminating defenses and thus preserving the old Cold War mutual hostage relationship and its concept of strategic stability where both sides are shackled together like scorpions in a bottle, is unlikely to prevail.⁵

Another part of that agenda of discord is the two sides' divergence on nuclear proliferation.⁶ While progress may

well occur on issues like new regimes for countering nuclear proliferation and Russia wants to restore the so called 123 treaty on nuclear exports, cooperation is unlikely to go much further than that. Russia still maintains that Iran shows no sign of building a nuclear bomb or missiles that it can use to strike Europe or even Russia, though its military has long since acknowledged this threat.⁷ Similarly Moscow clearly holds the US accountable for the breakdown of the six-party talks on North Korea's nuclear program and opposes meaningful UN sanctions upon it or Iran despite Russian talk of the UN's primacy.⁸

When we turn to regional issues on this agenda Russia's intransigent position clearly derives from its presupposition of an inherently conflicted relationship with an adversarial West and America. These issues demonstrate how much Russian policies are driven by what domestic and foreign commentators acknowledge to be an inveterate anti-Americanism.⁹ Moscow loses no opportunity to demand a privileged sphere of influence for itself in the CIS while its ambassadors routinely disparage those states' sovereignty.¹⁰ Moscow's furious reaction to the EU's new Eastern partnership and threats of realignment and walkouts from cooperation with NATO over its exercises in Georgia shows that Russia cannot and will not accept the European status quo and the rights of its members, including those in Central and Eastern Europe, anytime soon.

Moscow's desire to retain the capability to threaten Europe with nuclear weapons underscores its opposition to US missile defenses there.¹¹ Indeed it has already broken the Bush-Yeltsin Presidential Nuclear Initiatives of 1991-92 concerning the removal of tactical nuclear weapons from

¹ This term was coined by Samuel Charap in a lecture at the Finnish embassy in Washington, on May 8, 2009

² Joint Statement by President Dmitry Medvedev of the Russian Federation and President Barack Obama of the United States of America, April 1, 2009, www.whitehouse.gov; *Joint Statement by Dmitry A. Medvedev, President of the Russian Federation, and Barack Obama, President of the United States of America, Regarding Negotiations on Further Reductions in Strategic Offensive Arms*, April 1, 2009, www.whitehouse.gov

³ Stephen Blank, *Towards a New Russia Policy*, Strategic Studies Institute, US Army War College, Carlisle Barracks, PA, February 2008

⁴ U.S. Assistant Secretary of State Rose Gottemoeller Outlines the U.S. Position On a New Strategic Arms Reduction Treaty With Russia," *Interfax*, May 4, 2009, <http://www.interfax.com/17/491670/Interview.aspx>

⁵ REMARKS BY PRESIDENT BARACK OBAMA, Hradcany Square, Prague, Czech Republic, April 5, 2009, www.whitehouse.gov; Stephen Blank, *Russia and Arms Control: Are There Opportunities For the Obama Administration?* Carlisle Barracks, PA: Strategic Studies Institute, US Army War College, 2009, pp. 17-24

⁶ Alexei Arbatov, "Terms of Engagement: WMD Proliferation and US-Russian Relations," Paper prepared for the US Army War College conference "US and Russian: Post-Elections Security Challenges," Carlisle Barracks, PA, March 6-7, 2008, in Stephen J. Blank, Ed., *Prospects for US-Russian Security Cooperation*, Carlisle Barracks, PA: Strategic Studies Institute, US Army War College, 2009, pp. 147-149; Stephen Blank, "Prospects for Russo-American Cooperation in Halting Nuclear Proliferation," Stephen J.

Blank Ed., *Prospects for US-Russian Security Cooperation*, Carlisle Barracks, PA: Strategic Studies Institute, US Army War College, 2009, pp. 169-284

⁷ Stephen Blank, *Missile Defenses in Eastern Europe: Who Threatens Whom and Why?* Forthcoming from the American Enterprise Institute; RUSSIA-U.S. RELATIONS: PERSPECTIVES AND PROSPECTS FOR THE NEW AGENDA SERGEY LAVROV, MINISTER OF FOREIGN AFFAIRS, THE RUSSIAN FEDERATION THURSDAY, MAY 7, 2009, Carnegie Endowment on International Peace, Washington, D.C., www.ceip.org (Henceforth Lavrov, Speech)

⁸ *Ibid.*

⁹ Cathy Young, "From Russia With Loathing," *New York Times*, November 21, 2008, www.nytimes.com; Vladimir Shlapentokh, "Are Today's Authoritarian Leaders Doomed to Be Indicted When They Leave Office? The Russian and Other Post-Soviet Cases," *Communist and Post-Communist Studies*, XXXIX, No. 2, Autumn, 2006, pp. 462-463

¹⁰ Stephen Blank, "The Values Gap Between Moscow and the West: the Sovereignty issue," *Acque et Terre*, No. 6, 2007, pp. 9-14 (Italian), 90-95 (English) "Interview given by Dmitry Medvedev to Television Channels Channel One, Russia, NTV, "August 31, 2008, http://www.kremlin.ru/eng/speeches/2008/08/31/1850_type82916_206003.shtml;

¹¹ Blank, *Missile Defenses in Eastern Europe: Who Threatens Whom and Why?*

ships in the Baltic sea.¹ Likewise, it refuses to sign an energy charter with the EU and continues using energy as a means to blackmail and intimidate its consumers throughout Central and Eastern Europe. Beyond that it uses energy revenues to corrupt and subvert all those governments as attested to by numerous sources.² Likewise, Russia is pushing a European security initiative that aims to give it a free hand in the CIS while eliminating or undermining the OSCE and NATO as functioning organizations.³ Finally in Central Asia Moscow orchestrated the expulsion of the US from its base in Kyrgyzstan -- a strange way of showing solidarity in the fight against the Taliban unless one realizes that Moscow's main aim is consolidating this sphere of influence, not helping the US. Indeed, it is hedging against a Taliban victory by angling for a sphere of influence in Northern Afghanistan, a constant Russian aim since 2001 if not earlier.⁴

This anti-Americanism also appears in Russia and China's effort to effectuate a massive reorganization of the international financial status quo where it gains the right to use the ruble as a regional reserve currency. Not only does this aim at Washington, but it also entails creating a ruble bloc in the CIS that will undermine the financial sovereignty of all its members, and replicates the similarly intended policies of Nazi Germany in Eastern Europe in 1933-39.⁵ Thus Moscow wants a free hand in the CIS like

the one it enjoys at home, i.e. an autocracy that does not answer to anyone for its actions. Russian analysts have long known that such a regime is inherently imperialist in its nature, outlook, and policy. Therefore it cannot accept the status quo in Europe or be a true partner for the West.⁶ For these and many other reasons whatever agreements that ensue will be partial and limited though valuable in and of themselves.

Therefore we can probably expect a treaty on strategic nuclear weapons and some progress on non-proliferation. But realistically we should not expect too much from this new dialogue even if we should be grateful for improved atmospherics. After all, a state who's avowed aim is revising the status quo, whose methods are intimidation and subversion, and who's ideological mantra is "sovereign democracy" cannot accept genuine partnership with the West for it believes, as would Bismarck, that in such a partnership it will be the horse and Washington the rider. As Gogol aptly reminds us, if Russia is to be likened to a horse and team, then it prefers to be a troika running off under its own or else nobody's control.

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The views expressed here do not represent those of the US Army, Defense Department, or the US Government.

¹ "Bildt Plays Down Russian Nuclear Threat," *The Local*, August 18, 2008, <http://www.thelocal.se/13780/20080818>; Mark Franchetti, "Russia's New Nuclear Challenge to Europe," *Timesonline*, August 17, 2008, www.timesonline.co.uk/tol/news/world/europe/article4547883.ece

² Author's conversations with members of European foreign ministries and intelligence services, 2008; Anita Orban, *Power, Energy, and the New Russian Imperialism*, Washington, D.C.: Praeger, 2008; Edward Lucas, *The New Cold War: Putin's Russia and the Threat to the West*, London: Palgrave Macmillan, 2008; Robert Larsson, "Nord Stream, Sweden and Baltic Sea Security," Stockholm Swedish Defense Research Agency, 2007; Robert Larsson, *Russia's Energy Policy: Security Dimensions and Russia's Reliability as an Energy Supplier*, Stockholm: Swedish Defense Research Agency, 2006; Janusz Bugajski, *Cold Peace: Russia's New Imperialism*, Washington, D.C.: Center for Strategic and International Studies, Praeger, 2004, passim; Richard Krickus, *Iron Troikas*, Carlisle Barracks, PA: Strategic Studies Institute of the US Army War College, 2006; Keith C. Smith, *Russian Energy Politics in the Baltics, Poland, and the Ukraine: A New Stealth Imperialism?*, Washington, D.C.: Center for Strategic and International Studies, 2004; Valery Ratchev, "Bulgaria and the Future of European Security," paper presented to the SSI-ROA Conference, "Eurasian Security in the Era of NATO Enlargement," Prague, 4-5 August 1997; Laszlo Valki, "Hungary and the Future of European Security," *Ibid.*; Stefan Pavlov, "Bulgaria in a Vise," *Bulletin of the Atomic Scientists*, January-February 1998, pp. 28-31; Moscow, *Izvestiya*, in Russian, 19 June 1997, in *FBIS SOV*, 97-169, 18 June 1997; Sofia, *Novinar*, in Bulgarian, 10 April 1998, in *Foreign Broadcast Information Service, Eastern Europe* (hereafter *FBIS EEU*), 98-100, 13 April 1998.

³ Speech at a Meeting With German Political, Parliamentary, and Civic Leaders, Berlin, June 5, 2008, http://www.kremlin.ru/eng/speeches/2008/06/05/2203_type82912type82914type84779_202153.shtml

⁴ Sergei Rogov, *The New Russian-American Security Agenda. How to Build a Cooperative Relationship Between Russia and the United States*, Carnegie Endowment for International Peace, Washington, D.C., January 13, 2009

⁵ Lavrov, Speech; David E. Kaiser, *Economic Diplomacy and the Origins of the Second World War: Germany, Britain, France, and Eastern Europe, 1930-1939*, Princeton, NJ: Princeton University Press, 1980

⁶ Maura Reynolds, "Moscow Has Chechnya Back--Now What,?" *Los Angeles Times*, June 19, 2000; Boris Rumer: *Central Asia: At the End of the Transition*, Boris Rumer Ed., *Central Asia At the End of Transition*, Armonk, NY: M.E. Sharpe & Co. Inc., 2005, p. 47

The Baltic Sea – model for well functioning cooperation and simultaneously a challenge from the Frontex' point of view

By Ilkka Laitinen

Frontex is a European Agency which coordinates the operational cooperation at the external borders of the Member States of the European Union. European Council Regulation stipulates that Frontex' objective is to facilitate and render more effective the application of existing and future measures of the European Community relating to the management of external borders. Frontex is doing so by ensuring the coordination of Member States' actions in the implementation of those measures. In that way Frontex is contributing to an efficient, high and uniform level of control on persons and surveillance of the external borders of Member States.

The vision is that Frontex is the anchor stone of the European concept of Integrated Border Management, promoting the highest level of professionalism, interoperability, integrity and mutual respect of stakeholders involved. One of the values of Frontex, interoperability, is crucial for the effective management of activities at the European external borders. The effective management calls for interoperability at national, European and international levels. Frontex aims to be the central player for promoting harmonisation of doctrines, needs, operational and administrative procedures, and technical solutions supporting effective management of the EU external borders.

Aiming to promote interoperability and effectiveness, Frontex will actively support and liaise with the regional border control cooperation structures including Member States and Third Countries (non-EU Member States). Working closely together with the law enforcement authorities of Third Countries will bring the authorities "on the same side of the border" leaving the other side for criminal organizations. In this respect, based on the risk analysis, the main focus of Frontex will be on the Mediterranean Sea area, Western Balkans and Eastern European Countries, followed by the Black -and Baltic Sea Regions.

All countries around the Baltic Sea have a long experience on the comprehensive and secure exchange of information and experiences with an emphasis on continuous monitoring and management of irregularities affecting in their security. The Third Country of the Baltic Sea Region, Russian Federation, was the first non-EU Member State which signed a working arrangement with Frontex in 2006 formalising the ways of cooperation. Based on that agreement Russia can participate in the operational cooperation coordinated by Frontex. During the first quarter of 2009 Frontex coordinated a joint operation on the Kaliningrad area. Border Guard Service of the Federal Security Service of Russian Federation took part in the operation.

The Baltic Sea is a small and confined sea that is almost entirely enclosed by land. Vessel traffic has increased significantly in recent years and the growth is expected to continue in the future. At the moment the risks on the Baltic Sea area are more related to other aspects than to the illegal immigration, like environmental protection. However, the cooperation between the various border control authorities in the Baltic Sea region has proven to be a success both operatively and politically and has influenced border security in all of the Europe. It can be said that the operational cooperation on the Baltic Sea Region is unique, even by European scale. Cooperation between the countries around the Baltic Sea has in a way been an export article. It can be indicated by the popularity of the Baltic Sea cooperation model. The applications of the Baltic Sea cooperation have had a clearly visible effect. Both in the Black Sea and even in the Pacific Ocean, border control authorities from different countries have organised their cooperation along the same main lines. The work coordinated by Frontex in the Mediterranean region has brought countries few steps closer to the similar model of cooperation.

Today we are in a position to declare that cross-border cooperation across the external borders of the EU between Member States and non-EU Member States can be organised effectively. This cooperation is expressly non-military and professional in nature with the legal competence to resolve special situations at different sea areas of the Europe.

Frontex is strongly encouraging the Member States to more actively deploy vessels, aircrafts and other means to joint operations for safeguarding the external borders of EU based on the risk analysis and needs of the Member States mainly affected by illegal immigration. One of the challenges of Frontex is to scrutinise different ways to get Member States to utilise their assets more often for common European operational activities, especially at the Southern Maritime borders of the EU. When talking about the surveillance of the external borders of EU, it is important to remember that no one is stronger than its weakest link. International cooperation is vital to tackle the challenges which the EU is facing. The development of different EU bodies including Frontex needs commitment of the Member States, so that the citizens of Europe can harvest the benefits from it.

The Member States around the Baltic Sea have modern and effective multi-purpose vessels and aircrafts which would bring added value to common European activities in case the Baltic Sea States would be willing to deploy them regularly to joint European operations. Taking into account the long distance from the Baltic Sea to the hot spots in the Mediterranean Region, the technical assets would have to be deployed for a quite long duration in order to guarantee the cost-effectiveness of the operations. One of the solutions could be to use the technical means of the Member States from the Baltic Sea region half of the year for joint European operations coordinated by Frontex and the other part of the year for national purposes in the territorial waters of the home Member States of the assets.

Frontex is putting a lot of efforts to accomplish a following scenario in the future also in the Mediterranean Sea: "Border guard surveillance aircrafts will fly common European surveillance missions covering the hot spots of the Mediterranean Sea. A broad variety of operational information collected by the technical means and fixed surveillance networks will be exchanged on a continual basis with all the relevant authorities of the area and additional assets provided by other supporting Member States. Border control authorities are in daily contact with one another and by doing that, have a common overview of all the vessels and other targets of interest sailing in the Mediterranean Sea giving enough response time for European law enforcement authorities to react and to handle the situation in appropriate manner."

This will result in improved quality of management of joint European operations and increase the level of security of European citizens. It is important to remember that irregular migration is a challenge for the whole Europe, not only to the Member States mostly affected by it at the moment. Mutual trust and solidarity can be considered as a life-insurance for the Schengen area.

Ilkka Laitinen

Executive Director

Frontex



Crisis modernisation – lessons of the past and tasks for the future

By Vladimir Mau

In the same way that generals prepare by analysing past wars, economists and politicians prepare by analysing past economic crises. On the whole, this makes sense, and it is not even a bad thing. It makes sense that we can only seriously analyse what is known. It is not a bad thing, as learning lessons from the past allows us to avoid the same pitfalls, but this can never be guaranteed in any country. Over the last one hundred years, many countries, with surprising obstinacy, continue to repeat the same blunders and have been hit repeatedly by the same economic crises – history has no limits and is ready to set the same lessons until they have been grasped by nations and the elite. However, the lessons learnt from the past do not ensure against new challenges (and, in relation to this, new mistakes) – history loves setting new puzzles, the minimum condition for, it would seem, tasks already solved.

One of the key questions for Russia now is the possibility of uniting an anti-crisis agenda with the agenda for modernisation. The last eight years have shown that in economic boom conditions, structural renewal of the Russian economy exists (and even starts). Now we will see if we understand whether this adds to the crisis conditions.

Modernisation is undoubtedly important for the strategic goals of Russian politicians. The experience of our country over the past three hundred years shows that successful and stable modernisation only occurs when it affects all the areas of vital activity of the given society. In the past, Russia periodically succeeded in deciding on individual modernisation projects; however, they were always unstable and were quickly set back. The problem was that the focus was on military, technological or social achievement, whilst ignoring political and economic aspects of modernisation or even taking these into consideration. Modernisation cannot solve the tasks before it if it focuses on some areas and neglects others. The logic of “step by step modernisation”: first the army and defence industry, then, perhaps, politics and social relations, does not provide stable results.

Already, for producing an anti-crisis agenda, it is important to formulate this in a modernisation context. There are two aspects to this problem. On the one hand, priority attention is devoted to measures to resist the crisis, which at the same time promote the renewal of the Russian economy. On the other hand, producing a set of our own modernisation actions which can exist in crisis conditions.

The list below shows some components of the anti-crisis modernisation agenda.

It starts by securing macroeconomic stability. For our budget and money systems there has come a time of complex testing. And we need to come out of this saving our “macroeconomic face”; that is to say without a breakdown in the vicious infinity of budgetary obligations, inflation, default and bartering. For a very long time, and at a painful rate, we got out of all of this in the 1990s; moreover, there was then a certain justification due to the revolutionary destruction of the old system and a deep crisis of state power. Now a return to the situation of monetary and financial collapse would be catastrophic for the future of the country.

With these come the links and contours of the financial policies. It should be built in consideration of the prospects of conversion of the rouble into a regional back-up currency. Even if this task now seems fanciful to anyone, a solution in the medium term is a total reality, if it is not done in the current period of serious foolishness and errors.

Establishing financial policy in crisis conditions does not mean doing what may only distance this prospect (above all having, in terms of a spin off, uncontrolled inflation or introducing currency control). It already makes sense to now develop a programme of steps to strengthen the international position of the rouble with a definition of stages which are not linked to a certain date but naturally and logically follow from one to another.

It is essential, when defining a policy, to reinforce the role of internal demand by promoting economic growth. It is in sectors which promote steady and multiplicative internal demand where all the limited resources that the budget will have should be centred. This type of sector includes residential and industrial construction and also education and health care. Moreover, the author suggests quickly starting to flood them with money. Modernisation requires, above all, institutional renewal of these sectors, which has been discussed to any extent for nearly a decade. Without institutional renewal, financing does not lead to growth in the quality of the goods and services provided, which means to growth in the internal market.

Hence, it would seem that demonopolisation is vital. All attempts to stimulate demand by us up to now have not led to growth of supply and quality but to an increase in prices. Therefore, a distinct and serious programme of demonopolisation (including the developer sector and intrinsic monopolies) is still one of the most important components of modernisation of the agenda. Without demonopolisation of a whole range of anti-crisis measures, it is simply not possible.

When considering the problems of the non-financial sector it is important to understand that serious changes are awaited here. It is not possible to help all companies to stay afloat. As is well known, “strategic” companies are specially monitored by the state. However, the main point of this attention should not be to occasionally (or regularly) give them money, but to not allow them to add to social and economic instability. Moreover, one of the forms of support for these companies by the state should be legal and other help when needed for their financial recovery.

When implementing measures for social stability, it is vital to follow one principle: the state helps people and not companies, not their top managers or owners. Moreover, supporting people should not only result in paying out unemployment benefits: it is vital to have the active involvement of them in different educational projects, targeting professional conversion training or increasing qualifications. The requirement of support of companies (particularly big ones) is often motivated by the amount of employees working in them. However, the aim of structural renewal of the economy does not mean preserving the entire range of existing companies. Here, the support of employees made redundant is a vital part of modernisation policy.

What is needed is staggered reform of the banking system, targeting the creation of a network of stable and effective private banks. Here, it would be very important to preserve a high level of competition in the banking sector, to stop a market crisis, which a few major banks would dominate.

* * *

Modernisation is sometimes related to the theme of prospects which open up for national producers due to the devaluation of the national currency. The low rate of the rouble may give a boost to economic growth. But without

the powerful input of oil dollars, this would not work, and the solution for modernisation focusing on the consumers of internal demand is not import substitution. Considering the experience from 1999-2001, this development model for many economists is completely realistic.

A worsening of foreign economic situations is now present, and the amount of oil dollars has considerably dropped. However, major activation of business activity should not be expected. The crisis has arrived, negative trends have appeared, and the rouble has been devalued. However, this other crisis is fundamentally different to that of 1998, and it would be strange to expect the same trends as in the last decade.

It is possible to outline several important features which limit the effect of devaluation on the functioning of the contemporary Russian economy.

First, contemporary Russia is in the investment stage of economic growth, in conditions where growth requires the input of additional capital. In simpler terms: in Russia now, there is practically no free capacity in which one could operate for free. The abundance of unused capacity in 1998 provided a powerful stimulus for economic recovery, especially in the private sector. This was accomplished with practically minimal capital investment (or with minimum investment). Political and macroeconomic stabilisation significantly increased with the safety of individuals and property, and already this (coupled with liberalisation of domestic activity) was enough to spark an economic rebound. Now, despite the crisis, investment is needed which would provide stability for the Russian economy and determine the usual term "modernisation". Investors are nervous about the uncertainty of demand and the lack of low-cost money on the market. Moreover, high interest rates in Russian are now at a level of 12%, which has led to high inflation.

Secondly, the global character of the current crisis. At the end of the 1990s, the crisis was a national one, but characteristic of developing markets. The continued unstable growth of global economies (developing market economies) has generated powerful demand; therefore, even a certain improvement in the macroeconomic parameters and corporate relations in crisis countries quickly led to new growth. Furthermore, as regards developing markets, these were staggered over time – 1997 – Asia, 1998 – Russia, 1999-2000 in Brazil and Argentina. With these crises, thanks to global growth and experience of combating the crisis amassed at the same time occurred in each country at a different time, one crisis began in one region of the world at practically the same time as another region came out of the crisis. In other words, devaluation against a backdrop of global crisis is not the same thing at all as devaluation in conditions of economic upswing.

Third, this devaluation is less severe than it was in 1998. This time, the exchange rate of the rouble dropped

more than the second and is now at a rate of 40 percent. Thus, the scale of its influence on the economy will be less important.

To some extent, this may even be a good thing; whereas, *fourthly*, the result of almost a decade of boom has been its dependence of parts of the national non-financial sector on the supply of foreign components and equipment. This was the price of the transfer from reconstructive growth (on the basis of the involvement of unused capacities) to investment growth. The integration of Russia had continued in global economic relations, the inflow of foreign capital has promoted the development of *know-how* and an increase in the productivity of labour. However, this means an increase in wages for the production of the associated goods.

Fifthly, devaluation in relation to the US dollar has happened not only in Russia, but practically all the currencies of the major trade partners of Russia in Eastern Europe and other former Soviet republics fell. Therefore, they have also increased their competitiveness, and Russian commodities are not as attractive in terms of price in comparison with them. Moreover, the rouble fell less in relation to the Euro, whilst a significant portion of Russia's imports are purchased in this currency.

These arguments do not mean that a lower exchange rate will not exert a positive influence on the economy. In the last few months, many importers have been feeling a lot better. Benefits of the weakened rouble have slowed the pace of the recession and we have already seen increased activity in February and March among some companies operating on the domestic market.

The pace and consequences of the 2009 devaluation show significant weakening in its ability to offer a favourable impact on the condition and dynamics of the Russian economy. We can no longer hope for a repetition of the "1998 Miracle". The conclusion is simple: Russia cannot achieve the strategic tasks in future without fundamental modernisation of its economy. And that reformation must be started now in the midst of a global crisis.

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Russia

Security as a competitiveness booster in the Baltic Sea Region

By Erkki Hämäläinen

Do we consider the Baltic Sea a safe and secure region to live or run a business? Or should we do more? Maybe it would be possible to devise Security as a competitiveness booster for the industry and commerce of the Baltic Sea Region and create an attractive area for people, customers and workers by developing the security of the region? My point of view is the fight against crime and security against damages caused by organised crime and terrorism.

In increasing globalisation, business location must be highly competitive to back up the economical growth of companies. Competitiveness influences business location decisions. A secure operating environment is widely considered an important location factor for businesses alongside the attractiveness of the region, the availability of labour, the proximity of markets and good transport connections. In this respect security is a significant factor of competitiveness not only for individual municipalities, but also for countries and groups of countries.

Although the Baltic Sea Region seems to be rather safe area in Europe, it is not self-evident that the situation will remain unchanged. According to Europol organised crime threat assessments, some OC groups are already showing a significant use of legal business structures in EU to facilitate criminal activities and to launder criminal proceeds and get established in legal business. They are also prepared to use influence and corruption in the EU both in the public and private contexts.

The Northeast region of the EU seems to present attractive opportunities for organised crime from the Baltic region and for OC groups originating from the neighbouring countries such as Russia, Ukraine and Belarus. A further facilitator for trade fraud in this region is the large volume of transports across the borders and other vulnerabilities of the logistics sector.

The use of illegal labour being one of the criminal phenomena that is the most detrimental to competition, is a serious challenge to the business sector. Illegal labour originates increasingly from countries outside the EU. OC groups, which combine legal and illegal businesses, often manage the supply and use of illegal labour in a way that harms the rest of the business community.

The growing value of the sea transportation of oil and other products in the Baltic Sea as well as the large passenger ferries could be tempting targets also for illegal activists or terrorist groups.

The currently ongoing process of producing a Strategy for the Baltic Sea is highly welcome not only for the maritime environment, maritime safety reasons or for energy and transport networks but also for the maintenance of and increase in security in the region. The citizens of the Baltic Sea region have their right to anticipate secure and safe environment to live, travel and work. The security is essential also for the competitiveness of the region in order to attract business investments.

Preventing and combating OC and terrorism should therefore be an essential element in the Baltic Sea Strategy. Crime prevention could not happen by the law enforcement means only. Close co-operation with other authorities and in particular in partnerships with the private

sector such as transport, harbour, logistics and other businesses as well as with the civil societies.

There are already trans-border law enforcement structures in place such as Europol, The Baltic Sea Region Task Force on OC (BSTF), Nordic Police and Customs co-operation as well as a bilateral co-operation.

The Baltic Sea law enforcement co-operation could be built on the groundwork laid by the BSTF. However, the BSTF is still a temporary structure. Stronger political support will therefore be needed in order to guarantee the stability and permanency of joint law enforcement co-operations in the Region.

Well functioning direct and practical mutual law enforcement co-operation between the Nordic countries could be a good practice to be applied more widely round the Baltic Sea region. Immediate mutual law enforcement co-operation gives much better possibilities to tackle crimes or criminals that affect at least two countries at the same time.

The OC groups operating in Russia and surrounding countries such as Ukraine and Belarus and having close connections with the active OC groups in the Baltic Sea region affect the security of the region. The external dimension of the Baltic Sea Strategy is therefore essential.

There are no sufficient or comprehensive mechanisms, structures or frames for joint crime prevention activities in the Baltic Sea region or for closer co-operation of all relevant public and private stakeholders (PPP).

Maybe it would be possible to create, in the framework of the Baltic Sea Strategy, a coherent Baltic Sea Security Program in order to identify and manage the main crime risks in the Baltic Sea area. The Program would bring together the key players of the public and private sector in the Baltic Sea States. Together, they should identify and prioritize the main crime risks in the region, agree on the means of managing risks and launch practical co-operation and partnerships for crime prevention.

The Program could consist of a solid security concept for the most critical functions in the region such as logistical chains of transportation, business networks and supply chains, financial transactions and the critical infrastructure of the region.

Yes. We could booster and facilitate the competitiveness of the Baltic Sea by strengthening the Security of the Region. We must not forget that the security against crimes and other intentional wrongdoings is and should be an important section of the comprehensive safety and security concept of the Baltic Sea Strategy.

Erkki Hämäläinen

*Detective Chief Superintendent
Licentiate of Laws*

*National Criminal Police
International branch*

Finland



Involvement of the City of Tampere in the Baltic Sea cooperation

By Timo P. Nieminen

As the cradle of Finnish industry, Tampere has always been strongly oriented towards international trade and cooperation. From the rise of Tampere into one of the leading industrial centres of Northern Europe in the 19th century, all the way to today's global businesses and the EU cooperation, the Baltic Sea region has provided a key framework for Tampere's international activities. In addition to a large number of export oriented companies – many of which are global market leaders in their respective fields – Tampere's world-class universities, cultural institutions and festivals make Tampere a recognized centre in the Baltic Sea region – one of the region's leading "regiopolises".

By its part, the City of Tampere actively participates in the various forms of local and regional level Baltic Sea cooperation. The city administration's contribution to and involvement in the Baltic Sea cooperation is based on the following four elements: A comprehensive twin city network, international organizations for local governments, EU projects, and the Baltic Institute of Finland – established and owned by the City of Tampere.

Tampere has numerous twin cities in the Baltic Sea region. In a "Nordic platform" – based on reciprocal twin city agreements - Tampere collaborates with the cities of Norrköping, Odense, Trondheim, Kopavogur and Klaksvik. In the Baltic states, Tampere has twin city agreements with Tartu and Kaunas - the second cities of Estonia and Lithuania. Cooperation between Tartu and Tampere is very active in various sectors, and it has broadened beyond local governments. With Kaunas, Tampere has participated in various joint EU projects for example in the field of eGovernment. In Poland, Tampere is proud to have the second city of Lodz as its twin city. With similarities and shared interests in industrial heritage and culture related issues, there are plenty of cooperation opportunities between Lodz and Tampere. Tampere's German twin cities, Essen and Chemnitz, complement Tampere's exhaustive twin city network in the Baltic Sea region, even though the German twin cities are located slightly outside of the Baltic parts of Germany.

In addition to its Baltic Sea region twin cities, Tampere has close cooperation with the City of St. Petersburg based on two cooperation agreements from 1994 and 2002. Joint projects with St. Petersburg encompass a variety of both bilateral and multilateral cooperation activities from innovation to environment protection, and from eGovernment to culture. Furthermore, Tampere is a partner in Helsinki Centre, a joint representation of the cities of Helsinki, Tampere and Kotka in St. Petersburg opened in 2008.

As regards international organizations, Tampere has been a member of the Union of the Baltic Cities (UBC) since 1995. Tampere, through the Baltic Institute of Finland, coordinates the UBC Commission on Information Society, and participates actively in UBC commissions in other sectors as well, such as environment, culture and urban planning.

Tampere makes its strongest mark in the Baltic Sea cooperation through the Baltic Institute of Finland which is based in Tampere. The establishment of the Institute in 1994 was one of the first and main Finnish responses to

the new situation of the Baltic Sea region emerged in early 1990s. The central aim of the Baltic Institute of Finland is to promote the launch of tangible collaboration projects in the Baltic Sea region and to facilitate the participation of Finnish organisations in these initiatives.

The Institute has established itself as one of the region's leading expert organizations for practical Baltic Sea cooperation with its high quality standards in international project planning and management. In Finland, the Institute operates nationwide, with prominent partners from all over the country. As a network-based organisation, the Institute initiates and implements practical, development-oriented projects, promotes trade and networking and raises awareness and distributes information on the current issues of the Baltic Sea region. In 2007 and 2008 alone, the institute was responsible for more than twenty collaborative projects in the Baltic Sea region and organised dozens of events in the Baltic Sea region and in Brussels.

The institute's geographical operating area covers the entire Baltic Sea region – the Nordic Countries, the Baltic States, Northwest Russia and the northern parts of Poland and Germany. As for the scope of activities, the key themes featured in the institute's projects include the development of the information society, environmental cooperation and the promotion of innovation and export.

For the City of Tampere, the founder and owner of the Foundation for the Baltic Institute of Finland, the Institute is a highly important partner and instrument in the implementation and development of the city's international relations strategy. The Baltic Institute of Finland is a valuable partner and resource for the City of Tampere and other local stakeholders especially as regards the preparation and management of the EU funded projects, as well as related networking and partner search. Tampere's extensive twin city network in the Baltic Sea region and the Union of the Baltic Cities provide a functional platform and partner base for the Institute's projects. The cities of Kaunas and Tartu have been especially important partners for the Institute.

The ongoing boom of the Baltic Sea cooperation and the coming EU Strategy for the Baltic Sea region underline the importance of the Baltic Sea region as a priority area for Tampere's international relations. There are various new interesting cooperation opportunities arising for Tampere in the Baltic Sea region, also concerning tourism and investments. Tampere's twin cities, as well as Helsinki, St. Petersburg and other metropolitan cities in the region, are our closest and the most natural partners and reference cities.

Timo P. Nieminen

Mayor

The City of Tampere

Finland



Vyborg Industrial Park

By Vasily Osipov

At the end of 2007 Lappeenranta and Vyborg have agreed on a mutual strategic purpose, to realize a project of industrial park on the territory of Vyborg district which will help to introduce enterprises of Lappeenranta and Southern Karelia into the Russia's market, will allow to use effectively area of 150 hectares, to create about 1000 work places and about 500 000 m² of buildings and structures with connected infrastructure and dedicated to different purposes.



Beside industrial park in Gorelovo, there are no other projects in Leningrad Region or Saint- Petersburg conception of activity of which would meet the presented model of the industrial park. Probably, the only industrial park of a large scale which is well known and more or less resembles our project is the industrial park of Kaluga which is located 200 km from Moscow.

Compared with Saint - Petersburg and its neighboring districts Vyborg has some most valuable advantage - lower cost of land. Vyborg also is considered to be a competitive place for building industrial enterprises very near to border and requiring less labor force.

In order to implement the project on the territory of or. Svetloe of Vyborg district a certain piece of land has been identified. It is located near the federal highway Saint- Petersburg, 20 km from the state border and 150 km from saint - Petersburg.

Feasibility study was financed by TACIS in the amount of 250 000 Euros.

It is planned to establish a joint venture for managing the project.

Shareholders of this venture will be: authorized companies of the cities - participants, enterprises responsible for infrastructure of the industrial park, construction companies - participants, "steam locomotive" companies that are planning to be located in this territory.

Principle owners will be responsible for financing estimated for the industrial park. The industrial park will be constructed in stages but the infrastructure should be designed according to final size of the project. In this respect at the initial stage of investments into the infrastructure a long period for financing, approximately 5-7 years, will be envisaged and calculation of profitability will be presented: if expenses for land use or for infrastructure are too high then it will not be possible to carry out construction projects competitively.

It is supposed that during the first stage about 27 000 m² of buildings will be built which will require about 400 workers. The following Table shows fields of activity of the enterprises that will participate in the first stage of the project (see table below).

Period of fulfillment of the first stage of the project: 2010-2011. Total period of the project fulfillment is 7-10 years. The project development team believe that the project will be interesting not only for Russian and Finnish businessmen but also will attract representatives of business structures from other Baltic countries.

Vasily Osipov

The Head of Vyborg City Administration

Vyborg

Russia

Field of activity	Need in premises (m ²)	Need in work force (people)
Assembly of power equipment	3000	30
Power and mechanical devices and equipment	3000	30
Power equipment for power engineering	1500	25
Metal works	3000	20
Network of subcontracting enterprises for metal- working	5000	10"x15
Metal and other furniture	1500	15
Surface finishing and treatment	1000	10
Designer's furniture	1000	10
Industrial valves	1000	15
Manufacture of metal trolleys	2000	25
Manufacture of boat equipment	1500	20
Excavators	1000	8
Surface treatment for stone-processing industry	1000	10
Carriage	1500	20
TOTAL	27 000	About 390

Rauma – Unesco world heritage town

By Arno Miettinen

Rauma is Finland's third oldest town. The coastal town with a population of around 40 000 is located in Western Finland, on the Gulf of Bothnia. Rauma is a popular seaside town, where modern industry provides employment and brings prosperity. Rauma is home to two Unesco World Heritage sites – the wooden Old Town area in the heart of the town and the Sammallahdenmäki burial site, which dates back to the Finnish Bronze Age (1500-500 BC). There are very few other culturally significant towns in Europe, or indeed in the world, that boast two World Heritage sites.

Multinational companies in the area have made Rauma an important export centre. Rauma has always been a shipbuilding town, and the STX shipbuilding yard, Rolls Royce propeller manufacturing plant and the Tampere Technical University hydraulics research centre are all in Rauma. The town is also host to major players in the paper industry; the UPM-Kymmene factory in Rauma is the second largest such facility in Europe, and the Metsä-Botnia pulp mill is the most modern in Finland.

The Forchem tall oil refinery is also among the largest of its kind in the world. The Oras factory in Rauma is one of Europe's largest tap and shower manufacturing facilities. The town's education offering and research expertise reflect the changing needs of commerce in the area.

The Port of Rauma

With 20 berths, the Port of Rauma offers comprehensive facilities for import, export and transit traffic. A reputation for excellent service and competitiveness has made the Port of Rauma Finland's primary harbour for the paper industry and the largest container port on the west coast. Its location on Finland's western coast gives the port excellent connections, and it can be accessed along 10 metre or 7.5 metre deep access channels.

As well as being a strong export harbour, particularly due to the pulp and paper industry, the Port of Rauma also has a large capacity for cost-effective import traffic. The port handles 18 departures a week sailing to European harbours, two sailings a week to the Mediterranean, and 7 sailings per month to the USA.

Combined traffic through the Port of Rauma was 7.1 million tonnes in 2008 – 3.6 million tonnes more than the previous year. This increase was entirely due to growing volumes of import traffic. Nearly 172,000 container units (TEU) were transported through Rauma in 2008, and a total of 1724 ships visited the port in the same year.

The Port of Rauma has:

- 115 hectares (1 150 000 m²) of field space
- 260 000 m² of covered facilities for general cargo
- 30 000 m² of heated warehouse space
- 230 000 m³ warehouse space for bulk cargo
- 175 000 tons of silo capacity
- 560 000 m³ of chemical and oil tank space

The Bothnian Sea National Park

The Town of Rauma has campaigned for many years and led the way in planning a national park scheme to protect the Bothnian Sea archipelago. The proposal is also

mentioned in the programme of the current Finnish government. Rauma Council has already made the decision to include areas owned by the town in the planned national park. The law giving a special role to local authorities is being used for the first time in Finland. As the first authority to take such a role, the Town of Rauma has been finding ways to co-operate with state officials. In the future the Town of Rauma will make its own decisions, through which it will carry some of the global responsibility for the conservation of nature and cultural values and for bringing them into the public eye. As the home of two World Heritage sites, Rauma is well qualified to carry such a responsibility.

The Bothnian Sea national park conservation area consists of a number of rugged islands near the open sea and the water surrounding them. In Rauma the area extends inwards to islands closer to the mainland, including the Kylmäpihlaja lighthouse island and the Kuuskajaskari island fortification. These islands offer good opportunities for visitors, and the founding of the national park also aims to help the tourism industry.

The Bothnian Sea national park is part of the European Natura 2000 programme. Nature is valued highly, and the forming of a national park brings tools for its conservation, use and awareness. The Town of Rauma is actively involved in the implementation of the Natura 2000 programme through the Baltic Sea project.

The Bothnian Sea national park is an ideal arena to share information and raise awareness to the plight of the sea. The Town of Rauma played a leading role in a co-operative project in the form of a book which asked: "How Are You Feeling, Bothnian Sea?" We are currently partnering in a study to establish the impact of climate change on the Bothnian Sea. The Town of Rauma's latest practical step in water conservation is the combining of public sewage treatment facilities with the treatment of waste water created by the forest industry, which has resulted in reduced nitrogen levels. Next on the agenda are water conservation measures for the region's beaches.

The Bothnian Sea is a strategic priority for Rauma. The Town of Rauma works for the good of the Baltic Sea in both its own decisions and in co-operative networks – also internationally.

In Finland, Rauma is involved in joint work along the Turku-Uusikaupunki-Rauma-Pori coast that has a strong focus on marine expertise. The Town of Rauma strives to co-operate with other Baltic coastal towns and research bodies, profitably and in a way that respects the sea, to improve the living environment for all of us.

Arno Miettinen

Mayor

Rauma

Finland



Five years in the European Union

By Solomon Ginzburg

Five years ago, on 1 May 2004, the EU welcomed ten new countries, including our neighbours Lithuania and Poland. The Kaliningrad area was the epicentre of geopolitical and geoeconomic games, linked with the enlisted power of a united Europe; which, according to economic indicators, can be compared with the USA, with over one and a half times its population.

Factor for a new partnership agreement.

On 30 November 2007, the partnership and cooperation agreement between the RF and the EU expired. This was an important document defining relations between the two parties. Therefore, the RF-EU summit, which took place last year in Khanty Mansisk, was the start of negotiations on a new basis for an agreement between the RF and the EU. It was very important to mention the Kaliningrad subject. A section on Kaliningrad should be present in the new international treaty, either in the basic text of the document or in the appendices.

After ratification of the agreement, it will have a framework-type character and will determine the conception of relations between the RF and the EU.

In the Kaliningrad section, there should be three parts: economy, freedom and security, education and science.

Economy. This section could cover issues related to federal, regional and European legislation; for example, how a federal law "on SEZ in the Kaliningrad region" is associated with one of the principles of the EU and not granting benefits according to the territorial principle. This should also logically include issues of common regulations and norms to promote close cooperation, the balancing out of competitive conditions and the free movement of goods, services and capital.

The issue related to legislation is a well-known problem. For a region in this programme, the experience of Switzerland, which is not part of the EU, is interesting.

The problem of the convergence of legislation in the economic area is an extremely current one. Otherwise, convergence with the EU is made not so much in depth but in width, in the scope of four general regions, which comprise, at first glance, everything, but in reality nothing. In this case, dialogue continues in conditions laid down for communication, which in interesting company and also at the expense of the state, may last for decades. However, this situation rightly reminds us of the never-ending negotiations on disarmament in the final years of the Brezhnev era.

The economy is a central link that is the basis for political, legal and humanitarian contacts. In the beginning, it is necessary to identify investment and trade links. Then the parties agree on the need to create and develop the corresponding legal basis.

Integration is a process and not a result. When opening markets, the economy always finds sizeable and

additional resources and benefits. The issue of convergence of legislation suggests unification. This concerns not the mechanical adoption of individual European norms and the instantaneous pseudosolution of difficult problems, but the use of the state arsenal of legal policies and practices to obtain coordinated goals in the interests of the people of Kaliningrad.

Freedom and safety. In this section, it is necessary to add norms regarding the provision of the inhabitants of the Kaliningrad region with free Schengen multi-entry visas.

Here again, it is vital to establish the position on freedom of inhabitants and employment, including the professional activity of citizens from the EU and people from Kaliningrad, the constant cooperation of legal bodies, especially in the fight against crossborder organised crime, illegal immigrants, drug trafficking, cooperation in the military field, and the carrying out of joint environmental and aid actions.

In the region and the EU countries, a single criminal area is taking shape. Organised crime is active wherever there are high-yield sectors of economy, the pull of investment, guaranteed production distribution, export directivity, the presence of a system of calculating cash circulations and the possibility of including illegally obtained capital in legal circulation. Special meaning is given to the problem when it occurs in a global recession situation.

Education and science. This section must contain the norms on long-term framework programmes, the joint financing of them, the creation of favourable conditions for cultural exchanges and mutual study of national history and the history of the European people. Training in the general educational field is possible on the basis of the Bologna process, which suggests the active exchange of teachers, pupils, students and those associated with the education sector and the mutual conversion of diplomas for higher education.

Solomon Ginzburg

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Russia



Ust-Luga Sea Merchant port – a strategic port of Russia

By Maxim Shirokov

Changing over cargo flows in the interests of the Russian economy is one of the most discussed issues in mass media. A significant role in this process is assigned by the Russian government to the Ust-Luga Sea Merchant port under construction in the Luga Bay of the Gulf of Finland.

The idea of building a new sea merchant port at the Baltic Sea has sound historical preconditions. Zbigniew Brzezinski, an American politologist, former national security adviser of US President Carter, denounced that Russia would disappear in the darkness and ice as its major ports found themselves in other states. At the time of the Soviet Union we were really a maritime power. The access to the sea was provided by 75 ports, most of them going over to former union republics after the collapse of the Soviet Union. Russia lost its maritime infrastructure and became directly dependent on transit countries. It is in the early 90-ies that we understood that development of the country's economy demanded building new links of a logistic chain. This is how "Ust-Luga Company" JSC was formed to fulfill the task of building an up-to-date multipurpose port and transforming the territory adjacent to it. Development of the new Russian port at the Baltic Sea was included in the Federal Target Programme "Modernization of the Russian transport system" and the scheme of the state and business interaction implemented in the port construction is one of the first examples of public private partnership in Russia.

The choice of the place for building the port was nonrandom. It was determined by the advantageous geographic position. The Leningrad region is a junction point of the international transport corridor connecting Europe with Southeast Asia. The port is situated in the Luga Bay 100 km away from Petersburg (130 km of navigable pass) in the south-western part of the Gulf of Finland and stretches 20 km into the coast between the Kurgalsky Cape in the west and the Kolgapnya Cape in the east. Due to the natural conditions of navigation in this area of the Gulf of Finland the port can operate all year round, with a relatively short ice channeling period.

The Luga Bay water area is very deep. In 2012 it is supposed to be brought to 17.5 m. This will correspond to the maximum values of the Baltic Sea. Given all these factors Ust-Luga will be able to admit dry cargo vessels of the deadweight of up to 75 thous. tons and to handle liquid carriers (tankers of various types) of the deadweight of up to 120 thous. tons. Besides, the port has a short ship channel of 3.7 km, which makes the ship passage much quicker.

A serious competitive advantage of Ust-Luga port is the availability of large territories adjacent to the port. They ensure development of the port-related logistic activities and creation of an industrial cluster naturally attached to the sea port as a large transport hub.

It is also important that the Leningrad nuclear power plant, a source of inexpensive electric power, is located next to the port.

The currently operating facilities of the port include the Coal terminal, Universal Transloading complex, technical sulfur transshipment terminal, motor-railway ferry complex (with the operating Ust-Luga – Baltiysk – Sassnitz (Germany) line), the Yug-2 Multipurpose Transloading Complex and the Factor Timber terminal. A container terminal is being built and a bulk cargo complex is supposed to be commissioned before the end of the year. Work is under way to create a complex of liquefied hydrocarbon gas transshipment and a complex of

liquefied gas condensate transshipment in the general cargo area. Ust-Luga port will become the terminal point of the route of the Baltic Pipeline System-2 for oil supply. The construction works are expected to start in summer 2009.

All the terminals are high-technology and are built in accordance with the world standards. For example, the Coal terminal is considered to be one of the most up-to-date coal transshipment complexes of the world. The quality of transloading of new imported cars at the Yug-2 MTC was marked very high by specialists of the Toyota Motors Company who officially announced that they wanted to make Ust-Luga port an anchor port for transloading of their cars.

The Yug-2 MTC is intended for transloading of rolling machinery, container and general cargoes of various nomenclature. But the priority cargo is new imported cars. Today this is the first and so far the only specialized car terminal in Russia meeting the world standards. It has obvious advantages over similar terminals of other Baltic ports. The area of the Yug-2 MTC is 97.8 hectares. Today the terminal grounds can simultaneously accommodate up to 5 100 cars and their number will increase up to 13 thous. cars after commissioning of the second stage. The first startup complex for 100 thous. cars per year is working now. When the terminal reaches its full capacity of 6 mln. tons export-import cargoes, it will be able to transload up to 360 thous. cars. It is important that working through Ust-Luga port rather than foreign Baltic ports a cargo handling company economizes up to 300 Euros on every car.

An undeniable advantage of the Yug-2 MTC and Ust-Luga port in general will be the Warehousing logistic center (WLC) taking the area of 115 hectares between the container terminal and the Yug-2 MTC. The WLC will provide a comprehensive range of services of outside cargo storage and indoor storage in controlled temperature conditions. The technical center of the WLC will render car retrofit services: installation of options in cars, washing off the protective transportation coat, PDI – Pre-Delivery Inspection.

Although the crisis has changed the time frames of construction of some terminals, Ust-Luga Sea Merchant port keeps developing. The main thing for Ust-Luga Company, the port construction management company, is proper attachment of priorities to lay the basis for future dynamic development, to preserve its competitiveness, including creation of new possibilities for investors and additional services for carriers.

In 2008 almost 7 mln. tons of cargoes passed through Ust-Luga Sea Merchant port.

In the first quarter of 2009 the cargo turnover of Ust-Luga port increased by 20% from the same period last year.

In 2015 the port capacity is to amount to about 170 mln. tons of various cargoes per year with account of the BTC-2.

Maxim Shirokov,

General Director

Ust-Luga Company, JSC

Russia



Russia: the loss of reserves and inflationary consequences of devaluation – the myth and the reality

By Alexei Moisseev

Russia's international reserves dropped \$173bn from 1 Oct 2008 to 1 Apr 2009. The rapid fall in 4Q08-1Q09 has been cited as a weakness in the Russian economy and its financial system. It has been argued that, despite the high volume of reserves accumulated before the beginning of the crisis, almost one-third was spent within six months, and if the rate of spending persists, the reserves will be exhausted by the end of the year.

Nevertheless, we note that, in reality, for the most part, currency reserves never left Russia, but changed hands domestically. As a result, a large proportion of currency assets has been transferred from the CBR's accounts to the accounts of companies and individuals that have increased the share of foreign currency assets in their savings. In this respect, we note that the devaluation that the CBR conducted in a gradual manner, has really accounted to balancing the aggregate short-dollar position of the private sector, including state-owned banks and corporate, at the expense of reducing the aggregate dollar long of the government. Below is where we found the reserves did go:

- **Differences in foreign currency translation:** International reserves are not held exclusively in dollars but also in euros, sterling and yen, therefore fluctuations in the dollar rate vs these currencies lead to changes in the value of international reserves measured in dollars. From 1 Oct 2008 to 1 Apr 2009, the dollar appreciated against the euro by approximately 6% and against sterling by almost 20%. Based on the indicative structure of international reserves, the **effect of the currency revaluation amounted to \$25bn.**
- **Cash currency operations:** The balance of individuals' currency acquisitions and withdrawals (deposit) to/from banking accounts during this period reached \$37bn.
- **Deposit conversion from roubles to foreign currency.** In the past six months, corporate and retail clients have been converting funds in their rouble deposits to foreign currency, especially in December and January. As a result, the balance of foreign currency deposits has increased \$46bn.
- **External debt redemption.** In 4Q08-1Q09, banks redeemed over \$40bn in loans, and government agencies and monetary authorities redeemed about \$11bn. These sums are cash flow based, and since the end of 2008, as banks have been aggressively buying out their debt, traded at considerable discounts, we believe that the reduction in the banking system's external debt was more significant than \$40bn (CBR statistics show a \$50bn reduction of banks' external debt).
- **Speculative open currency positions.** Banks continue to hold speculative positions vs the rouble, which we estimate at approximately \$30bn as of 1 Apr 2009. At some point in time they will have to sell them back to the CBR.

Within the international reserves balance, we note that the CBR continues to record commercial banks' accounts held with the CBR in foreign currency, which totalled about \$35bn as of 1 Apr 2009. Thus, in reality, international reserves fell \$205bn from 1 Oct, rather than \$170bn. We estimate \$20bn flowed out of the 'other segment', which we believe is a kind of real capital outflow. Nevertheless, we reiterate that most of the total fall in international reserves is not an irreversible capital outflow, but represents a conversion of corporate and individual savings to foreign currency and the redemption of external debt. Moreover, as a result of converting clients' funds to foreign currency, banks have accumulated large currency holdings that exceed, according to our estimates, \$100bn. This liquidity cushion can be used for further redemption of external liabilities of the banking and corporate segments without turning to direct or indirect use of international reserves.

A material risk related to pro-active government policy in managing the economic and banking crises is inflation, especially in a country like Russia which has high inflationary expectations. Nevertheless, there are also plenty of historical examples that indicate the lack of government liquidity could deepen the economic downturn. The Russian monetary authorities provided the banks with over RUB2.5trn as of 1 May 2009; however, monetary policy has been excessively tight, in our view – the money supply decreased 20% and only then did it stabilise.

While the way the CBR has conducted the devaluation may have been a blessing as far as the external solvency of corporate Russia is concerned, it has also had a very negative connotations for the real economy. I guess it is fair to say that the more rigid the foreign exchange has been coming into the crisis, the greater is the decline in the real economy due to the procyclical nature of fx bands and similar arrangements.

Russia's monetary policy has been some of the tightest in the world, with real policy rates exceeding 5%, and, with the obvious problems of the banking system, real cost of credit to the real economy exceeding 20%. It appears that the recent devaluation is actually the only factor spurring inflation, while final demand is obviously extremely low. Weekly CPI values grew materially when rouble devaluation reached its peak; however, in the past few weeks, weekly CPI changes have been decreasing rapidly. If we extrapolate the inflation registered in the past two weeks, its annual level would equal a mere 5.3%. Clearly, this extrapolation is unrepresentative due to a complex set of factors, such as seasonality, and an insufficient observation period, but one could argue that inflation is obviously on a downtrend, and a further drop in the indicator cannot be ruled out. Moreover, in Apr 2008, the weekly inflation level was three times higher (0.3% vs 0.1% in Apr 2009). Thus, we believe monetary policy is excessively tight, which has resulted in an economic squeeze.

On 29 Apr, President Dmitry Medvedev signed a bill on the 2009 federal budget, stipulating a RUB3trn deficit. About RUB2.7trn will be financed by the Reserve Fund, which will be achieved through printing money. The CBR will buy foreign currency from the Ministry of Finance for newly printed money, which is, in fact, equal to issuing money. Nevertheless, we do not think that this issuance will contribute to inflation, at least not in 2009. On the contrary, it will compensate for the reduced money supply caused by devaluation. One could argue that, with the economy being squeezed, there is no need for the same volume of money supply, but in other countries with transitional economies, the money supply has grown since the beginning of the crisis. In real terms, these figures are even more telling.

Finally, even if inflationary pressures resume, there is still an opportunity to quickly reduce the money supply by limiting CBR bank loans to banks that mature in the short term and whose total volume is close to the size of the target budget deficit. In this light we believe that the growth in the money supply should be limited when inflation has stabilised rather than when it is falling rapidly.

Alexei Moisseev

Head of Fixed Income Research

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Russia

The second wave of the banking crisis – to be or not to be?

By Natalia Orlova

After experiencing some turbulence on the interbank market, the Russian financial system felt the first significant effects of the international financial crisis in the second half of 2008. The first wave of the banking crisis was accompanied by a liquidity squeeze, unstable exchange rate and significant withdrawal of bank deposits. However, since there had been a similar run on the largest banks in summer 2004, these developments were neither new nor particularly ominous. Having learned from previous experience, the Central Bank took action by cutting banks' reserve requirements and expanding refinancing options to provide banks with the needed liquidity.

A greater threat to Russia's banking sector is the question of nonperforming debt that looms on the horizon. This debt is particularly dangerous for Russian banks because they do not have experience working with bad loans. In the 1990s, all banking sector activity was focused on the currency market and later moved on to the state bond market. Prior to 1998, loans made up only 40 percent of bank assets — compared with the current level of 60 percent — and were concentrated on interconnected borrowers. Thus, in 1998, bad loans in a number of cases reflected bank owners' decision to sacrifice their banking business in order to save the productive assets of the group.

Lending began to grow in Russia in 2003 and 2004, fueled by greater penetration of foreign banks into the local market as well as the wider availability of foreign capital. In the period from 2002 to 2008, corporate loans as a proportion of gross domestic product grew from 15 to 30 percent, and the retail lending market sprouted from a ridiculously low 1 percent of GDP in 2002 to 9 percent in 2008. During the recent years of high economic growth, bad loans — particularly bad corporate debt — were not an issue for the banking sector. In the first half of 2008, the level of nonperforming loans under Russian accounting standards accounted for only about 1 percent of banks' lending portfolios.

Today, however, Russian banks are vulnerable to one overarching risk — the palpable decline of economic activity that is affecting all sectors of the country's economy. Russia's GDP fell 9.5% y-o-y in 1Q09, and in April it dropped by 10.5% y-o-y. The current economic downturn means that all banks will see an increase in nonperforming loans to one degree or another. Exporters are suffering from the decline in global demand and the unavailability of foreign capital, so they will certainly face liquidity problems. Furthermore, the decline in the country's construction sector suggests that the credit quality of companies operating in the manufacturing, transportation and trade sectors will deteriorate. The dramatic drop in equity and real estate prices has reduced the value of collateral used by borrowers. Retail clients will also have trouble servicing their long-term debt.

Another concern is the short maturity of Russia's debt. Companies need to redeem around \$220 billion by the end of this year. Half of this amount is denominated in foreign currency, which imposes an additional financial burden considering the significant depreciation of the ruble since September. The \$220 billion debt figure is equal to roughly 20 percent of Russia's current GDP. Given today's environment of declining global and local demand, it is indeed difficult to imagine that the real sector of the economy will be able to generate the necessary revenue

flows to service its outstanding debt. Nonperforming loans can be expected to peak in the third quarter, at which point Russia will experience the "second wave" of the crisis.

Because \$220 billion in debt has to be paid this year, a level of bad loans of 15 percent looks inevitable, and a "domino effect" of bad debt could push nonperforming loans to as high as 30 percent. Banks are clearly working to reduce their exposure to troubled borrowers in order to keep bad loans in check. This, in turn, is exacerbating the situation for struggling companies that face severe liquidity problems, making it likely that some will become insolvent.

During periods of economic trouble, the issue of corporate governance often comes to the fore. If financial markets remain closed for a long time, borrowers may decide to restructure the principal part of their debt without making any effort to honor the initial schedule or play by the rules of the market. For this reason, creditors readily agree to almost any proposed restructuring scheme in order to keep the company from entering bankruptcy, which could result in a very low recovery ratio. Needless to say, this leads to the appearance of "ghost" companies that continue to exist without performing any economic activity.

Another obvious risk a decline in the transparency of Russian banks. In the last six months, the largest Russian banks have restructured around 5-10% of their loan book in response to clients' liquidity problems. These loans were usually restructured ahead of their maturity date and so were not reported as NPLs and did not require additional provisions. However, with companies' liquidity problem quickly turning into a solvency problem, these hidden NPLs must be detected through stress tests performed by the Russian regulator. Thus, the second wave of the banking crisis could also be triggered by NPLs reported from these restructured loans.

There is, however, some reason for optimism. First, the Russian economy as a whole is not highly leveraged by global standards. Russian companies' debt amounts to around \$800 billion, or 50 percent of last year's GDP. By way of comparison, in the East Asian economies that were overwhelmed by the crisis of 1997, corporate debt accounted for up to 150 percent of GDP. After bad loans peak in the second half of this year, the Russian economy could restart growth by expanding leverage. Thus, the downside potential of the Russian economy appears limited. The question is whether it will be able to generate growth.

Second, this crisis offers an excellent opportunity for a much-needed consolidation in the banking sector. At present, 200 banks control about 90 percent of the country's banking sector. This suggests that there is significant scope for smaller banks to improve the efficiency of their business through consolidation and by finding synergies to address the current crisis. Consolidation would also make the Central Bank's task of monitoring banks a lot easier.

Natalia Orlova

Chief Economist

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Russia

Russia on the Baltic

By Timo Vihavainen

Russia is in many ways the quintessential continental country, whose outlets to the sea are few and mostly unfit for large scale trade. However, the dearth of sea routes has made the remaining ones all the more important.

In the Middle Ages Novgorod was already integrated into the Hanseatic League. After the rise of Muscovy, the Russian tsars, most remarkably Ivan the Terrible, tried to gain the mastery of the Baltic, but was defeated.

During the Time of Troubles Poland and Sweden were able to put Russia to its knees. In the 1617 treaty of Stolbovo Sweden enlarged its territory deep to the east

On the early 18th century Peter the Great, of course, thoroughly changed this situation. Since the peace of Nystad (Uusikaupunki) in 1721, Russia was a serious naval power, especially on the Baltic. But this did not mean that its mastery of the sea was unchallenged. On the Baltic Sea, a couple of remarkable naval powers could outweigh Russia's Baltic Navy. More than that, Sweden alone could try to do this at a moment when Russia was tied in a war elsewhere.

This was what happened in 1788. Sweden was not happy with its defeats in 1721 and 1743. It allocated huge amount of resources for building up its sea power. Partly Sweden was helped by France, which financed the building of the sea fortress Sveaborg. Sveaborg did not have just defensive role, it could also be used as a place d'armes, a base for offensive warfare.

When Gustav III invaded Russia in 1788, it was his aim to take the Russian navy by surprise and to proceed to St. Petersburg. The main forces of the Russian army were then tied to a war with Turkey and with the Baltic Sea in Swedish hands the Russians could in principle be overpowered by the Swedes.

Gustav's *blitzkrieg* came to nothing for several reasons. However, the shock of the invasion was so great in St. Petersburg that Russia sent its foremost general, Alexander Suvorov to build a formidable chain of fortresses on the Russo-Swedish border, which then went along the river Kymmene (Kymijoki). Once again, money was not spared and the Russian fortresses Ruotsinsalmi, Kymminlinna, Hamina, Utti, Taavetti (Davyvovo), Lappeenranta, Savonlinna and several minor outposts formed together a fortified line, which can be compared only to the next Russian system of fortifications, which was built during WWI.

This latter system was called the Fortress of Peter the Great and together with the fortifications around Helsinki it was supposed to be able to shut the Gulf of Finland from the German navy. The system of fortifications consisted of heavy artillery on Finnish and Estonian coasts and also a circle of smaller fortresses, especially around Helsinki, armed with hundreds of artillery pieces and machine guns. Completed with sea mines, submarines and surface vessels this seemed to be enough to save St. Petersburg from invaders.

In fact, the German navy was able to come to Finland only after the Bolshevik revolution had destroyed the Russian war-machine.

The idea of closing the Gulf of Finland in order to prevent attacks against Saint-Petersburg remained important also from the Soviet strategists. When both Estonia and Finland were independent, they could also try to prohibit the Soviet navy from getting out of the pit of the

Gulf of Finland. For this they could use the remaining heavy artillery of the fortress of Peter the Great complemented with submarines and sea-mines. This weaponry was effective enough to form a mortal danger for any kind of warships.

As we know, after the Molotov-Ribbentrop pact of 1939 the Soviet government took to its hands military bases on both sides of the Gulf of Finland in the year 1940. In fact this strategic position proved to be of little use, when the German attack reached Estonia and when Finland joined the war on German side in 1941. Hanko, which had been taken from Finland at the tremendous cost of the Winter War, proved quite useless for the defense of St. Petersburg and the Soviets also had to evacuate Tallinn by sea, which cost terrible losses in terms of ships and human lives. During most of WWII, the Soviet fleet was closed into the pit of the Gulf of Finland.

After WWII the position of the Soviet Union on the Baltic Sea was so dominating that, from its point of view, it was quite logical to call it "the sea of peace". Even after the return of the Porkkala naval base back to Finland in 1955, the Soviet hold of the Baltic Sea was firm, with the entire eastern coast in its hands.

After the collapse of the Soviet Union the situation has changed. Only a narrow corridor in the middle of the Gulf of Finland is now international territory, where Russian vessels and airplanes are free to operate. The Kaliningrad oblast in the south is a Russian exclave surrounded by foreign countries, which belong to the NATO.

In our days, fears concerning the security of Saint Petersburg against a naval invasion through the Gulf of Finland would make little sense. On the other hand, the Baltic Sea now is an even more important economic artery than it used to be when Russia was almost autarchic. Russia has nowadays very little even of economic maneuvering space in the Baltic Sea. This concerns especially its vitally important products, oil and gas. The Gulf of Finland is now almost totally in the hands of respectively Estonia and Finland and if both these countries would like to make trouble for the construction of the Nord stream pipeline, for instance, their joint effort could seriously threaten Russia's vital interests. So far, Finland seems to prefer avoiding confrontation with Russia in this question, while Estonia has adopted more negative attitude.

Mastery of the Gulf of Finland has been a high priority to Russia for centuries and this can not be expected to change in the foreseeable future. The shallow waters of the Baltic Sea may once again turn into a field of struggle, where vital national interests are concerned.

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The post-western world – implications for Russia and the West

By Andrei P. Tsygankov

The second half of 2008 has revealed that the world is entering a principally new stage of development. While the global economic crisis has severely undermined the West-centered model of global economic expansion, the Russia-Georgia war ended the West's monopoly for unilateral use of force previously demonstrated by NATO's military attacks on Yugoslavia and the United States' invasion of Iraq. That Russia choose to use force in the Caucasus in defiance of the West implies de-centralization of hard power usage and promises serious difficulties for Western nations with continuous expansion of NATO's geopolitical responsibilities at the expense of political arrangements, such as Shanghai Cooperation Organization and Collective Security Treaty Organization.

It is becoming clear that attempts to dominate others by using tools of military and economic coercion are going to be increasingly de-centralized and undertaken without consultation with Western nations. Observers are increasingly aware that the West-centered world is beginning to unravel. Structurally, it is still the familiar world of American primacy with the Western – especially American – military predominance and the West's global superiority in political, economic and cultural dimensions. But dynamically the world is moving away from its West-centeredness even though the exact direction and result of the identified trajectory remains unclear.

At this point in history, Russians need to develop a coherent response to changing structural conditions of the international system. In the post-Western world, Russia's development will continue to be complicated by the expansion of Western military infrastructure and the rise of China. The latter will increasingly present Russia with the challenge of progressive power differentials. As Russia continues to supply China with energy and weapons, and as China grows at a considerably higher rate than its northern neighbor, the risk of Moscow becoming a junior partner in a Beijing-led coalition increases. Although the two's relations are good, there are signs of China's increasing assertiveness. They may include Russia's unwillingness to press environmental claims against its neighbor when it polluted the Amur River, the recently demarcated borders with several territories going to China, and Beijing's efforts to negotiate energy supplies below market prices. Finally, there is a challenge of oil markets, as Russia remains dependent on their stability for its continued modernization.

In response to challenges presented by the post-Western world, Russia should seek to devise collective security and collective prosperity systems across the world, rather than to merely normalize relations with the West. The international legitimacy of such a strategy may be accomplished, in part, by participation in multilateral arrangements. As a member of several important organizations, Russia may take full advantage of being an international participant. In a post-Western world, security alliances increasingly lose their traditional significance, making it imperative to rely on soft balancing tactics. Issue-specific international engagement is a way to make such tactics more effective, and Russia ought to become more active in regional institution-building. For example, unable on its own to effectively respond to security challenges

from NATO, Russia should continue to develop soft balancing coalitions with selected European countries, China and Iran. However, Russia should also continue to build ties with European Union, United States, India, South Korea and Japan as soft balancing tactics to address the issue of rising China. Similar flexible engagements may be relevant for addressing issues of weapons proliferation, terrorism, energy and drug trafficking.

Arrival of the new post-Western world also has important implications for the United States and European nations. Rather than trying to secure the 21st century as another American or Western century, Washington and Brussels will do well to acknowledge the irreversible – albeit gradual – nature of Western decline and prepare for an honorable retreat from the position of global hegemony. In application to relations with Russia, the latter attitude means the need to act in concert and consultation with the Kremlin, rather than out of expectation of it being helpful in executing the West's grand plans. Although many in the United States and Europe are skeptical of a serious improvement in relations with Russia, their interests are compatible not just in fighting terrorism and arms control, but also in areas of historical perceptions, energy relations and political development.

If the Western nations continue to act on unilateral and imperial temptations, new challenges will inevitably arise, as the George W. Bush's era has demonstrated all too well. In this case, the non-Western nations beginning with Russia will act in defiance by unilaterally asserting what they see as their strategic and economic interests. In the absence of sufficiently strong international institutions, such interaction is likely to result in new conflicts across the world. On the other hand, the post-Western world promises new opportunities to those who are willing and able to seize them. A gradual retreat of the West does not have to be accompanied by growing destabilization across the globe, but instead may create an international environment for reducing arsenals of deadly weapons, devising more socially egalitarian and politically responsive institutions, and developing greater cultural sensitivity in the world. The still predominant West would then need to lead by example showing the way not to the new "Western century" but to a controlled disarmament, a new economic order, assistance with regional political institutions, and initiation of innovative cross-cultural learning programs across the world.

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Green valley on top of Europe – new and strong initiative can boost energy co-operation in the Baltic Sea Region

By Hans Brask

- The Baltic Sea Region (BSR) benefits both economically and environmentally from closer co-operation in energy planning. This has been substantiated by an analysis of countries' energy systems, building on hard data and transparent analytical instruments.
- A shared regional energy agenda is not easily set and the benefits are not easily exploited. Most stakeholders in the region share, however, the same objectives regarding reduction of Green House Gasses, increase of renewable energies and energy efficiency and the promotion of green tech solutions.
- The EU and the European Commission provide new vitality to the regional energy co-operation. Nordic Council of Ministers is also helping in setting higher ambitions. But regional actors need to exploit the new possibilities.

These are the three main conclusions that Baltic Development Forum presented at the opening of the energy seminar *Creating a "Green Valley" of Europe - Different Scenarios*. The seminar was held in connection with the meeting of Foreign Ministers of the Baltic Sea Region, 4 June in Elsinore.

The conclusions are based on the energy project that Baltic Development Forum has advanced during the last 18 months. The project has two objectives: 1) to promote a common energy agenda for the BSR through the involvement of all relevant stakeholders 2) to provide a solid basis for discussions on how to fulfil the EU's new energy targets through collective action and better use of the region's many energy resources/energy-mix. The final report of the study *Enhanced Regional Energy Co-operation in the Baltic Sea Region*¹ will be ready by the end of the year but the preliminary results are available in June 2009.

As regards the first objective, the conclusion is that the involvement of various stakeholders on different levels does contribute to a better and shared understanding of the benefits from a more integrated energy co-operation. So far a Joint Energy and Climate Platform² for BSR organizations has successfully been created, giving full support to the project. Now it seems necessary to go further by establishing an energy stakeholder forum that includes also ministers and representatives of the private sector. Combating climate change is a hugely complex exercise that requires the involvement of actors both cross-level and cross-sector. Baltic Development Forum proposed that such an energy forum was organized at the last ministerial meeting of Baltic Sea Region Energy Co-

operation (BASREC) in February. It was favourably received by the chair.

But unfortunately, the BASREC ministerial meeting did not produce results that will help bringing new vitality to the regional energy co-operation. New initiatives will mainly have to come from the EU and Brussels – not from the regional organisations. The Commission's recent proposals for a European Energy Programme for Recovery, a Baltic Interconnection Plan and an EU Strategy for the Baltic Sea Region are promising policy frameworks that can create stronger regional energy co-operation and investments in an energy infrastructure development. It will also help making better use of the many energy competences that this region possesses.

The EU Strategy suggests establishing a list of priority projects in the framework of the Baltic Energy Market Interconnection Plan. If this is done successfully, the BSR will become a larger and more efficiently working energy market. It is very encouraging and such projects will surely advance positive effects from regional integration.

Today, the BSR has also a very strong position on environmental technologies, accounting for more than 10% of patents filed in the US and Japan in renewable energies. In other areas, the position is also strong. In 2008, an International Cluster Mapping Project identified that the BSR has drastically improved its global market share in the area of power and power generated equipment.³ The BSR has a chance to position itself further as an interesting place for investors and traders. It will require, however, agreement on an overall vision that all stakeholders can relate to. Baltic Development Forum proposes that the vision should be to create *A Green Valley of Europe* in order to mobilize the strong traditions in the region for public-private co-operation. The former Danish Prime Minister presented this vision for the first time at Baltic Development Forum's Summit 1-2 December 2008 in Copenhagen-Malmö.

In 2009, global attention is firmly directed towards the BSR due to the UN Climate Summit in Copenhagen in December and the Swedish EU Presidency. These high-level events are unique opportunities for the countries in the region to brand themselves individually. Therefore, it has been rather difficult to advance regional approaches to branding. It has simply been too tempting to choose national branding strategies. Maybe it will be easier to work together on a regional level in 2010 when the global attention is moving away. The Nordic Prime Ministers have decided to set a common and ambitious energy and climate agenda for the Nordic co-operation. It could be a very useful tool for advancing the wider co-operation in the BSR, involving also the three big countries – Germany, Poland and Russia. Individually, each of the countries and the markets of the Region are too small to penetrate globally, therefore a common approach seems obvious.

Finally, the stakeholder process has revealed a need for common training programmes in order to improve a better understanding of the potential benefits from regional collaboration in energy planning. A regional energy agenda is not only politically defined. It is also defined by national energy experts and by local and national traditions.

¹ The energy project is mainly supported financially by Nordic Council of Ministers and the analysis is carried out by Ea Energy Analysis. The report and results can be found of www.bdforum.org

² Joint Platform on Energy and Climate consists of the Union of Baltic Sea States (UBC), Baltic Sea States Sub-regional Co-operation (BSSSC), Baltic Sea Parliamentary Conference (BSPC), Nordic Council and Baltic Development Forum. One objective of the platform is to improve co-ordination of the different activities in the energy field and promote a shared agenda.

³ See Baltic Development Forum's State of the Region Report 2008, Sustaining growth at the Top of Europe

Therefore, common training exercises can provoke out-of-the-box thinking and help to see new opportunities. Such programmes should also aim at developing the exchange of experiences and best practices among officials at local and national level.

As regard the second objective of the project, interesting conclusions can – so far – be drawn from the study, demonstrating clear benefits from regional energy co-operation. Some of them deserve particular attention:

First of all, BSR possesses many different renewable energy resources that are sufficient to achieve a regional target of at least 50 % CO₂ reduction in year 2030 compared to 1990.

Secondly, there are significant economic effects and benefits through a stronger co-ordination of the energy policies across the region. The countries are simply better off, if they decide to work together. Energy diversification and security of energy supply would increase in parallel.

Thirdly, there is a huge potential for cost-efficient energy savings and energy efficiency measures by end-users (private household and business) and at power generation facilities. A lot of “low-hanging fruits” are waiting to be picked.

The study also shows that an increase in the use of combined heat and power generation and the reduction of electric heating will lead to very substantial reductions in primary energy consumption and CO₂ emissions.

It confirms furthermore that there are many benefits from building new transmission grids for electricity in the Region. In particular, the benefits exist in linking the thermal power based systems in Poland and Germany and the Nordic power system dominated by hydro power.

Similarly, there are attractive benefits from strengthening the electricity connections between the Baltic countries and the Nordic countries.

Finally, integrated off-shore wind grids could serve a twofold purpose: connecting the wind farms to the transmission grid at shore as well as linking the electricity markets in the region closer together.

The off-shore windmill park at Kriegers Flak – a relatively shallow-water area in the Baltic Sea – could be a very strong pilot project for other integrated offshore grids. The region needs such demonstration facilities as showcases for comprehensive and sustainable energy systems.

The final result of the energy project will be presented at the end of the year. Baltic Development Forum Summit in Stockholm 5-6 October will further promote a common regional energy agenda and present the advantages of joint initiatives.

Hans Brask

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The Baltic University – a network for sustainable development

By Lars-Christer Lundin

Started in a different world

The Baltic University Programme (BUP) started in 1991, when the Baltic Sea was still a barrier between the people of the Baltic. The end of the Cold War era created new possibilities for international cooperation and the interest from the universities around the Baltic Sea was large. Already during the first year 70 universities joined the network. Initially, the common ground was environmental issues, whereas democracy and human rights were off limits. The first common undertaking was thus a course on the Baltic Sea environment, attracting some 3,600 students in ten nations. The growing trust and the rapid political developments made it possible to give a course on history, democracy and security, called Peoples of the Baltic, already in 1992. Sustainability was introduced as a concept in 1997 and in 1999 the first master level course, on sustainable water management, was run. During the early days, satellite TV broadcasts were the means of connecting the students and teachers in the region, followed more and more by the Internet. In 2003 the first e-learning course was given. Today the almost 70,000 students (presently some 10,000 per year) from the 220 member universities that have been fostered and educated in sustainable development issues make BUP one of the largest networks of its kind in the world

A regional network

The aim of universities is to develop the societies they serve. BUP promotes development in the Baltic Sea region. The region is delimited by the water divide of the Baltic Sea, a rather novel concept at the time, gathering all nations that contribute rainwater to the Baltic Sea. Later, the EU Water Framework Directive's focus on catchments and water divides made the choice of delimitation even more rational. The region thus includes Sweden, Finland, Russia (Northwest), Estonia, Latvia, Lithuania, Belarus, Poland, Ukraine, Czech Republic, Slovakia, Germany, Denmark and Norway. Already from the start, the region was an open region, incorporating teachers and scientists also from the US, the Netherlands and other countries.

The main activity of BUP is the production of undergraduate and master courses and course material on various aspects of sustainable development but research related activities, capacity building, in cooperation with industry, authorities, NGOs and public outreach are also on the agenda.

Courses and course formats

The main outcome of the network activities are the so called higher education course formats, the term format being borrowed from the media world. A course format consists of course material (textbooks, teacher's guide, films, examination coordination, course homepage, etc), a model curriculum, regular teacher training, and course coordination. Each format is promoted by a mentor, an experienced teacher. Any member university can thus with minimal effort start a local course and get support to the teacher responsible for it. The Baltic University Press offers more than 40 titles and has made some 40 video productions, most of them in support of some of the course formats. Currently there are eight course formats available: Area Studies, Education for Change, Environmental Management, Environmental Science, Sustainable Community Development, Sustainable Development, Sustainable Water Management and Education for Change.

The principle is that courses are run at the member universities and coordinated by the secretariat, organizing common videoconferences or some other cooperative activity. Typically some 250-300 courses are run every year, involving some 350 teachers.

Organization and funding

BUP originated as an initiative from Uppsala University and was for its first 15 years run by its originator Prof. Lars Rydén. Activities were very much centred on the secretariat in Uppsala although regional centres were formed already in 1994. Today the secretariat, headed by Christine Jakobsson, is a part of the Centre for Sustainable Development Uppsala (CSDU) and is an

integrated part of the sustainability work at Uppsala University. Members of the network were initially loosely tied but are now signing bilateral agreements with Uppsala University, still being the network host. The network is headed by an international board, with representation from the member universities. The biannual student's conferences gather students from the courses, elect student board members, and treat some topic in the form of an intensive course.

Financial support has been given mainly from the Swedish Institute and Sida. Regular base support has been given by Uppsala University and since 2001 also directly by the Swedish Government. Together with other project support the total turnover is close to €1million. In addition to this, member universities contribute, mainly with personal resources, and some of the regional centres are sponsored nationally, e.g., the Finnish centre that has received direct grants from the Finnish Government.

Networks for sustainable development

The concept of networking is as such highly relevant today. Networking enables rapid responses to a changing world, quick exchange of experiences and ideas and gives a social or societal context to its members. BUP is a regional network, with a common unique intra continental sea in focus. The main asset of the network is its teachers and its students. History and culture differ but relations of the people go back to the Viking age. Today the Baltic region is under influence of globalization and the perhaps most unique feature of BUP is the network itself. Presently the network concept is being discussed in the Lake Victoria region, in the eastern Mediterranean region, and in the Great Lakes region in US and Canada, where the BUP serves as a model and mentor network. I believe there is a mission for similar networks in other regions of the world, either centred on a clear hub, supervising the satellites, or peer-to-peer networks, working with different aspects of sustainable development. It could involve universities and education for sustainable development or authorities for sustainable management.

Future prospects

The future for the Baltic Sea region looks bright today despite the present economical recession. It is an open region, most countries being EU Member States. The agenda of sustainable development will last for years to come but the possible avenues to pursue it will increase, giving more competition to networks like the BUP. I thus believe that the agenda must be both elaborated and extended. One interesting aspect is the network concept itself, aiming at a network of regional networks, together addressing global aspects of sustainable development, perhaps in combination with developing local networks; universities working together with local authorities, municipalities, schools, and industry to address local sustainable development.

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Times are also hard for Russia forecasters

By Jouko Rautava

Forecasting economic crisis is known and proven to be an unforgiving task. According to a study on the accuracy of forecasts with an emphasis on so-called consensus estimates, out of the 26 crises experienced in industrial countries and major emerging economies over the past few decades, only two were successfully forecast a year in advance. Furthermore, forecasters are particularly cautious in changing their view of the economic situation, and in many cases, a crisis is not detected until it is upon us. The present crisis has again shown that the accuracy of growth estimates is at its weakest when one needs them the most. Forecasts on Russia are no exception.

All forecasts revised sharply downwards

As recently as last October, the International Monetary Fund (IMF) forecast slight growth in the euro area and the United States for 2009, but following repeated revisions, its April forecasts are now deep in negative territory. For Russia, the change of view has been even more pronounced – expectations of a 6% growth in October had turned to a decline of 6% by April. Private sector forecasters have not succeeded any better. The consensus estimate for 2009 in October predicted 5% growth in Russia, while in April it stood at a decline of 3%. Subsequently, many forecasters have revised their estimates further on the clearly more negative side.

The variation in forecasts on Russia is considerable. Although Russian total output sank in the first quarter over 9%, the most optimistic pundits expect a rapid economic turnaround and believe GDP growth in the last quarter of 2009 will reach the levels of the end of 2008. According to the gloomiest current forecasts, output will sink by 8% this year. Both extreme ends of forecasts are found among Russian forecasting agencies. Although the extreme ends of the various forecasts are disparate, the majority of forecast agencies presently believe the Russian economy will contract by 3–5% in 2009, while almost all of them believe the Russian economy will grow in 2010.

Oil price assumption does not explain differences in forecasts

A majority of forecasts published on Russia are based on simple deduction and very rough calculations. Few institutions publish all main components of aggregate demand, and in some cases the forecasts are clearly internally inconsistent. Although the comparison of forecasts is somewhat difficult, they do show unmistakable common characteristics. Views concerning the government's fiscal policy in terms of the budget deficit are relatively consistent, as a majority of the forecasts are based on the government's budget deficit target of about 7–8%. Also with respect to the current account, the views are similar as most expect the current account to stay slightly in the surplus in 2009. At the end of the year, inflation is commonly expected to remain in the 10–15% range and the exchange rate at 34–36 roubles per dollar.

It is interesting that the oil price assumption in the most recent forecasts on Russia ranges from USD 40 to 55 per barrel, but expectations of oil price developments only explain differences in GDP growth estimates weakly. The slowest economic growth is forecasted at an oil price of

USD 40 per barrel, but even the most optimistic forecast is based on a price of only USD 45.

The differences in forecasts on Russian GDP highlight how the crisis is expected to be reflected in different demand components. In these calculations, private consumption has the highest weight, since its proportion of total demand is two thirds, with investments accounting to about a quarter. Differences in views about the development of private consumption and investments are also reflected on import forecasts, according to which import volume will decrease 13–33% this year. In contrast, the volume of commodity-based exports is believed to contract relatively slightly.

Often more interesting than the forecast figures are the risks seen in the developments. Even up to the past few months, forecasters have emphasised that the risks lie on the downside, which has also materialised in forecasts revisions in May. Deterioration of the international situation and the related potential decrease in prices of energy and commodities are at the top of the list of uncertainties. Observers of the Russian economy also emphasise that consumption has only recently begun to react to the decline of income and employment, which means that the situation may still be heading downhill. The potential weakening of the overall situation would in turn lead to an increase in banks' non-performing loans, undermining economic recovery. Although views on inflation and exchange rate developments are reasonably consistent, published forecasts also include views of inflation reaching a level close to 20%, leading to a devaluation of the rouble, in breach of the limits set by the central bank.

Despite their deficiencies, forecasts help decision making

Differences in the forecasts on Russia show that there is competition in the field which is beneficial for users. However, considering the deficiencies of forecast methodologies and uncertainties of the situation, it is certain that the publication of forecasts to the tenths of a per cent is futile. Considering the high variations in Russian growth rates one may doubt whether even differences of a couple of per cent in forecasts would have any practical significance to the users of the forecasts.

Not all forecasts can be right but they can all be wrong. Every agent will nevertheless seek to form a view of the future, one way or another. The advantage of traditional forecasts is that they force one to think about the possibilities and risks as well as policy coordination in some consistent manner. If business and policies are based on rumours, this undermines the stability and predictability which are particularly needed in crisis situations.

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Russia's crisis budget

By Philip Hanson

Russia's public finances are stronger than those of most countries, but the rate of deterioration recently has been striking. The Russian government has had to make dramatic revisions to its budgetary plans for this year. Those revisions, made in February-March 2009, may not be the last such changes that have to be made. In late April it emerged that the Ministry of Finance (MinFin) was considering some new sovereign borrowing, both domestic and foreign.

The political leadership was late in grasping that Russia would be hit by the global crisis. The federal budget for 2009 was put into law on optimistic assumptions as late as November 2008. There would be yet another budget surplus, based on high oil prices and continuing Russian GDP growth. But the budget was already under pressure. The Urals oil price, reckoned as a monthly average, had already peaked at \$130.8/barrel in July and fell to a low of \$38.1/barrel in December. MinFin's Economic Expert Group has estimated that oil and gas revenues to the federal budget were running at 12% of GDP in July 2008 but had fallen to 7% of GDP by December.

The fall in oil prices was not the only bad news for Russia, but it ranks high in a list of adverse events. There was also a flight of investors from emerging markets in general; a slowdown in Russian industry after mid-2007, turning into a slump in fourth-quarter 2008; and early signs of difficult domestic credit conditions from late 2007. But the oil price was a big part of the story. The expected budgetary loss from falling commodity prices in 2009, according to the IMF's Fiscal Affairs Department, would be far higher in Saudi Arabia (26.8% of GDP, against 6.4% projected for Russia), but Russia's prospects are now judged in most forecasts to be a good deal worse than those of the Saudis. This is partly because the Russian economy is more open than the Saudi economy.

This year's federal budget, at all events, had to be drastically revised. The government cut its GDP forecast for 2009 to a fall: -2.2% year on year. Recently the Ministry of Economic Development has revised this down again, to a range of -6 to -7.4%. For the moment, however, the federal budget is based on the 2.2% projected decline in GDP, an average Urals oil price over the year of \$41/barrel and an average exchange rate of Roubles 35.1 to the US dollar.

In the revised federal budget, compared with the outturn for 2008, total revenue goes from 22.3% of GDP to 16.6% of a slightly smaller real GDP. Of these revenues, oil and gas taxation is planned to provide the equivalent of 5.1% of GDP, against 10.5% last year. In contrast, expenditure is now supposed to increase to 24.0% of GDP, compared with 18.2% in 2008. This produces the projected change from a surplus equal to 4.1% of GDP to a deficit of 7.4%. That is a bigger fiscal turnaround than is anticipated in most countries..

Russia's policymakers have opted for a substantial assistance package, by global standards. It is hard to make a firm distinction between that part of a fiscal stimulus that arises semi-automatically from the effect of a recession in squeezing revenues and pushing up social-spending obligations (more recipients of unemployment benefits and the like) and that part which can be classified as discretionary. MinFin has cut previously-planned spending, including on defence and security, by R943

billion (2.3% of GDP) and increased planned spending under other headings by R1611bn (4.0% of GDP). The identifiable spending increases designed as assistance to banks, other businesses and social support come to 3.0% of GDP. That is a discretionary spending package that is higher than the equivalent figures for most other countries.

The budget deficit this year should, if all goes according to plan, be covered by running down the Reserve Fund (\$121bn at 1 April 2009) by about half. Propping up the budget when the oil price falls is precisely what the Reserve Fund was designed for. But Finance Minister Aleksei Kudrin is a far more serious devotee of fiscal prudence than Gordon Brown ever was in the UK; he plainly fears things could go worse than plan; and in any case he does not want to see the Reserve Fund run down fast, because of the effect on confidence. Therefore he has spoken of plans to borrow a modest amount abroad in 2010 and further modest amounts domestically in 2009-11: \$5bn of sovereign foreign borrowing and a total of domestic borrowing provisionally equivalent to around \$46bn over three years.

If all this borrowing were to happen, Russia would still be a strikingly under-borrowed country. Its sovereign foreign debt is now below 3% of GDP and domestic sovereign debt is about 3.5% of GDP. If we omit the very provisional sum mooted for 2011, the new lending would bring total state debt, domestic and external, to a little over 10% of projected 2009 GDP: barely visible by the standards of most modern states.

Commentators have drawn attention to the rapid rise in foreign borrowing by Russian banks and companies. It is certainly the case that many Russian oil, gas and metals companies have borrowed abroad in foreign currencies and are now caught by falling revenues and the almost-two-fifths fall in the rouble against the dollar. Some of the assets, particularly foreign assets, acquired on credit have been relinquished to settle the loans and others are for sale on a falling market. But at the start of 2009 total Russian foreign debt, public and private, was only just over 40% of GDP. Eleven of that 40% was attributable to state-controlled companies (but not to the state in the strict sense). This looks manageable in aggregate, even if some big names lose quite badly.

Thus Russian macro-economic management under Kudrin continues to be highly cautious and conservative as the crisis hits. It may indeed be over-cautious. The puzzle is quite why the macro forecasts for Russia are almost all so dire. What if the rare, contrarian optimists like Evgenii Gavrilin of Troika Dialog turn out to be right after all? Perhaps then the Russian state could go on a spending spree, and even the Ministry of Finance would not be able to object.

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The history of the Baltic States – a minefield

By Anu Mai Kõll

It is exciting to be a historian of the Baltic Sea area. Here, history often stands at the centre of debates - in politics, rhetorically, in newspaper headlines and every-day discussions. There are even occasional street-fights over how to interpret history.

History never stands still. Today's concerns always determine the relative relevance of historical themes. Among post-89 Baltic states, centre stage is held by World War II. The first task has been to rediscover parts of the past. Of this, the Molotov-Ribbentrop Pact is probably the best example, but so are the (somewhat idealised) stories of the so-called forest brother's resistance to the Soviet take-over. Here, also, one finds history-writing on Soviet repression. It was begun in the 1960s, during the thaw that followed Stalin's death; unhindered access to historical sources allows its fulfilment.

The Baltic States EU accession has entailed new historical confrontations. West Europeans did not share the image prevalent in the Soviet Block – that of being abandoned by the West, sacrificed in exchange for post-war peace. In Europe, and not least in Sweden, there was a discourse on Nazism and the Holocaust, pointing out that much of the latter had occurred in East Europe. Confront your own history, they exhorted East Europeans. Competing images of victimisation were thus established.

The Baltic States are a rich source for those studying the increasingly popular topic of "the public use of history". Many pages have been written on the attempt to raise a statue to Baltic members of the Waffen-SS, to be celebrated as warriors for Europe's freedom. Still more attention was given the fight over Tallinn's Bronze Soldier. This struggle over symbols has deep roots in the Baltic resistance movement, part of which consisted of a militant home-history movement which uncovered and re-established memorials to the independent republics of the inter-war period.

One of the first steps taken by the post-89 Baltic States was to abolish Soviet history textbooks and start work on replacements. Many of the textbooks I have seen are based on professional historical work. They are factually accurate - certainly more so than the textbooks they replace. It is, however, evident that their first purpose is to promote identity-creation. Their national stories do not allow for much critical analysis. The space allotted women is infinitesimal. The account of the national movement overshadows other social movements. The stories of minorities are glossed over, as if ethnic contradictions were non-existent; and so on.

The Baltic States have established History Commissions, whose task it is to identify and investigate crimes against humanity that took place during World War II. They are not meant to interpret history, but to answer legal questions on crimes against international law and norms. In the process, however, the Commissions work through and illuminate a good deal of unexamined archival material, quantifying and defining. Although not their ostensible purpose, their wide-ranging and useful work will certainly contribute new historical interpretations.

Elsewhere, commissions are working more directly on "conflicting history-writing". The model for this was elaborated after World War II, when French and German historians were asked to help uproot myths on the causes of the war and to harmonise the two countries' history-writing. One could describe the result as negotiated history. Today, comparable work is being done on the ethnic cleansing of the Polish-German borders. In Transylvania, Hungarian and Rumanian historians are collaborating on a similar basis, with similar goals. "Is there no such collaboration between Russians and Estonians, Latvians and Lithuanians?" I am asked with surprise. There is no pressure to do so from the European Union - which, one is compelled to admit, was the precondition for existing collaborative efforts.

But is it possible, or even desirable, to write completely impartial history, one which tells the same story to Latvians and Russians, Hungarians and Rumanians? Professional historians often encounter histories which methodically present only one side or perspective, in order to make a moral or exculpating point. The interesting thing, here, is the search for what has been excluded. Where are the Nazis in the Estonian version of the battles over Tallinn's Bronze Soldier? Where are the Baltic peoples and their rights in the Russian narratives of the Great Patriotic War? What place do the Jews have in the stories of the repression of Ukraine and Lithuania?

The antidote to one-sided history cannot be history which includes absolutely everything – a map exactly as large as the territory represented. Rather, its opposite is to focus on the historical issues which cause contention. One must acknowledge the existence of different perspectives, approach the conflict from both sides and test different versions critically. Only then can history become a tool for analysis rather than for struggles. But we should not be too sanguine in hoping that this approach will solve the real contradictions which first led to the use of historical interpretations as weapons.

Europe's history should, probably, be as multi-vocal as Europe itself. Up to now, the history of Central and East Europe has been sadly absent from Scandinavian school and university education. Until the eighteenth century, Europe was a whole. Thereafter, it is as if the earth's tilt altered, hiding the eastern side from view. This should be changed by us.

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Look back – and learn

By Aarno Kotilainen

Nowadays we use a lot of time and effort on planning the future, trying to think of what we should do to get the best possible results. However, quite often it is useful to look back. Who knows - we might learn something.

You can look back at your personal life and try to figure out what you did right or wrong, like in raising kids. This is a current issue in many homes at this time when kids finish their schools and come back with their school reports. Also sportsmen/-women look back when analyzing their success or failure in big events. It is important to look back in history so that mistakes done earlier would never repeat themselves again, like in politics. Or you can look far back in time, into geological history, trying to understand past changes in the Earth's environmental history.

There is no doubt that humans have affected the Baltic Sea and its environment in several ways during the past years and decades, or even longer, for centuries. And the list is long; we have enhanced eutrophication, increased chemical pollution, and we have even provided better possibilities for alien species to enter the Baltic Sea basin. More alarmingly, the present climate change, that is partly human induced, will probably increase sea surface temperatures and winter precipitation, as well as decrease the length of the ice season in the Baltic Sea. In this way, human influence on the Baltic Sea is greater than ever. These changes affect hydrography and biogeochemical processes in the Baltic Sea, and thus the whole Baltic Sea ecosystem.

Warmer climate conditions are not a totally new thing in the Baltic Sea region. The history of this sea is geologically very short – the Baltic Sea has developed into its present state during and after the latest deglaciation in the past 16 000 years. During warmer phases, the Baltic Sea has experienced environmentally deteriorated times. We can see that in geological records, in the Baltic Sea sediment archives, which provide information on past environmental changes. For example a carefully selected 10 meter long sediment core from the Gotland Deep, one of the deepest basins in the Baltic Sea, provides almost continuous information from the whole Baltic Sea history. All changes are recorded in those archives, older freshwater or more saline water phases, or even the Chernobyl nuclear power plant accident that can be seen in the surface part of sediment core. The long sediment cores from the seafloor of the Baltic Sea indicate that environmental problems like eutrophication together with intense algal blooms and anoxic seafloor conditions have occurred also earlier, but at that time naturally with very little if any anthropogenic loading.

Around 1 000 years ago, during a climate phase called the Medieval Warm Period, the climate in the Baltic Sea region was a few Celsius degrees warmer than today. The sea level might also have been slightly higher. During those days the Vikings were sailing through the seas, to Greenland, to North America, and around Europe - also in the Baltic Sea. It is most probable that those brave seamen did see thick algal blooms on the sea surface and were wondering about it, as their beautifully carved wooden ships left trails on the greenish water. They did not know what that strange green slimy stuff was, or even less, why it occurred there.

Today, when we are sailing through the same waters, or having sauna by the sea, we can also experience that similar unpleasant phenomena, intense algal blooms. But

what makes the difference between us and those earlier Baltic inhabitants? We do know what that phenomenon is, and at least partly know the reasons for them. For the first time in the history of mankind, we know what we should do to improve the state of the environment.

Efforts towards a better Baltic Sea have been made for decades. Waste water treatment has improved and nutrient loadings have decreased efficiently. Also safety of marine traffic has enhanced dramatically. HELCOM and other policy tools and instruments have guided us towards a better future of the seas. However, we have not finished our mission yet.

Coastal and marine activities have increased worldwide, thus pressure to use marine resources are today higher than ever. This is valid also for the Baltic Sea. In addition, lessons from the past indicate that present climate warming does not necessarily provide a better forecast for the future development of the Baltic Sea. It is evident that environmental problems, like anoxic periods at the seafloor, have occurred in the past too. However, together with increased human activities, anthropogenic loading and climate change, the effect on the Baltic Sea ecosystem is greater than ever. That is the reason why we need to continue our work towards a healthier Baltic Sea. The already taken measures are not enough. The heat – and pressure – is on.

That work needs cooperation on different levels. Practical actions include reducing the nutrient loads from agriculture and a total ban on sewage discharges from ships sailing in the Baltic Sea. Beside actions, we also need to deepen our scientific knowledge on e.g. what are the mechanisms behind environmental changes in the Baltic Sea. We also lack marine (abiotic and biotic) data, or if it exists, it is too difficult to get. That knowledge and information will provide basis for improved management and implementation of policy strategies regarding the Baltic Sea environmental issues. But we are on a good track: the new EU instruments such as the Marine Strategy and the new programmes like BONUS - The Joint Baltic Sea Research Programme - are tools that enable us to produce required information for a better and sustainable use of the seas.

We need to act wisely so that people of the future would say that it was us, the people of the 21st century, who were the first to know what to do. And that we did it. We did save the Baltic Sea for the future generations.

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Policy platforms for regionalizing EU-Russia energy relations

By Pami Aalto

When speaking of the present realities and future prospects of EU-Russia relations, we often end up stressing the role of energy issues simultaneously as a source of conflict and the glue of the whole relationship. This is because EU member states are so divided over the issue, in a situation where there are not many driving forces in sight that could easily bring them onto the same page.

Some EU member states have a solid and mutually positively viewed energy relationship with Russia. In the very minimum, these member states seek to maintain the present volumes of imports from Russia whilst they also have to think of what sort of a package of political and economic measures might best ensure that (e.g. Germany, Finland, Italy, France). Some import all of their natural gas from Russia, making it account for up to one third of their total primary energy consumption, on top of importing substantial amounts of oil from Russia. These states increasingly view the imports as leading to too high vulnerability and look for alternatives without much hope of a rapid turnaround (e.g. Poland, the Baltic states, the Czech Republic). Some are drifting into more intense energy relations with Russia (e.g. the Netherlands, UK). Some are unlikely to ever import much from Russia. They are hence largely disinterested bystanders in what by now are regular disagreements over gas supplies in the relations between the EU, Russia and Ukraine (e.g. Spain, Portugal).

The combination of the divisions on the EU side, and the highly differentiated bilateral energy relations that Russia is building with its customers in the north, east and south of the EU area, will most likely mean that the relations are becoming more regionalized. Transit of natural gas and oil is shifting towards the northern and southern routes in the Baltic Sea, Barents Sea, Black Sea and the wider Balkans at the expense of the east and central European pipelines. The latter are either ageing and operating at below full capacity, or in the short to medium term unlikely to attract much further investment as a result of political differences in sectors other than energy and for reasons of transit avoidance. This more regionalized landscape may lead to coalition-building on the EU side and is likely in any case to represent a better option than the current combination of Russian unilateralism and European bilateralism.

In these conditions we need to determine what policy platforms there are that can bring a substantial number of EU member states into the same table with Russia so as to reduce the problem of the commons in EU-Russia energy relations. Such policy platforms should be defined by sufficiently strong common interests and relatively few political controversies that today are increasingly related to energy when it is perceived as a 'high politics' issue.

First, *market access* represents a policy area where several economic actors on both sides call for policy measures in an era where economic nationalism is raising its head. In fact, we need to think much less in terms of economic interests on 'our' and 'their' side than we conventionally do. The practical operators in energy policy are companies and international financial institutions. Many of them are stock market listed companies and hence part owned by private investors and funds on both sides; or they are otherwise cross-owned. This applies to Lukoil, Rosneft and Gazprom just as it does to E.ON Ruhrgas and the Finnish natural gas distributor Gasum.

Another shift required in thinking is to acknowledge the marriage between states, companies and markets across the wider European area. This is as normal for Russia as it is to Norway. The needed big investments; research, development and education; and demand for regulation in this sector of policy often mean that energy companies and markets need government support and scrutiny. An increasing share of energy globally is becoming produced by state owned, part state owned or otherwise state bound companies. Governments, companies and market actors also need to work together due to the complexity involved in the building and maintenance of energy chains. Here technical, environmental and financial challenges are conjoined by the need to increase the knowledge base and build institutions and agreements augmenting the problems ensuing from energy chains transgressing state borders.

Improving market access hence means cross-investments and asset swaps among companies, and clear rules for how and where such arrangements can be made, in order to pile resources for financial and human capital intensive energy projects. The relations between German and Russian energy companies – involving swaps of gas field access for the German party to shares of companies operating in the consumer market for the Russian party – represent a good example. Allowing Gazprom's involvement in consumer sales gives it part of the profits in the downstream sector and makes it unwilling to lose those profits. In the very long term, European states and companies in particular need to think hard what is the added value they can offer to the Russian party compared to what Russia's Asian partners can offer.

Second, the question of added value brings us back to how mere energy relations – exchange of goods and raw materials for an agreed price – can be transformed into concrete policies of common benefit. Here technology transfers, joint knowledge production and education projects in the area of *energy efficiency, energy savings and renewable energy* can well hold the keys. These issues have climbed higher on Russia's energy policy agenda during the past decade. They are in fact set to become ever further highlighted due to the economic crisis, most likely rising energy prices in the medium to long term, and the need to reserve enough fossil fuels to export to generate profits supporting Russia's economy. Reducing the wasting of energy together with Russia's energy intensity are areas where there is a lot of room for progress without even needing to go for expensive high-tech measures.

Peat ranks high in Russia's energy strategy right after the conventional fossil fuels natural gas, oil and coal, and hydropower and nuclear power. Peat and wood burning can provide local sources of energy in non-fossil fuel producing regions and can simultaneously generate employment in impoverished remote areas of Russia. In this sector for example Finnish and Swedish actors can offer knowledge, finance and technology, and simultaneously make themselves more interesting energy customers to Russia. German and Danish actors have good experience in the construction and operation of large-scale windmill parks where the Russian party lacks expertise. Iceland utilises extensively geo-thermal energy and works on wave energy.

Third, creating a *pan-European electricity market* can help to overcome capacity problems, problems of grid strength and the black-outs that occasionally take place on both sides. Much like sustainable energy, this sector is not very politicized. Structural reforms for unbundling the generation, transmission and consumer sales sides of electricity chains are underway on both sides. The decent economic rationality, pooling of resources and adjustment of the differences in seasonal capacity that prevail in the Nordic electricity market can be replicated on a wider pan-European scale. That can add an element of positive interdependence. In a word, in conditions of more regionalized EU-Russia energy relations, there are many policy platforms where we can shift the debate beyond images of the Russian bear closing off the natural gas taps.

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State enterprises are still a problem for common markets

By Aki Koponen

Blinkered analysts have seen the current economic crisis as a failure of the free market economy. These kind of quick conclusions have also led to demands for more market regulation. While these demands have been vocal in political rhetorics, some recent reforms give hope that Finnish regulation develops to be more market friendly even in the near future. This article reviews some recent planned and also decided regulatory reforms in Finland.

On 28 May 2009 Council of State of Finland decided that all retail stores can be open on Sundays through the year. According to the new act, the small shops can mainly decide freely their opening hours while the big markets will be still under the old regulation with exception of Sundays.

The reform of opening hours regulation is not the only decision concerning economic freedom. Also the operations of state or municipality owned organizations, especially State Enterprises, have been seen problematic in competitive markets.

State enterprises drew attention to them starting a couple of years ago, when European Commission started to investigate the state aid to Tieliikelaitos (currently Destia Ltd), the successor to the national road service. The organization was set up as a State Enterprise, when Finland opened its road service market to competition. As a result of the investigation, the Commission requested the Finnish government to put an end to the certain privileges that Tieliikelaitos enjoyed. The main privileges were the non-application of normal bankruptcy and corporate income tax legislation. The absent risk of bankruptcy decreases the risk premiums of loans and gives competitive advantage over private companies finance acquisition.

In the Destia case the privileges were formally eliminated by organizational change from state enterprise to limited liability, albeit the state of Finland is the sole owner of the Destia. Even this case has been solved in a way satisfying the Commission, the problem is still topical in Finland. Previously mentioned privileges are still applicable for five state enterprises under the control of the state and for unclear number of organizations owned by municipalities.

In order to solve the of state enterprises there have been two working groups: one appointed by Ministry of Trade and Industry (MTI) had a special focus on municipalities and Ministry of Finance has led a working group focused on the state enterprises governed by the state.

Working groups have concluded along with the decision of the Commission that the state enterprise as an organizational form is not compatible with the common market. The state (or municipal) enterprise is an organizational form which can be used for operations

internal to public sector. Otherwise common corporate forms should be applied.

These conclusions are quite a good start as such, but organizational restructuring do not eliminate the market distortions created by state aid or more generally, by operations of public organizations in competitive market. As the working group of MTI has put it "differences in the conditions and baselines for engaging in business activity inevitably result in problems in terms of competition neutrality and the functionality of the markets".

There have been actually already some hints of market distortions besides the most obvious dominant position cases (e.g. Itella). In some cases required returns on investments are even lower than current ECB steering interest rates. This kind of behavior can be seen as a tax-funded economic subsidy affecting on the competitiveness of the private companies in the markets. Actually rivals of the Destia have very recently accused Destia for dumping prices.

The real problem is not therefore the organizational form, but the existence of publicly owned companies in free markets. And believe me or not, it is not so likely that municipality or state owned companies are let to go bankrupt – no matter of the organizational form.

Altogether, there is a visible silver lining around the dark cloud of the regulation in Finland – government really shows some interest on the free enterprise. But as a cynic, I see the cloud itself more clearly, made even darker by the lining. The danger of the reform is that state owned organization will continue to distort markets, but even in a more opaque manner as limited liability corporations.

Even this writing focused on Finnish case, the problem is universal. Along with the arising populist tendencies of protectionism such corporations will hinder the favorable development of European common markets. As a friend of free market economy, I hope that European Competition authorities including European Commission will be empowered and willing to intervene effectively on competition restrictions generated by publicly owned companies.

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Lithuania in the Baltic Sea Region – a common destiny and shared responsibility

By Andrius Kubilius

The Balts, forefathers of modern Lithuanians, settled by the Baltic Sea more than four thousand years ago. Ever since location by the sea was important to our ancestors from both military and commercial perspectives. Nowadays, membership of eight countries around the Baltic Sea in the European Union provides for a historic opportunity to integrate the region under the banners of peace and prosperity. An opportunity that we must seize and turn into reality.

Lithuania already has strong economic and financial ties with other countries of the region. Over half of imports from and two thirds of exports to the internal market are with the 7 EU member states of the region. Trade within the region constitutes over one third of all Lithuania's international trade. Two thirds of all FDI come to Lithuania from the region. Investment examples include the banking sector, telecommunications, the oil refinery, among many others.

We currently face the important task of overcoming the isolation of Lithuania and other Baltic states from the EU's energy markets. Lithuania, Latvia and Estonia are well linked among themselves and have further energy connections towards Belarus and Russia but there are no inter-connections of the gas and electricity network with the rest of the European market. To this end, we have to build power links with Sweden and Poland, a gas inter-connection with Poland as well as an LNG terminal. The need for these infrastructure links is highlighted by the imminent closure of the Ignalina Nuclear Power Plant at the end of this year. A new NPP in Lithuania is foreseen to be constructed as an unprecedented regional project involving Lithuania, Latvia, Estonia and Poland.

Regional economic integration makes it feasible to undertake coordinated actions to promote economic development. Re-energising the financial sector and removing the remaining hindrances to the well-functioning internal market should be priorities in this respect. It is important to address the „innovation gap“ in order to facilitate the inclusion of Lithuania in the innovation networks powered by the North and the West of the Baltic Sea.

Lithuania's geographical location determines the importance of the development of transport infrastructure. The Baltic region should be accessible and well connected to the rest of the EU and to the neighboring countries. Overcoming existing communications bottlenecks is crucial to Lithuania as well as to the whole region. The building of the “Rail Baltica”, the development of the “Via Baltica” and the East-West Green transport corridor are the most notable projects in this field.

The Baltic Sea is not just a geographical notion, it is a living organism for which we all are responsible. We should make sure that any large-scale infrastructure planned on the seabed is laid only after careful consideration of its impact on

the environment taking into account that the Baltic sea is already ranked among the most polluted seas in the world. HELCOM is an important actor for developing and coordinating the implementation of the measures that could have a positive affect on the state of the Baltic Sea. We should also help the Baltic Sea eco-system through measures with a local dimension, such as improved waste water treatment in neighbouring countries.

The Baltic Sea region is primarily about its people. After long decades of forced isolation, we now discover many opportunities to communicate, share ideas and build a common future. I hope this learning process continues, and we can envisage the emerging and strengthening of a regional identity. We should support this process by promoting extensive contacts between people, in particular but not least the youth.

While strengthening and deepening cooperation of EU member states of the region, we should find ways to engage more closely our neighbours the Russians and the Belarusians to share the dividends of regional peace and prosperity. We believe that existing regional structures, first of all, such as Council of the Baltic Sea States and Northern Dimension could be instrumental in achieving this goal.

In July, Lithuania will take over the responsibility of presiding over the Council of the Baltic Sea States. Innovations, cross-border cooperation and safe and clean region have been identified as main Lithuania's priorities during its one-year presidency. Our objective is to promote the region as a modern and creative space for communication and cross-border cooperation. In June 2010 Lithuania will host a summit of Prime Ministers of the CBSS.

Lithuania fully supports the development of the EU strategy for the Baltic Sea Region and looks forward to its adoption under the Swedish EU Presidency in the second half of this year. I hope the implementation of the Strategy will successfully live up to its considerable potential and the high expectations it already managed to create. I sincerely believe that more coordinated and focused EU cooperation in the Baltic Sea region will contribute to the strengthening of the whole EU.

Lithuania is looking beyond the current economic turmoil, aiming to emerge better equipped to face the challenges of the post-crisis world. More cooperation and coordination in the Baltic Sea region will be essential to this end.

Andrius Kubilius

Prime Minister

Lithuania



Future challenges of transport in the Baltic Sea Region

By Antonio Tajani

The successful development of the Baltic Sea Region depends heavily on a well performing transport system. This region, which is located outside the economic centre of Europe, but dynamic and highly dependent on foreign trade in goods, needs transport infrastructure for its economic prosperity.

Focusing on the interconnection of national networks and links between the EU's peripheral and central regions, the trans-European transport networks (TEN-T) have a particular importance for the Baltic region. The TEN-T policy aims at ensuring the functioning of the internal market as well as economic and social cohesion in the EU through realising a number of strategic priority projects. Furthermore, it contributes to sustainable development objectives by minimising negative environmental effects.

The projects of common interest identified in the TEN-T Guidelines with respect to the Baltic Sea region, and in particular the priority projects, respond to these objectives.

The Øresund Fixed Link project, implemented in the framework of a Danish-Swedish public-private partnership scheme with financial support under the TEN-T budget, was already completed in 2001. It has had a positive impact on cross-border regional development and plays an important role for the connection between Scandinavia and, via Germany, other EU Member States.

Other priority projects are partly completed, such as the Nordic Triangle multi-modal corridor, involving rail, road and maritime infrastructure in Sweden and Finland; linking the Nordic countries and their capitals to each other; and improving passenger and freight transport from the region to central Europe, the Baltic countries and Russia. Other projects are under preparation, such as the "Rail Baltica", which links Estonia, Latvia, Lithuania and Poland and connects with a rail ferry link to Finland; or the Fehmarn Belt Fixed Link between Denmark and Germany, which constitutes an extension of the Øresund crossing and the Nordic triangle road and rail links.

Among the main future challenges with regard to the TEN-T development in the Baltic Sea region are the development of rail interoperability; the removal of bottlenecks, especially to facilitate rail freight transport; the establishment of inter-modal connections, in particular between railways and ports, in order to facilitate freight logistics; and the implementation of traffic management systems to ensure efficient use of infrastructure.

These challenges are addressed in the framework of a broad review of the TEN-T policy, the first milestone of which has been the Commission's Green Paper, adopted in February and followed by a large public consultation. Based on new challenges, in particular the climate change objectives, this review looks into options for further developing the trans-European transport networks.

Well-functioning transport logistics, supported by appropriate logistics infrastructure, are also fundamental to the creation of a sustainable and competitive transport system in the Baltic Region. This also includes innovative systems and cost effective processes contributing to reducing CO₂ emissions and at the same time strengthening the global competitiveness of the European transport industries. The EU's Swedish Presidency will take forward the work on freight logistics, rail freight networks, ports policy and maritime freight transports in the second half of 2009.

Naturally, maritime transport plays a key and still increasing role for the region. A strategic vision for this transport mode is reflected in the Commission's recently adopted Communication on a European maritime transport policy up to 2018. Looking at the development of shipping, ports and related sectors over the short, medium and long term is essential, especially at a time when sustainable and competitive alternatives to road transport need to be developed. In parallel, the Commission has developed the concept of a European Maritime Space without Barriers. This aims at effectively implementing the Single Market by simplifying the existing regulatory and administrative framework.

The rail freight market in the Baltic States mainly relies on the trade with Russia given the rail network's characteristic (wide gauge). Its growth, especially over long distances towards the Far East, will depend on the development of efficient rail freight corridors with good intermodal connections. Furthermore, access to the rail market and its safety and interoperability will have to be enhanced in consistency with the Community requirements.

Due to increased globalisation, the very basis for flows of goods, capital, people and ideas has changed. This means that transport needs in the Baltic Region have to be evaluated not only from a national, regional or European perspective, but also from a global perspective. There are increased trade flows from the North (iron ore, wood products) and from the East (new routes to Russia, Central Asia, Far East) which can, if managed well, put the Baltic Sea Region in a strategic position between Europe, North America and Asia.

Antonio Tajani

*Vice-President, Commissioner
for Transport*

European Commission



Neighbouring area cooperation and Baltic Sea Strategy of the EU – complementary instruments to support cooperation (and sustainable development) in the Baltic Sea Region

By Paavo Väyrynen

The deepening global economic downturn has already had a strong impact on the Baltic Sea region's economies. The signs of a longer term economic recession can be detected in differing forms. In this situation the task of the governments is to use all available means on both national, regional and other levels to encounter challenges and threats facing them.

We have to ensure that the Baltic Sea region will also during the time of a crisis continue to be a dynamic economic region, building on the EU internal market, focussing i.a on the science and innovation policy and efficient transport and logistics networks as well as on energy and ICT.

The forthcoming Baltic Sea Strategy should help us to identify more clearly the concrete opportunities and challenges of the Region and give us efficient instruments to make the best use of its untapped potential. The Strategy is indeed an evidence of EU's growing interest and engagement to the Baltic Sea Region. EU's both internal and external policies and programmes should be fully taken advantage of in order to create sustainable and environmentally sound economic growth on the regional level.

One of the specific features of the Baltic Sea region is that it forms one part of the external border of the European Union. In this respect it is important to note that the Northern Dimension (ND) framework provides the basis for the external aspects of co-operation in the Baltic Sea Region, as outlined in the European Council's conclusions in December 2007.¹

As to the financing of the Baltic Sea Strategy, the Cohesion policy and the Northern Dimension partnership model consisting of several financial sources - EU budget, national budgets, private sector, IFIs, such as IBRD, EIB, EBRD, NIB - should serve as a model. Setting out clear priorities for the region as such should contribute to better use of the existing financing opportunities.

Promoting regional co-operation across the borders round the Baltic Sea including the northernmost parts of our region has been one of the key priorities of Finland since the post-war period. Finland has been working actively both on national, regional and more recently on EU-level in order to generate ideas and innovations that should bring closer together the countries, economies and regions. One of these innovations has been the Finnish Neighbouring area co-operation programme, which has also served as a source of inspiration for the new EU approach to the cross-border-programmes currently embodied in the so called ENPI CBC programmes.

Finland's neighbouring area cooperation focusses primarily on Northwest Russia, basing on the Agreement between Finland and Russia that I initiated and signed in 1992 as the then Foreign Minister. Since the 1990's 293 million euros has been allocated to Finnish-Russian

projects carried out in Russia. The total funding for this year is 19,5 million Euros. Neighbouring area cooperation is also used to support the EU-Russia strategic partnership, the work in the Northern regional councils (especially CBSS, BEAC and Nordic Council of Ministers) as well as the Northern Dimension policy and its partnerships, including the Partnership on Environment and Partnership of Health and Social Wellbeing and the evolving new partnerships in the fields of transport and logistics as well as the partnership of culture, presently under preparation.

The greatest successes of the Finnish neighbouring area cooperation coincide with the successful flagship projects of the Northern Dimension Environmental Partnership, namely the St Petersburg Southwest Wastewater Treatment Plant, which is of special importance for the protection of the Baltic Sea. (Finland has supported its construction by about 12 million Euros.) Cooperation in the field of forestry promotes sustainable forestry and biological diversity. In the field of radiation safety the promotion of the safety of the Kola and Leningrad nuclear power plants is our priority. Finland has also made a marked input in the prevention of communicable diseases, especially to combat HIV/Aids and tuberculosis, both within the Northern Dimension Partnership and in supporting international cooperation in the Barents region.

The Finnish Government has outlined its new priorities of the neighbouring area cooperation taking into account the recent developments in its neighbourhood. The main objective of Finland's cooperation with its neighbouring areas is to support economic and social development in the area and to promote the preconditions for cooperation between the public authorities, business life and citizens. The cooperation fosters administrative and legislative reforms and encourages civil society development. Furthermore, efforts are made to reduce risks related to the environment and nuclear safety and to prevent the spread of drugs and communicable diseases. Finnish neighbouring area cooperation will focus more than before on the promotion of economic cooperation, which is of special importance during these challenging times of economic downturn.

Paavo Väyrynen

Dr., Minister for Foreign Trade and Development

Finland

¹Northern Dimension is a common policy between the EU, Norway, Russia and Iceland, and the ND area covers both the Baltic Sea and Barents regions. The Northern Dimension covers a broad geographic area from the European Arctic and Sub-Arctic areas to the southern shores of the Baltic Sea, including the countries in its vicinity and from north-West Russia in the east to Iceland and Greenland in the west. (Northern Dimension Policy Framework Document, paragraph 2.)

The Arctic region – shift in geopolitics?

By Jānis Sārts

Global warming and climate change have brought new challenges to world politics. The Baltic Sea region is no exception. Harsh weather conditions and high costs for extracting resources have deterred major business activities in the Arctic region and the Baltic Sea region remains the cheapest and most reliable option for transportation of goods in the Northern European region. However, due to the melting of the Arctic ice cap, these conditions may change and increase the economic potential for the High North. Research suggests that in the very near future the melting of ice will open new sea routes and ease access to large fish and hydrocarbon resources. In the next 20 years the Arctic Ocean could be accessible to transportation at for several months out of the year. These are issues that we should take into consideration.

The Arctic region and its challenges should be addressed in the wider context of the Northern Dimension that addresses not only international implications of new challenges, but also increases the importance of regional politics thus having effect on the Baltic Sea region in terms of environment, economy and security.

Three out of six Arctic rim states (Norway, Denmark, Russia) are also part of the Baltic Sea region thus the challenges faced in the Arctic surely will have implications in this area.

The European Union already has developed its Northern Dimension policy which historically was firstly applied to the Baltic Sea region and now is broadened to also include challenges posed by climate change in the Arctic. The EU has demonstrated its clear interests in Arctic problems as this has implications to the growing energy demands of the EU where the Baltic Sea is of strategic importance. One important aspect is that the Nord Stream gas pipeline that will cross the Baltic Sea will most likely carry gas from the Shtokman gas field which lies in Arctic Circle.

Sweden has already indicated that during its EU presidency in the second half of this year the main focus will be devoted to climate changes and challenges. especially devoting Efforts will be particularly devoted to the Arctic and the Baltic region, as well as improving cooperation with Russia thus stressing the importance of synergy of these regions.

Russia is certainly an important actor in this context. It is a country that has already demonstrated its ambitions in the Arctic region by claiming not only the extension of its economical zones, but also by increasing military activities. The key in this process is cooperation based on equal contribution towards common objectives. However, economic interests should not replace security concerns and the interests of all states involved. The geopolitical environment of the Baltic Sea region can be defined as a microcosm of wider Europe and is somehow similar to the High North. It includes members of NATO and EU, Russia

and neutral states (Sweden, Finland). Comprehensive involvement of international organizations has ensured security and stability in the Baltic Sea region and some of the lessons learned are worth considering for further High North policy. Therefore I would like to argue that the mechanisms for cooperation in the Baltic Sea region could serve as a basis for further engagement with Russia in the High North.

Development of the High North will also involve security challenges that go beyond the competence of the Arctic rim states and will stress the need for broader cooperation and the possible involvement of NATO. Although only five Arctic rim states are NATO members, consequences of the trends in the High North could have implications for the entire Alliance and it seems appropriate to suggest that NATO may have an increased role to play in the High North. Further development of the High North may considerably increase NATO's possible area of interest. However, NATO's role should not be transform into an arbiter in interpreting international law. The main basis for solving territorial claims between Arctic rim states should remain the Arctic Council. The main challenge for NATO, in an area as large as the High North, would be the provision of maritime security. Advantages of new shipping routes and increased commercial activity in the High North may also be used by organized crime for shipping of weapons, narcotics and human trafficking. The increase in shipping activities will also increase potential for accidents requiring search and rescue support. NATO could provide these necessary capabilities. Moreover, the growing amount of shipped and piped hydrocarbon resources will proportionally increase the risk of ecological disasters and need for relief operations.

From the Latvian perspective, the positive side effect could be the increase of geographical and situational awareness of the challenges in the northern parts of NATO, including the Baltic Sea region. The issue of the High North should not be excluded when Allies will start reviewing NATO's Strategic Concept. NATO must define its role. I believe that the High North issue once again underlines the importance of NATO's role, tasks and responsibility for its territory, taking into account concerns of each ally and the principle of indivisibility of security. Moreover, NATO must to strengthen its capabilities to respond quickly to unforeseen circumstances and meet the challenges of the 21st century, including concerns already raised in this context.

Jānis Sārts

State Secretary of Ministry of Defence

Latvia

A vital alliance turns 60

By Martin Erdmann

NATO (THE NORTH ATLANTIC TREATY ORGANIZATION) approaches its 60th Anniversary. Maintaining an Alliance of Sovereign Nation-States over six decades remains a unique historic achievement. NATO is thus often ascribed being the most successful politico-military Alliance in history. Yet, the anniversary is being celebrated with few signs of euphoria or triumphalism, as the achievements of NATO's past cannot hide the challenges of the present and future.

Talking about NATO: What kind of Alliance do we have in mind? Does the NATO of, for instance, 1985 equal the NATO of 2009? Certainly not! As every other successful institution NATO had to adapt itself over time to the ever changing security environment and will need to continue.

In my view today's NATO is an Alliance in its fourth incarnation.

NATO in its first incarnation is long gone, does not exist anymore, but is preserved until today in the memories of most people. That is the NATO of the Cold War, from 1949 to 1989/90. That NATO is the NATO of the history books.

The second incarnation started in 1990, when the Alliance after the end of the Cold War stretched out its hands to the newly democratic and independent States of Central and Eastern Europe and of the former Soviet Union. Today, ten of these then newly democratic and independent States have become members of this Alliance. In the period between 1990 until 1995 NATO developed its partnership relations in the framework of the Partnership for Peace (PFP) and the Mediterranean Dialogue. Finland since those years has become one of the closest Partners of NATO. Today the Alliance has partnership relations with more than 40 nations, including countries as remote as Australia and Japan.

The third incarnation started with NATO's operational activities in the Balkans after the Dayton Peace Agreements for Bosnia in 1995. The Alliance thus begun operational peacekeeping and peace enforcing activities in Bosnia-Herzegovina, Kosovo, later on in Afghanistan, in the context of the Darfur crisis in Africa and only most recently in the fight against piracy off the coast of Somalia. Until 1995, for more than 45 years of its existence, the Alliance never fired a single shot. That changed in 1995 when NATO and NATO Partner Nations started their operational activities in the Balkans.

The 11th September 2001 was the starting point for NATO's fourth incarnation when all of a sudden the new dimension of asymmetric threats entered the global stage. It turns out this incarnation period to be the most difficult one. Amidst mounting operational difficulties and demands, NATO Allies are grappling with divergent threat perceptions and increasingly fragmented security perceptions, domestic constraints on the use of their national armed forces and a more and more impatient public opinion vis-à-vis the felt lack of progress in the reconstruction of Afghanistan.

And there is more. Just as NATO is trying to adapt to the globalization age, an assertive Russia has brought NATO's traditional European mission back into focus. Russia's new found self confidence, bolstered by an economic upswing due to huge oil and gas revenues, has allowed her to go beyond merely articulating its discontent with the observer role granted to her by the West. Russia's aggressive rhetoric against some of its neighbors, its use of energy deliveries as a political tool and most of all its disproportionate use of force in the August 2008 conflict with Georgia indicate that Moscow has decided that it will take action whenever it perceives Russian interests to be at stake.

This new Russian assertiveness has created a challenge for NATO at several levels. First, it has raised new questions about the proper balance between NATO's collective defense at home and expeditionary missions abroad. With several of NATO's easternmost Allies arguing for a review of NATO's defense planning and deployment patterns, and with a palpable desire of some Allies to host additional NATO and/or

US installations on their soil, the limits of a mere "virtual" military presence in the new NATO members have become painfully evident. Second, Russia's assertiveness has called into question the future of NATO enlargement as a benign means of consolidating Europe as an undivided and democratic security space. With many pundits now criticizing NATO's enlargement policy as the problem rather than the solution to European security, there is a widespread expectation among the international strategic community that this process may now have come to a halt. Nevertheless, NATO's open door policy remains as valid as ever and unchanged, as laid out in Art. 10 of the Washington Treaty.

Most importantly, however, the Caucasus conflict has exposed divisions among the Allies on how NATO's future relationship with Russia should be structured. While the desire for a trustful and trusting NATO-Russia relationship is shared by all Allies, views continue to differ on whether that relationship should be conditional, i.e. dependent on Russia's behavior, or whether it should be pursued largely independently of Russia's rhetoric and policies vis-à-vis its neighbors. The freeze in NATO-Russia relations immediately after the August 2008 provided both NATO and Russia with some time to reflect on their future relationship. Sooner or later, however, the issue needs to be resolved.

All this adds to why NATO celebrates its 60th Anniversary in a rather contemplative mood, without a self-congratulatory attitude.

On this occasion we may not forget the contribution NATO enlargement followed by the enlargement of the European Union has brought to the stability of the Euro-Atlantic area as a whole and the Baltic Sea Region more specifically. Today six coastal nations of the Baltic Sea including three former Republics of the Soviet Union are members of NATO. Finland and Sweden are working closely together with NATO and have in the past 15 years considerably increased political consultations and military interoperability with NATO. The public debate in Finland about a future possible membership in the Alliance underlines the importance the Finnish public opinion attaches to NATO. And rightly so: The whole Baltic region since the end of the Cold War has become a more secure and stable environment in the north-east of Europe.

We tend to take those developments for granted. But let us not forget: These developments are based on political choices that NATO Nations and Aspirant Nations once had to take about their membership. Today we see that the choices were the right ones.

Martin Erdmann

Ambassador

*Assistant Secretary General
for Political Affairs and
Security Policy*



Mr. Erdmann exclusively expresses his personal opinion.

Baltic Sea gas pipeline in Finland's economic zone – project raises many questions

By Bo Österlund

With present energy solutions, Europe is increasingly dependent on gas coming from Russia. Treaties concluded, a statement issued in 2006 by Vladimir Putin when he was President and the estimates of security arrangements over the pipeline route presented at a public hearing on 11 March 2009 in Turku concerning environmental impact assessment (EIA) of the gas pipeline are, from Finland's point of view, neither commensurate nor in line with policy. In giving its consent to the project that may be carried out in the Exclusive Economic Zone of Finland, the country must agree on questions of supervision and responsibility unambiguously and in advance.

The gas reserves of the European Union represent about 2% of the world's known sources of gas. Natural gas is responsible for 20 - 25% of basic energy consumption in the EU. According to Kari Liuhto, the EU's own production covers less than half of its total gas consumption. Of natural gas consumed in Europe, 43% comes from Russia. In 2005, production stood at 314 billion cubic metres (57% of consumption). It is estimated that imports will increase to 509 billion cubic metres per year (81% of consumption) by 2025. With present energy solutions, Europe is increasingly dependent on gas coming from Russia.

Russia, then again, is just as dependent on gas exports as Europe is on its import. Of Russian gas exports, 75% goes to the 27 countries of the European Union. The oil and gas industries are the basis of the Russian economy, and the export of gas is a significant source of income in the nation's budget. Oil and gas account for 20% of total industrial production and 40% of tax revenues. Gazprom alone brings in 25% of the State budget.

Russia has the world's largest gas reserves, at about 50 trillion cubic metres. The Baltic Sea Gas Pipeline Project in its entirety is part of the gas programme under the Russian state administration. Europe increasingly requires gas for the needs of industry and transport.

The shareholders of gas pipeline company Nord Stream are Gazprom of Russia, BASF and E.ON Ruhrgas of Germany and Nederlandse Gasunie of the Netherlands. By joining Europe's gas pipeline network to Russia's natural gas reserves, it will be possible, through the Nord Stream project, to transfer to Central Europe the quantity of natural gas required for consumption by the EU countries.

The length of the pipeline planned between Vyborg and Greifwalder and consisting of two adjacent pipes will be 1,220 kilometres. The pipeline will pass through the territorial waters of Russia, Germany and Denmark and through the exclusive economic zones of Finland and Sweden. As a result of opposition from Estonia, the pipeline was previously moved away from the territorial waters and exclusive economic zone of Estonia. In the Gulf of Finland, it is planned that 375 km of the gas pipeline will pass through the Exclusive Economic Zone of Finland but **outside its territorial waters**.

It is planned that the first pipeline will be ready in 2011. In the second phase in 2012, an identical adjacent pipe will be added to the route, which will double the annual capacity to about 55 billion cubic metres of natural gas. This quantity corresponds to the loads carried by about 650 LNG tankers, so about 1,300 voyages per year across the Baltic Sea. On a daily basis, this means 3-4 vessels constantly coming or going in the Gulf of Finland.

As far as the Exclusive Economic Zone of Finland is concerned, issues and boundary conditions relating to the laying, supervision, operation and protection of the gas pipeline are dealt with in the United Nations Convention on the Law of the Sea (UNCLOS), the Act on the Exclusive Economic Zone of Finland, the Penal Code, the Water Act, the Act on the Protection of Certain Submarine Cables and Pipelines and the Environmental Impact Assessment (EIA) in the Espoo Convention.

The Exclusive Economic Zone of Finland, established in 2005, constitutes the maritime area in the immediate vicinity of Finland's territorial waters, the outer boundary of which is defined by agreements concluded with Finland's neighbouring countries. The location of the outer boundary is assigned by Government decree. The new Act on the Exclusive Economic Zone of Finland is based on UNCLOS. It is a question of almost the same area, which

Finland previously prescribed in the Continental Shelf Act and the Act on the Fishing Zone of Finland. According to UNCLOS, an exclusive economic zone may stretch no more than 200 nautical miles from the base lines of the territorial waters. For geographical reasons, however, nowhere does the Exclusive Economic Zone of Finland extend out to its full proportions. Finland has agreed on the outer boundaries of its territorial waters with Russia, Sweden and Estonia. Other nations bordering the Baltic Sea previously formed their own exclusive economic zones. It has been agreed with Estonia that the exclusive economic zone of neither country will extend over the midline of the Gulf of Finland onto the other side.

The regulations of the previous Continental Shelf Act and Act on the Fishing Zone of Finland are combined in the new Act on the Exclusive Economic Zone of Finland. According to the Continental Shelf Act, Finland has the exclusive right to survey the continental shelf at its coast and its interior, and to exploit certain natural resources in its territory. The Act on the Fishing Zone of Finland, then again, gives Finland the exclusive right to rule on fishing taking place within its fishing zone, and to take steps to conserve and increase its fish stocks, unless otherwise prescribed by EU directives or international agreements.

All countries are free to navigate through or fly over the Exclusive Economic Zone of Finland, free to put down underwater cables and pipes and free to utilise the sea for all other activities approved in international law. This concerns, for example, activities with vessels, aircraft, undersea cables and pipelines, which are in harmony with UNCLOS regulations.

Legislation for the Exclusive Economic Zone

UNCLOS provides extensive rights for the laying of undersea cables and pipelines in an exclusive economic area: 'All countries have the right to lay undersea cables and pipelines on the continental shelf in accordance with the regulations of this article'. On the basis of this, therefore, Finland cannot forbid a pipeline project that is appropriately implemented.

The regulation on jurisdiction is also extensive. According to the agreement 'The regulation in this section in no way affects the right of a Baltic coastal state to set conditions for cables or pipelines running through its territory or territorial waters, nor does it affect the jurisdiction, which a Baltic coastal state has in connection with surveying its continental shelf, exploiting the natural resources on the continental shelf, or with work involving artificial islands, equipment and constructions under State jurisdiction in relation to cables or pipelines to be installed or used'.

Upon receipt of an application, the Government may give consent to the exploitation of natural resources on the seabed and its interior within the Exclusive Economic Zone of Finland, and to exploration aimed at such exploitation or to the performance of other work in the Zone, the purpose of which is the economic exploitation of the Zone. Upon receipt of an application, the Government may also give consent to the building and use of artificial islands and equipment and other constructions used for the above-mentioned activity and other such equipment and constructions that might hamper Finland's use of rights based on international law in the Exclusive Economic Zone. The contents of such an application are dictated by Government decree.

The Government may give consent for a fixed period of time or until further notice. The decision must define the conditions, which are necessary from a point of view of safety and the public good. This puts the Finnish Government in a challenging position. The supervision of jurisdiction comes under the Finnish Border Guard. UNCLOS addresses the issue as follows: 'A coastal state may take the necessary steps to ensure compliance with the acts and regulations approved in accordance with this agreement. In these cases, it may, for example, be a question of boarding a vessel, the carrying out of inspections and arrests and the initiation of legal proceedings'.

An offence committed on or targeted at an artificial island, equipment or other construction referred to in the Act on the

Exclusive Economic Zone of Finland and within the Exclusive Economic Zone and attempts to punish such an offence will be deemed to have taken place in Finland in accordance with the Penal Code. An offence committed in another exclusive economic zone: environmental offences in the zone, a violation of Water Act permit in the zone, a fishing offence, the illegal concealment of a catch, a fishing violation and breach of general fishing policy in the zone, a hunting offence, illegal concealment of quarry, a hunting violation and breach of the provisions of the Hunting Act in the zone, a mining violation in the zone or other unlicensed activity in the zone and attempts to punish them will be deemed to have taken place in Finland in accordance with the Penal Code. Through the establishment of the Exclusive Economic Zone, Finland's legitimate jurisdiction, which includes the right to use coercive measures, was endowed with significantly more extensive scope, rights and obligations.

In order to gain Finnish governmental consent for the laying of a pipeline through the Exclusive Economic Zone of Finland, on 9 March 2009 the gas pipeline company, Nord Stream, submitted the application required under section 7 of the Act on the Exclusive Economic Zone of Finland (1058/2004).

The Espoo Convention - the special position of Russia

Environmental impact assessment in a transboundary context has been agreed in the Espoo Convention (Convention on Environmental Impact Assessment in a Transboundary Context). Finland ratified this European Economic Commission convention of the UN in 1995. The agreement entered into force in 1997. The Baltic Sea nations, Russia excepted, are all parties to the Espoo Convention. Russia has signed the agreement, but has not yet ratified it. According to gas company, Nord Stream, 'Russia acts as a party of origin as long as it considers it possible according to its legislation'.

The contractual parties have the right to participate in environmental impact assessment procedures carried out in Finland, if the harmful environmental impact of the project under assessment will probably affect the country in question from the territory of Finland. This means that Finland is a subject of origin. Correspondingly, Finland has the right to participate in the environmental impact assessment procedures for a project located in the territory of another country, if the impact of that project will probably affect Finland, whereby Finland is the object. For the time being, however, Finland is not entitled to participate in impact assessment originating from the Russian part of the Gulf of Finland.

Extensive round of statements

In March 2009, the gas pipeline project moved to a stage, the purpose of which is to offer parties the opportunity to express their opinions and statements on EIA work related to the gas pipeline. The assessment presentation round began on 10 March in Helsinki, from where it continued to Turku on 11 March and on to Hanko on 12 March. The assessment was presented in Maarianhamina on 16 March and finally in Kotka on 19 March.

UNCLOS acknowledges the plans of a foreign country to utilise the exclusive economic zone of a coastal state by laying a gas pipeline through its territorial waters: 'The determination of the route of a pipeline in an exclusive economic zone requires the approval of that coastal state. The coastal state has the right to carry out whatever measures and exploration it deems as reasonable, in order to exploit natural resources and prevent, reduce and monitor damage caused by the pipeline. The supervision of legal administration in the Exclusive Economic Zone rests with the Finnish Border Guard.

When exercising its rights, the organisation laying the pipeline should take into account the rights of the coastal state and comply with the acts and regulations, which the coastal state has approved. According to UNCLOS, 'A coastal state may take the necessary steps to ensure that acts and regulations approved in accordance with this agreement are observed'. In these cases, it may, for example, be a question of boarding a vessel, carrying out inspections and arrests and initiating legal proceedings.

According to UNCLOS, a foreign vessel may be pursued if there is good reason to suspect that the vessel has violated the acts and regulations of the coastal state within that state's territorial waters or exclusive economic zone. Immediate and direct pursuit may only be initiated by the coastal state's naval vessels or military aircraft or by other vessels or air-craft that are clearly marked as being involved in and bearing the authority to engage in such State reconnaissance tasks. Finland principally used Border Guard vessels for such functions, which have the responsibility of monitoring the Exclusive Economic Zone, and have the authority required for the necessary actions.

As, according to UNCLOS, the Baltic Sea is a semi-landlocked maritime area, the countries that border it are obliged to cooperate and should act collaboratively when using their rights in accordance with UNCLOS.

Since 2005, Russia's Baltic Fleet has been involved in the Nord Stream gas pipeline project. As Russia's President, Vladimir Putin stated in a televised address on 26 October 2006 that the Russian Navy would participate in researching, constructing and monitoring the pipeline. "This is a major project, very important for the country's economy, and indeed for all Western Europe. And of course we are going to involve and use the opportunities offered by the Navy to resolve environmental, economic and technical problems, because since the Second World War no one knows better than seamen how to operate on the bottom of the Baltic Sea. Nobody has similar means to control and check the bottom, nobody can better accomplish the task of ensuring environmental security".

By the action of the project management, it has been reported that a 200-metre plated security zone the security of which 'shall be enforced', will be established above the gas pipeline. It has also been reported that, during construction, the security zone would be kept at 2.5 - 3 kilometres. Putins's announcement means that the frequency of sailing of Russian Navy surface vessels and certainly also submarines will increase in the Exclusive Economic Zone of Finland in connection with the protection of the pipeline.

Russian Foreign Minister, Sergei Lavrov, further announced in march during his visit to Poland that Russia, as builder of the pipeline, has the right to decide along what route the pipeline will be laid.

In an article dealing with the pipeline project in the Helsingin Sanomat on 15 March 2009, a representant from the Finnish Ministry of Defence made a statement about the sweeping of mines and underwater explosives beneath the pipeline: 'Our resources for carrying out this job are limited, and the Naval Forces are concentrated on sweeping mines within the territorial waters of Finland. The gas pipeline project is purely a private venture'.

The above-mentioned convention, the statements by Putin when he was President and Foreign Minister Lavrov and the EIA presented at the public hearing in Turku on 12 March concerning the security arrangements for the pipeline, which amount to a separate 'security department', are neither commensurate nor in line with policy.

Within our Exclusive Economic Zone, have we internalised the significance of the responsibility of a coastal state in the above-mentioned operations? Is it possible that the project will give rise to conflict between parties with different interests? Will we be saddled with the overall responsibility for monitoring and guarding the entire 375 kilometres of pipeline that will pass through the Exclusive Economic Zone of Finland and are we also ready to allocate the necessary additional resources to it?

If necessary, these matters should be agreed in advance, as investigation taking place after the fact might uncover new problems.

Bo Österlund

Commodore (ret)

Finland

Finland is developing the European Union's border security

By Jaakko Smolander

Europe's border security has again been brought to the fore in recent times. For example, the recent expansion of the free movement area (i.e. Schengen area) to new EU member states and Switzerland has significantly improved the movement of people between countries. To counterbalance the development of the Schengen area, the EU is strengthening its external border control noticeably. EU member states with an external border play a major role in the fight against borderless crime on land and sea and at airports.

Finland and the Finnish Border Guard have played a central role in the development of the EU's border security. Today, external border control on land and sea as well as at airports is managed by specially trained border guard units operating under interior or justice ministries, as agreed in the Tampere Summit.

The core element of border security is a jointly prepared risk analysis that provides an accurate picture of current threats and challenges. This procedure, which was developed by the Finnish Border Guard, has been used by Finnish authorities for decades. Now it is in use throughout the EU. The initial analyses were prepared at the risk analysis centre in Helsinki. The risk analysis is now carried out by the EU border security agency (FRONTEX). Finland played a major role in establishing the agency, which is now led by the Finnish Border Guard General Ilkka Laitinen. Each member state is responsible for its own border security, but FRONTEX can support planning and training by lending additional troops and technical equipment. Every year FRONTEX organises and finances tens of operations in cooperation with member states in target areas indicated by risk analyses.

During the previous Finnish Presidency of the EU, Finland submitted a proposal for the introduction of an integrated border management system along the EU borders. With this model, the authorities can already tackle borderless crime in the country of origin and transit. The model's next level involves cooperation between neighbouring countries and the country's own border control. The final level focuses on seamless cooperation between internal security authorities inside the EU.

Much has been done. But what is the current situation along our borders and what measures should be taken in the future. Finland's border security is under control. Several tens of people cross the European Union's longest external land border illegally, with almost all of them being apprehended. Each year, at border crossing points, the authorities deal with more than a hundred attempts to enter Finland illegally, most of which involve false documents. They also investigate tens of human trafficking cases annually. Most of these cases lead to criminal sentences.

What about elsewhere in Europe: each year the authorities apprehend at borders about 170,000 persons who have been illegally assisted into the EU and about 10,000 organisers of illegal immigration. The real situation is much worse. For example, in 2004 about 700,000 people were deported from the EU and over 200,000 illegal residents left voluntarily. The current estimate is that there are about 8 million illegal persons in the EU. The key routes for illegal immigration are Central Europe, the Balkans the Mediterranean Sea, and the Canary Islands. Other centres of illegal immigration are the biggest

airports. In light of these numbers, one can conclude that our joint borders are leaking badly. Today human trafficking is a profitable form of crime, as transporting one person can cost up to 15,000 euros. In fact, human trafficking is currently more profitable than drug smuggling and sentencing is more lenient.

What has led to this situation? The key issue is the need to bring illegal labour into the EU. Of course, this includes more serious forms of human trafficking such as prostitution. Those countries that are the biggest users of illegal labour exhibit the same key trends in human trafficking.

To gain control of the situation, authorities must take measures at all levels of the integrated border security system. The visa application process must be improved to identify fake applications in the country of origin. In the future, common visa policy could logically lead to joint EU consulates that work towards shared targets effectively. The labour requirements of EU member states should be channelled legally through such consulates.

The border surveillance of countries of origin and transit countries must be supported with various training and support projects. Such measures must also apply to refugee and asylum policies. For example, the Finnish Border Guard has assisted Tajikistan, Azerbaijan, Georgia, Ukraine and Belarus. This cooperation helps to proactively prevent pressure build-up at the EU's external border.

There is a need to cooperate closely with the EU's neighbouring countries to ensure border security. For example, return agreements for illegal immigrants need to be implemented along the entire external border.

In order to make the EU's external border surveillance more effective, the member states need to improve their performance in areas indicated by the risk analysis. Member states also need to continue joint audits of border security, which help identify faults in national border security. Lastly, an effective registration system must be developed to keep track of people entering and leaving the EU.

At the same time all key internal security players in the EU must cooperate seamlessly. These parties must also have joint access to information collected by FRONTEX, Europol, national customs agencies, as well as immigration authorities. The use of illegal labour must be made a criminal offence for employers and subcontractors. Europeans must also take a hard look in the mirror. **No one is abused if there are no abusers.**

Once all these measures are implemented, the EU's "leaky" borders can be controlled and the member states can carry out the active immigration policy Europe sorely needs in the future. Such measures also ensure that people who need protection receive it at our borders.

Jaakko Smolander

Vice Admiral (ret)

Finnish Border Guard: Assistant Chief 1998-2004 and Chief 2004-2008

Finland

Do we really need Nord Stream?

By Hanna Foltyn-Kubicka

The Baltic Sea Region (BSR) is gaining more and more importance within the European Union. With the launch of the European Strategy that will be officially implemented by the upcoming Swedish presidency, we shall get new tools to coordinate the cooperation and shape the future of our region. Although it will not be as significant as the Mediterranean (which has its own EU – financed budget line, and despite the fierce efforts of the Baltic Europe intergroup in the European Parliament, this probably will not be the case with the BSR), it marks the beginning of a new era with enhanced possibilities for all the littoral states. One of the landmarks of this plan is to resolve the environmental challenges related to the Baltic Sea. And that means that we will have to tackle one of the most important dangers to the fragile ecosystem of the Baltic, which is the North European Gas Pipeline.

Nord Stream, a project almost purely political in its nature (contrary to what the main shareholders, Germany, Russia and the European Commission constantly repeat), from the very beginning has been contested as – at best – doubtful from the economic point of view. Its estimated costs has dramatically risen (from around 4 billion EUR in 2006 to 12 billion EUR or even more today), while the actual construction process have not yet started. There are numerous voices raising concerns about Russia's ability to provide a sufficient amount of gas to fill the pipeline, and they are coming from even the highest circles of power in Russia itself. Gazprom has been heavily affected by the crisis and instead of pumping money to the budget, it is asking the Kremlin for loans, and therefore will not be able to invest in new gas fields – and that is a *sine qua non* condition of being able to use the pipeline to its full capacity. Moreover, there are gas shortages for the consumers inside Russia and if there is no radical change in Gazprom's strategy, the experts predict a possible break down of the internal gas market by 2011. And even if the gas somehow will finally flow, the question of its price for the consumers in the EU remains open.

Regardless of the market aspect of the whole project, the main opposition is on the grounds of the ecological danger it will pose to the Baltic. The recent information about the plans to detonate an unidentified number of World War II munitions lying on the path of the pipeline (their number may be anywhere between 30 and 900), mainly in the Bay of Finland, caused very serious concerns among the Members of European Parliament, ecologists and the general public. Data provided during the Baltic Europe Intergroup meeting in March by Anders Tarand, MEP from Estonia, is really alarming – according to these facts, 20 cm under the bottom of the Baltic lies a thick layer of mud containing dioxins, one of the byproducts of the paper – producing industry in Finland between 1940 and 1984 that were pumped directly to the sea. It is easy to imagine the impact on the ecosystem if these chemicals begin to mix with the water as a result of no less than 30 explosions. Each of these will heavily contaminate the area in the radius of at least 15 kilometers. According to the scientists even today there are traceable quantities of dioxins that can be found in the Baltic herring, and one can

only imagine what will happen, if Nord Stream goes ahead with its plan of underwater detonations. If we add to that the information given to the Baltic Intergroup members by Andreas Calgren, Minister for Environment from Sweden, who said that out of 26 independent ecosystems which exist in our sea only 10 are functioning normally – and that even their number is constantly decreasing – we arrive at a really distressing picture of the situation.

Even before the information mentioned above became public, the European Parliament adopted a highly critical report that strongly condemned the plan to build the North European Gas Pipeline under the bed of the Baltic Sea, pointing out numerous dangers connected with the construction: the hazard of detonating the chemical and biological weapons that still lie under its waters, shipwreck graveyards lying on the path of the pipe, the threat to numerous species living in the Baltic (especially to porpoises), disturbing a total area of 2400 square kilometers of its soil or the plans to clean the pipeline with toxic glutaraldehyde that would be eventually pumped into the sea. The work on the report was marked with heavy Nord Stream lobbying – to the point where whole sets of amendments tabled by some MEPs were actually prepared by the company and aimed at removing large quantities of text (in fact if they all were adopted, the final resolution would be about one page long!). There are two crucial points mentioned in the report: one that voices the opposition of the EP to carry-out the investment on the proposed scale without first having a positive environmental impact assessment, and another one calling for analysis of alternative ways, especially the overland routes.

Such an alternative actually exists – a pipeline that would connect Russia and Germany, going through the Baltic States and Poland, all members of the EU. The Amber Pipeline, as it is called, would be more cost effective (the total expenditure would not exceed 3 billion EUR) and, what is even more important, much more friendly to the environment. However, Russia does not even consider this option – again mainly due to political reasons.

The last thing the Baltic Sea needs today is another danger to its already fragile ecosystem. Let us hope that the Swedish presidency which will take over from the Czechs this summer and which plans to focus on the Baltic will see that and act accordingly.

Hanna Foltyn-Kubicka

Member of the European
Parliament

Poland



The EU and Russia

By Reino Paasilinna

Where is Russia heading? There exist many informed opinions about this. Some say that Russia is a prisoner of its own history, its geography and thus can't change. Russia prepares its initiatives and legislation rationally, but executes and interprets them 'creatively'. For example Vladimir Putin's program to stamp out corruption has been a victim of this trend.

During the last decades the Russian economy has expanded dramatically and the internal political situation in the country has calmed down. Russia has found a stable place in the international sphere. Its leaders have made a conscious decision to switch from being exporters of raw materials to being salesmen of knowledge based products and services. President Dimitri Medvedev has distilled these goals into five 'i's: investment, institutions, infrastructure, innovation and intelligence. Russia is a great power and wants this to be recognized internationally. According to this doctrine, we have moved away from a uni-polar world towards one where cooperation between actors is necessary.

Relations between Europe and Russia have suffered individual difficulties for years. Examples are the Polish beef crisis and the Nord-Stream gas pipeline in the Baltic. The EU enlargement to former Warsaw Pact countries put an even greater strain on relations.

Now since the war with Georgia and the latest Ukrainian gas crisis, Russia's relations with Europe are once again going through a rough patch. As the gas crisis has once again underlined, European energy dependency on Russia is the defining element in the relationship, albeit Russia is equally dependent on European payments and investment. The steep drop in world oil prices has had a major impact on the Russian economy. Initiatives of OPEC to slow production to bring the price up again have so far been unsuccessful.

The World Bank has calculated that the Russian economy will contract 4.5 % this year. Russia is of course especially influenced by the world economic downturn because of its dependency on oil and gas exports. Last July oil was being sold at 150 dollars a barrel and now the price is 50 dollars. That is a huge drop.

If the latest gas crisis has made the EU doubt Russia as a reliable supplier, the war between Russia and Georgia in July 2008 damaged its political reputation even more. Russia came in for intense criticism in Europe, although Georgia was the one to start hostilities by heavily bombing Tskinali, the South-Ossetian capital. Russia did, however, prove its willingness to use force at its troublesome border region.

In a BBC World Service poll, conducted across 21 countries in January 2009, views of Russia have become more negative compared with the year before.¹ In the big EU countries only just over 22% of the public felt positively towards Russia while almost 59% felt negatively about Russian influence. In general, views of Russia around the world had also become more negative with 30% positive against 42% negative. This may be a general reflection of Russia's growing influence.

Even if the public perception of Russia is still rather dark, diplomatic efforts between the EU and Russia can be intense as well. During the gas crisis the Russians as well as the Ukrainians were in intensive contact with the EU

and there was a real willingness to solve the problem (at least in the short term) in trilateral talks between Russia, Ukraine and the EU. In a situation where the EU had one simple common interest, i.e. the resumption of gas deliveries to Europe, it was for once able to speak with one voice.

In general, however, Europe's political situation is not favourable for Russia. The EU gained new members a few years back in its Eastern expansion. Some of these countries are keen to seek compensation for the wrongs done to them during the Soviet period.

Apart from the most recent political crisis situations in Georgia and Ukraine, Russia looks forward to enjoying possibly better relations with the US under President Obama than with George W. Bush. Obama has already hinted that the plans for the US military base in Poland will not go ahead. I believe that membership in the EU in the long term of some countries, such as Ukraine, would be less provocative towards Russia than their membership in NATO.

However, the problems we now have with Russia are limited. They don't have an ideological base and both parties want to find solutions to them.

It is important for Russia's image that the Partnership and Cooperation Agreement (PCA) PCA-negotiations advance rapidly. The renewed would create a framework for both sides could develop their cooperation. The EU incorporates at least three approaches to the negotiations. Some want in depth negotiations linked to Russia's membership of the WTO. Others would be content with a short political declaration connected to the sectoral agreements². And of course there are those who would be happier without any agreement.

The poor image of Russia in Europe hinders it from achieving its political goals and solving issues. Trade is more difficult and investors are more careful. Many barriers can be lowered by developing Russian legislation and policy public. An important image factor, Russian culture, is fairly unknown in the West. There is a need to get the communication strategies of large companies to the same level as in the West Europe. To copy what the Americans and Japanese have successfully done would be especially important within the European Union.

Reino Paasilinna

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¹ Views of China and Russia Decline in Global Poll, 6.2.2009, http://www.worldpublicopinion.org/pipa/pdf/feb09/BBCEvals_Feb09_rpt.pdf

² Colmart, Thomas: EU-Russia Relations, CSIS July 2008

The EU's relations with Belarus – how to get things moving?

By Aloyzas Sakalas

Belarus has often been labelled as "Europe's last dictatorship". Although the regime has frequently announced that it would be interested in a better relationship with the EU, these words have rarely been followed by deeds. The EU has designed its European Neighbourhood Policy (ENP) to encompass Belarus, but it found itself caught in a trap insofar as participation in the ENP programmes is conditional on progress on democratisation and human rights. As the Belarusian regime has for many years abstained from substantial progress, Belarus could not be included into the ENP. No policy framework for relations between the EU and Belarus was developed and the EU could not deploy its usual political, financial and other instruments in order to execute political leverage on the Belarusian regime.

In November 2006 the European Commission issued a non-paper which explains what the EU could bring to Belarus' citizens if the regime fulfilled certain conditions as the release of all political prisoners, the abolition of the death penalty, an assurance of a free media and freedom of expression, the independence of the judiciary, respect for democratic values and for the basic rights of the Belarusian people. In order to strengthen Belarusian civil society, the EU has however been supporting the independent media, Belarusian NGOs and students as well as the exiled European Humanities University in Vilnius, Lithuania.

Still, the situation inside the country remains largely unchanged. In 2008 the EU therefore undertook several steps to come out of this deadlock. The Commission opened a Delegation in Minsk in order to enhance dialogue. In October 2008 the Council of Ministers furthermore decided to provisionally suspend a visa ban on certain regime officials. On 16 March 2009 this suspension has been prolonged for a further 9 months. Belarus' Minister for Foreign Affairs was invited to Brussels in the margin of a Council meeting in October 2008 and in January 2009 and the EU's High Representative for Foreign Affairs Javier Solana travelled to Minsk on 19th February. Although the EU has not yet set up regular forums for dialogue, these first meetings clearly blew a breach that enables the EU to better convey its messages towards the Belarusian leaders. The establishment of a human rights dialogue is currently under discussion between the EU and the Belarusian authorities.

As a strong advocate of a policy towards Belarus which offers better opportunities to Belarus' citizens, the European Parliament has adopted many resolutions over the last years. On two occasions it has awarded its annual Sakharov Prize for Freedom of Thought to Belarusian citizens (the Belarusian Association of Journalists in 2004 and the opposition politician Aliaksandr Milinkevich in 2006). The European Parliament is closely monitoring arrests and releases of members of civil society and opposition activists. During election periods it has

repeatedly called on opposition leaders to demonstrate unity. It has also actively been lobbying for a reduction in visa fees which, due to the enlargement of the Schengen zone to Belarus' direct neighbours Poland and Lithuania, rose to 60 EUR.

In contrast to the Commission and the Council, the European Parliament is less optimistic about the recent developments in the EU's relations towards Belarus. Due to their regular contacts to Belarusian opposition politicians and representatives from the civil society, Members of the European Parliament are well aware that many of the changes announced by the regime will probably remain cosmetic changes. It is therefore all the more difficult to decide if the moment for a restricted cooperation with the regime has already come. It seems only possible to soften the regime if the latter can see at close range on which advantages it misses out by not cooperating with the EU. In order to let the regime understand this, a minimum of communication and a minimal opening towards Belarus is necessary. The European Parliament though is closely monitoring the latest developments so that this opening does not betray the EU's goal of democratizing Belarus on the long term. By building up relations between the EU and Belarus, the EU intends to support democratization and not the regime's stabilization.

In May the EU will host a summit with its Eastern neighbours Ukraine, Moldova, Georgia, Armenia and Azerbaijan in order to formally launch its new Eastern Partnership. An invitation to take part in this initiative could also be extended to Belarus. This would be an opportunity to show once more to the Belarusian regime what are the clear advantages of countries engaged on the path towards democratic reforms in terms of international cooperation. Participation in the Eastern Partnership would also open new possibilities for Belarusian NGOs and the civil society. However, the EU can hardly allow Belarus to take part in the Eastern Partnership on the same level as the other five partner countries; that means fully and unconditionally. The launch summit in Prague should be used to demonstrate to Belarus what it could expect from better relations with the EU, but no promises should be made.

It remains to be seen if the country is willing to engage on the necessary path of reforms. In order to do this, it is however necessary to strengthen dialogue with the government and the opposition at the same time. The European Parliament will remain the EU's strongest advocate of the Belarusian opposition.

Aloyzas Sakalas

Member of the European Parliament

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Towards a sustainable and secure energy policy in the Baltic Sea Region

By Ville Niinistö

Energy policy has become a vital issue for the European Union countries in the last few years because of several reasons. If European decision-makers are wise, they should tackle the different root causes of energy uncertainty by a coherent strategy that lays the foundation for a sustainable and secure energy policy for the future. The Baltic Sea region countries have much to win in coordinating these efforts.

Firstly, international climate experts are unanimous in asserting the fact that man-made climate change is challenging the very core of our civilization unless we minimize greenhouse gas emissions in a short time period by making drastic changes in our energy production and usage. In other words, concerted action must be taken now in order to save the planet and our civilization.

The European Union countries have agreed to scale down emissions in 2020 from 1990 levels by 20%, and if international agreement is achieved by 30%. They have also acknowledged the fact that in order to limit global warming to 2 Celsius-degrees the industrialized countries need to scale down emissions by 80-95% until 2050 as estimated by the UN climate panel IPCC. It is clear that these goals are not achieved by small adjustments.

Secondly, energy as a vital resource has become once again a tool in international politics and especially in EU's relations to Russia. Energy independence and energy security have been frequently used concepts among decision makers in Europe ever since the gas conflict between Russia and Ukraine in January 2009.

The importance of energy policy is reflected in the Lisbon Treaty. In addition to encouraging member states to increase their use of renewable energy, the Lisbon Treaty now includes a writ of solidarity with regard to maintaining energy security in the Union.

Much can be achieved both in energy efficiency and in energy independence by a better functioning European energy market and a modernized infrastructure. Insufficient energy infrastructure is seen as a spoke in the wheel of attaining the hoped-for energy solidarity. A solution would be to extend the energy transmission networks as widely as possible.

At the same time the European energy transmission network should be modernized to intelligent HVDC grid (High Voltage Direct Current). At the moment almost 10 percent of energy is lost in poor transmission of energy. HVDC super grid would also enhance the competitiveness of decentralized and local energy production such as wind and solar energy. It makes possible a new energy policy largely based on small local energy production which in turn makes us more independent on both foreign resources and the few energy giants in the market.

The energy security situation in the Baltic Sea area is currently somewhat unbalanced, as the Baltic countries are more or less completely dependent on Russian gas and electricity delivery, with the exception of the Estlink-cable between Finland and Estonia. The demand of imported energy to the Baltic countries is expected to increase as the old Ignalina nuclear power plant in Lithuania is shut down. Emphasizing Russia's role as Europe's most important energy supplier, stresses the importance of reaching an exhaustive agreement between EU and Russia, in which the rules of the energy trade game are clearly outlined. Currently, a high level EU working group is preparing the Baltic Interconnection Plan that will map the

needs of energy connections in the area. Already the Estlink 2-cable is included in EU stimulation measures.

Lately, the use of the Baltic Sea as a cross-border energy transit has been subject to debate in the area. Nord Stream (owned by Russian, German and Dutch energy companies) recently launched its Environmental Impact Assessment report regarding the construction of a 1200 km long gas pipeline that would run from Portovaya Bay on the Russian coast to Griefswalser Bodden in Germany.

The Nordic countries headed by Finland and Sweden, have chosen to regard the possible construction of a Baltic Sea offshore gas pipeline from an environmental point of view. Proper measuring of the project's environmental impacts has therefore been greatly emphasized. Estonia for its part, did not allow building the pipeline on its side of the sea, as they feared the construction of the pipeline would seize an opportunity for others to gather intelligence on the countries resources.

Is Europe taking a risk by tying the knots with the Russian gas market through a pipeline in the Baltic Sea? Will the pipeline serve the purpose of increasing energy security in the area on the cost of security in other senses of the word? With the recent gas crisis between Russia and Georgia in mind, it became clear that Russia does not exactly fear EU sanctions. What kind of long-term lessons can be drawn from the gas crisis earlier this year?

More important than trying to fulfill the seemingly never ending increase in demand for energy, is to start questioning wasteful usage of it. Investments need to be made in local renewable energy production like wind and solar power, at the same time as financial resources are channeled to energy efficiency measures and innovations. Green solutions also create more jobs and therefore should be an essential part of stimulating the economy.

Europe can achieve true energy independence best by combining its fight against climate change to efficient energy production and transmission solutions. All in all, a decreased demand of energy is fulfilled principally using energy produced through a combination of different, local renewable energy resources.

Also Russia's long term interest is to diversify their economy and therefore seek part in this process. During an interim period Russia can see the EU countries as reliable export destinations of energy, but no country can build its success for long on fossil energy in future low-carbon world.

The Baltic Sea region countries should find cooperation in upgrading energy transmission networks and joining scientific expertise in clean technology together with local renewable energy possibilities. It is there we can also find joint economic opportunities.

Ville Niinistö

MP, Finnish Parliament

*Vice-Chair of the Green
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Finland



The Baltic Sea Region is crucial to the Konrad-Adenauer-Foundation

By Bernhard Vogel

The foundation's offices in Tallinn, Vilnius, and Riga, Moscow and St. Petersburg, Warsaw and London, where our work in the Nordic countries and Baltic Sea cooperation is conceptualized and organized, reflect the Foundation as an active observer, supporter and co-designer of manifold dialogue and collaboration in the Baltic Sea region. For us this is more than just about bilateral contacts and relationships with Germany. With our programmes and initiatives we furthermore regard ourselves as participants in the effort of ensuring and reinforcing the continuation of the success-story of peaceful development of the countries in the region since the fall of the Iron Curtain. This being in terms of freedom, democracy and the rule of law as well as to ensuring the countries' economic stability in a global competitive environment through close cooperation.

2009 may be a significant year for ensuring just that. The EU-Baltic Sea Strategy will be presented by the EU Commission and advocated by the Swedish Presidency. The form and results, of this first-time engagement in a regional strategy of the European Union, will serve as an example for politics in the Mediterranean, the Black-Sea region or for the countries of the Visegrad Group. In the future, the expanding European Union will need to rely on such regional pillars increasingly if the Union's joint roof is to remain firm and stable, in spite of its diversity and size.

In this respect the Baltic Sea region has made distinctive contributions in earlier years on which we need to build. Nowhere else have opportunities for bridging the gap between "old and new Europe" been used so proactively and successfully. This experience and the attitudes shaped by various histories should be brought together and applied to our dialogue with Russia, meanwhile the only Baltic Sea state that isn't a member of the European Union. The instrument for such a dialog is the Northern Dimension. It has to be combined with the European Neighbourhood Policy and the Swedish and Polish Initiative for an "Eastern Partnership" in order to make a uniform policy vis-à-vis our Eastern neighbours.

With the establishment of the Baltic Sea Free Trade Area (BFTA) in 1993 and following EU enlargement in 2004, the Baltic Sea region provided a unique example of economic prosperity in Europe and for many years it remained the region with the highest economic growth in the world, following NAFTA. Today, in times of failing economic strength and crisis on the financial markets, a dialogue around the Baltic Sea may, in turn, make a

contribution towards ensuring that people, in the new EU Member States especially, do not lose confidence in free market systems or in the democratic or constitutional order that initially was achieved with great effort. The German model of a social market economy or the social security systems known from the Nordic countries create a social balance that helps alleviate the risks of a societal division in times of economic and financial crisis.

It is in difficult times the potential of the region needs to be disclosed and made accessible with even more determination. This applies directly to cooperation in research and technology, university networks and the development of traffic infrastructures or joint tourism projects.

In particular, the Baltic Sea region can tackle environmental and climate challenges jointly. Starting with the sea, connecting everyone. The decision of the European Council on 14 December 2007 for the EU-Baltic Sea Strategy is that: "This Strategy should help to address the urgent environmental challenges related to the Baltic Sea". Many state and private organizations have adopted this objective.

From the EU-Baltic Sea Strategy it also must be expected that an even closer agreement on action, with clearly outlined responsibility, is agreed.

This applies beyond the issue of environmental protection. What in previous years has emerged and grown in terms of structures of Baltic Sea collaboration has to be scrutinized in today's joint EU Membership. Less may now be more. The agreed cooperation under the umbrella of the EU makes all Member States partners in Baltic Sea cooperation. This strengthens the region and gives it a role far beyond Northern Europe. The next months are of utmost importance for status and redefinition. In this case it should primarily be the countries of the Baltic Sea region themselves that provide the initiative and indicate the way ahead.

Bernhard Vogel

Dr., Chairman

The Konrad Adenauer Foundation

Germany

Climate crisis requires regional collaboration

By Michael Butler

There is little doubt that the Earth's environment is changing rapidly. Melting glaciers, prolonged droughts and disappearing forests are profoundly impacting delicate ecosystems. No country is immune. In the Nordic region, lighter snow cover has changed reindeer migration patterns. Further south, rising temperatures in the Baltic Sea have led to severe algae blooms, threatening the native fish species upon which local communities depend. Across the Atlantic, American forests are dying from beetle infestations spurred by warmer winters, while coastal cities are battered by longer, more severe hurricane seasons.

President Obama's administration is actively addressing the global climate crisis. We are in the early stages of putting in place a strong, mandatory plan to cut emissions and develop a low-carbon economy. Over the next ten years the US plans to invest \$150 billion to bolster private efforts to build a clean energy future by focusing on alternative and renewable energy sources, ultimately saving more oil than the US currently imports from the Middle East and Venezuela combined. This includes putting one million plug-in hybrid cars on the road by 2015, ensuring 10 percent of our electricity comes from renewable sources by 2012, and 25 percent by 2025, and implementing an economy-wide cap-and-trade program to reduce greenhouse gas emissions 80 percent by 2050. This is a bold new vision of America's leadership role in this vital area.

The European Union has also been a vocal advocate for mitigating climate change. In December 2008, the European Parliament approved the EU's Climate and Energy Package which calls for a 20% reduction in emissions and a 20% increase in the use of renewable energy sources by 2020. The EU has pledged an additional 30% emission reduction if all parties at the December 2009 UNFCCC climate talks in Copenhagen agree to similar targets.

Both EU and American energy targets are ambitious. Under the EU package, some of the heaviest burden will fall to the Nordic countries. For example, Finland must reduce emissions by 16% and increase its use of renewable energy sources by a hefty 38%. The Finnish government has already taken the first steps to meet the targets, but the path to success will not be easy. Additional mitigation measures will be expensive and more difficult to finance amid the global economic crisis. Similar challenges exist for the US.

One solution lies in cooperation. Climate change is a global issue that affects all nations, and only by harmonizing our research and development efforts can we make the immediate impact needed to decelerate global warming. Targeted joint partnerships will efficiently harness scientific talent, attract financing and speed-up technological breakthroughs.

Such collaboration is already successfully underway between the United States and Finland. In the summer of 2008, US Embassy Helsinki's Embassy Science Fellows Program sponsored a research exchange for Dr. Alan Rudie, Supervisory Research Chemist from the US Forest Service (USFS) Forest Products Lab in Wisconsin. Dr. Rudie spent three months in Finland collaborating with top Finnish scientists from VTT and the University of Helsinki to advance the production of economical, multi-purpose biofuel from forest trimmings. Dr. Rudie's cooperation with his Finnish colleagues continues to this day. He

recently returned to Finland for a biomass conference to provide updates on the USFS's latest biofuel research developments. The USFS Chief Abigail Kimbell and the Deputy of the USFS Forest Products Lab Dr. Ted Wegner have also visited Finland to solidify a more formal biofuel research partnership between the US and Finland. We are optimistic that this field holds many possibilities for US-Finnish cooperation.

In September 2008, the US State Department convened its biennial review of the US-Finnish Science and Technology Agreement (S&T). The meeting, held in Washington, brought together decision makers from the American National Science Foundation (NSF) and the Finnish Funding Agency for Technology and Innovation (TEKES) to discuss tighter scientific cooperation. NSF and Tekes subsequently launched an international research fellowship called the NSF Graduate Research Fellows Nordic Research Opportunity, which supports research visits for advanced American graduate students between three and twelve months to Finland. The program will bring Fellows in contact with leading Finnish scientists and institutions, and expand opportunities for innovation. The first Fellowships will be granted in mid April 2009.

At the Washington International Renewable Energy Conference (WIREC) hosted in March 2008 by the US Government in cooperation with the American Council On Renewable Energy, the US Government pledged to reduce America's carbon footprint. A new State Department-led initiative, the Nordic-US Cooperation on Renewable Energy (NUCORE), is a multi-agency effort which promotes regional cooperation between the US and foreign countries in specified regions by focusing on R&D in renewable energy science and technology. Its objective is to create regional R&D partnerships to address issues and challenges in the rapid scale-up of renewable energies and yield results that are larger than the sum of their parts. The hope is to reach beyond unilateral efforts and even bilateral partnerships to promote a regional approach to searching for renewable energy breakthroughs. At an exploratory meeting between NUCORE administrators, Finnish scientists and policymakers, NUCORE received enthusiastic support, and its official launch is set for spring 2009.

These efforts are just a few examples of US-Finnish scientific partnerships currently underway. Additional collaborations outside of the region, such as the Asia-Pacific Partnership on Clean Development and Climate, are also yielding great results. The climate crisis is not just an environmental or energy issue, it also has health, economic and security implications which require immediate action. Focused bilateral and regional partnerships can be an important catalyst to advance clean technology innovations at the pace required to blunt the effect of global warming. Finland and the US are working together to do their part.

Michael Butler

Chargé d'Affaires

US Embassy Helsinki

Estonian economy in anticipation of the euro

By Andres Lipstok

The world has been experiencing a real economic crisis for more than a half a year. By now it is almost certain that economic recovery in advanced countries is not expected before 2010. Also in medium-term, economic growth may be modest compared to the rapid development of the past decade.

In the European Union Member States, the harsh reality is approaching. The output in the economies of new Member States may also fall more than it is currently expected. So, according to the risk scenario, the decrease of the Estonian gross domestic product in the first half-year might be measured in double-digit figures.

Earlier risk factors have remarkably decreased

In Estonia, economy started to slow down already in the middle of 2007 - considerably earlier than in most other European countries. The most significant change in the Estonian economy over the past half-year is the sharp and rapid decrease in several risk factors, which has been facilitated by the reserves accumulated by the government and banks in earlier years.

Estonia's current account deficit - i.e. the difference between economy's savings and investments or dependence on the current inflow of foreign capital - has decreased very sharply. This year the economy's current income and expenses will probably be in balance for the first time in the last fifteen years and the possibility of the current account surplus cannot be excluded either. The total volume of Estonia's external debt is also very likely to decrease. At the same time, the external debt of banks operating in Estonia should decrease as well because the growth in household deposits and the weak loan demand enable to repay some of the money borrowed from parent banks in previous years.

Here I would like to stress that the balancing of the current account is a correction resulting from the very large investments of previous years. In the medium and long term, the inflow of foreign investment into Estonia will definitely continue. Estonia's capital formation per person is still significantly lower than in the European Union on average and the average return on investment remains higher than in the so-called old Member States.

During the past half-year, the overall price level in Estonia has not increased, which is the first time after the adjustment in prices following the accession to the European Union. The inflation of 2009 is likely to be negative. In the years to come, the fixed exchange rate of the kroon and the currency board system will keep prices stable. That being said, it is worth mentioning that the halt in wage growth and the decline in interest rates of the euro support the real purchasing power of income.

Rapid normalisation of these essential risk factors shows Estonia's flexibility and adaptability. The positive changes in the economy over the past six months have created first preconditions for a gradual economic recovery. The matter of fact is that our households and enterprises have enough resources to look ahead much more confidently than at the moment. We have let some of the doomsayers intimidate us too much. It is rather the question of if and how Estonia can use the current opportunities.

Path to new economic growth

It is characteristic of the today's world that countries relying on the growth of domestic demand as well as economies relying on the export of industrial goods suffer equally. The growth model based on cheap loan money and American and Asian demand is now exhausted both in Estonia and in the rest of Europe. Economic recovery in Estonia and Europe will therefore be based on profound structural changes.

Further development of the Estonian economy must rely on areas with higher value added in order to ensure a future increase in wages and income. Enterprises must review their current business plans, rearrange their activities and, if needed, end businesses with no perspective. The main task of the government is to contribute to these rearrangements. This requires primarily maintaining the economic environment that is open, stable and supports business. As regards the recovery of economy and investments state budget, labour market, credibility of the banking sector, and accession to the euro area are of the critical importance.

Estonia's fiscal policy has so far endured the crisis successfully. The rapid increase in the 2008 budget expenditure contributed extremely strongly to the avoidance of economic recession. This year the deficit accompanying the decline should definitely remain within the limits set by the Maastricht criteria. In the next two years the objective should be the structural balance and surplus of the budget. The government has no easy choices while making short-term fiscal decisions; in any case the financing of social expenditure targeted at vulnerable population groups and at the same time the maintenance of a reasonable volume of state investments should be ensured. Yet the question is not only about the restoration of the budget balance. The changed economic situation is also a suitable time for thinking about the long-term fiscal sustainability.

In the short run, it is appropriate to use flexible employment solutions in the labour market. All in all, employment still has to decline in areas with decreasing demand since this is the only way to create preconditions for growth in other sectors of the economy. Well-functioning unemployment insurance and retraining are clearly supportive measures. But the employment will eventually depend on how easy or expensive the creation of new jobs is and whether wage agreements reflect the economic situation of a specific enterprise.

Economic adjustment and growth largely depend also on banking. As a result of previous years' very high profits and rather strict banking standards, banks operating in Estonia are very well capitalised. Nevertheless, this year the total volume of bank loans will probably decrease. This reflects mainly lower demand for credit, but also the changed situation in global financial markets.

Adoption of the euro

The euro adoption is a natural stage of development in the Estonian economy. Since in the economic sense we have participated in the euro area for almost 17 years through our monetary system, it is an expected and natural course of events that Estonia will join the euro area. In the light of the current situation of the global economy particularly, the clear and concrete perspective of changeover to the euro adds confidence and helps to increase Estonia's credibility.

According to current estimates, by the end of 2009 Estonia will meet all criteria required for the adoption of the euro, including the inflation criterion, which has been a problem so far. But as already mentioned, the budget deficit criterion will certainly become one of the key challenges. The Estonian Government has approved the deadline for the adoption of the euro, which is 1 January 2011 at the latest.

Andres Lipstok

Governor of Eesti Pank

Estonia

The University of Helsinki as an engine of Baltic Sea research

By Thomas Wilhelmsson

As one of the leading multidisciplinary research universities in the Baltic sea region the University of Helsinki carries a strong responsibility for generating research concerning the endangered environment. The University in many ways responds to the demand for research-based knowledge and new solutions in this field.

The University of Helsinki has a strong foundation for performing research in this area. In the beginning of the millennium, it was invited as one of the founding members of the League of European Research Universities, thereby assessed to belong to the twelve leading universities in Europe. In research assessments measuring contemporary research performance the University often is considered to be among the ten most excellent universities in Europe. A particular strength of the University lies in its multidisciplinary broadness. Centres of excellence in research can be found on all four campuses of the University: on the campus for arts and social sciences, for medicine, for science, and for biosciences. Self-evidently a broad approach is needed when studying the complex problems related to the Baltic sea.

Climate change is a huge global challenge affecting the Baltic see as well. The uncertainties in this area are large and the demand for research accordingly very strong. In the University of Helsinki researchers on climate change are in the forefront of global excellence. The Finnish Centre of Excellence in Physics, Chemistry, Biology and Meteorology of Atmospheric Composition and Climate Change, headed by Professor Markku Kulmala, is one of the leading international spearheads of research concerning these issues, with collections of series of data that make most researchers full of envy. The research group is also part of a Nordic Centre of Excellence.

The state of the Baltic sea, its eutrophication, requires research responses from various quarters. Strengthening of Baltic sea research in biosciences has been a strategic goal of the University of Helsinki. Internationally valued multidisciplinary research is performed in particular at the research station of Tvärminne, close to the city of Hanko. Research projects are performed in cooperation with the city of Kotka as well. Several ministries and public research institutions are involved in the work.

Another example of research focusing on consequences of eutrophication are the activities of the national Centre of Excellence in Integrative Photosynthesis and Bioactive Compound Research at Systems Biology Level. Research activities carried out in the University by professor Kaarina Sivonen are dealing with cyanobacteria, also known as blue-green algae. Cyanobacteria are well known for the capability to produce toxins and bioactive compounds harmful for humans and animals. Therefore, understanding how they react to the environment, extending from genome function through to the protein and metabolic level is of great value.

Typical for the research concerning the Baltic sea is its multidisciplinary nature. Several faculties, including the Faculty of Biosciences, the Faculty of Science, the Faculty of Agriculture and Forestry as well as the faculty of Social Sciences, participate in this work. Only in this way can sufficient knowledge concerning such a complex issue be produced.

In its recently adopted strategy for the years 2010-2012 the University has included a societal promise in its vision. It will actively work to promote the well-being of mankind as well as the development of a just society. Performing its main tasks, teaching and research, the University endeavours to focus in a more systematic manner on its national as well as global social responsibility. This includes working for a healthy relationship between society and nature. Offering strategic support to Baltic sea research is one of the ways in which the University attempts to fulfil this responsibility.

Thomas Wilhelmsson

Rector

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Finland



Russia-EU relations

By Konstantin Khudoley

For already two decades the relations between Russia and the EU have been extremely important for both sides and for the global stability in general. During this time these relations have experienced both ups and downs. In the early 90s optimism was the mood of political forecasters. The Partnership and Cooperation Agreement of 1994 reflected their optimistic prognosis. However, following the economic crisis of 1998, we began to witness a rising trend in Russia toward another model of socio-economic and political development, namely, state capitalism and full sovereignty. Thus, the development patterns of Russia and the EU have become increasingly different. In this regard, the discussion about a possibility of full or associate membership of Russia in the EU, which used to take place in the 90s, now has virtually stopped. Relations have become increasingly based on principles not only of partnership and cooperation but competition. In terms of financial and economic crisis that is now global, there is a trend toward greater differences between Russia and the EU.

Firstly, Russia and the EU have differing assessments of both the current crisis and the way out of it. The prevalent view in the EU is that the existing economic model must be preserved although significantly reformed and updated. Growing government interventionism in the economy in most cases is seen as a forced, temporary measure.

The Russian approach is totally different. Major part of the political and economic elites agree with the point of view of the State Duma Chairman Boris Gryzlov that Russia is going to come out of the crisis stronger, while the United States and European Union weakened. Many of the Russian initiatives (including the proposals for the G-20 summit) instead of focusing on transforming the existing model of the world economy are calling for its complete overhaul and creation of a new world economic order. This primarily refers to the pitch for a new reserve currency to replace the dollar. During a debate in the State Duma some representatives of the "United Russia" made it quite clear that the Russian proposals were aiming to put an end to the "American financial monopoly." Increased government intervention in the economy is thought of as an important step, which is sometimes given ideological colors. This is presented as "the collapse of liberalism".

At the same time, while the financial and economic crisis is getting worse in Russia, other more cautious voices are beginning to speak up. They emphasize the need for cooperation with the EU and the United States as a way to overcome the crisis. They also admit the limited ability of Russia to influence the global financial system. It can be assumed that this trend is likely to grow and some convergence of views between Russia and the EU will occur. However, in all cases, the position of Russia will be a combination of different trends, and complete convergence with the EU will not happen.

Secondly, the crisis has exacerbated tensions and disagreements on a number of economic problems that existed before.

Energy resources are now and likely to remain the main commodity of trade between Russia and the EU and both parties are interested in this trade to continue. However, one cannot help seeing the growing difficulties. Russia has not ratified - and it is unlikely to do so in the future - the Energy Charter. There is still no set of common rules of the

game in the energy sector. Formulation of such rules is already facing considerable difficulties and, doubtless, will require a long time. Russia has also negatively reacted to the intention of the EU to diversify its sources of energy. Particularly painful for Russian political and business community are the plans to build an oil pipeline «Nabucco» bypassing Russia.

Adverse trends are also seen in other areas of commerce. Thus, the decrease of Russia's imports of equipment from the EU at the end of 2008 was due not only to the effects of the crisis. The Government of Russia is seeking to adopt policies that support their industries, including the reduction of imports and import substitution.

On this basis, we can assume that the crisis will lead to a reduction in trade between Russia and the EU.

Thirdly, the relations between Russia and the EU in the post-Soviet area have significantly gotten more complicated. After the enlargement in 2004 the EU has been striving to play an increasingly prominent role. This was evident during the «orange revolution» in Ukraine, «gas» conflicts in 2006 and 2009 between Russia and Ukraine and the armed conflict in the Caucasus in August 2008. In some cases, such as the Caucasian conflict, the EU acted as mediator. However, in general, Russia is critical of EU activities in this direction. The program «Eastern Partnership», proposed by the EU to Ukraine, Belarus, Moldova, Armenia, Georgia and Azerbaijan, is perceived even more negatively. Influential circles in Moscow, believe that this is an attempt to tear these states apart from a close cooperation with Russia. In fact, there emerges a large «zone of suspicion» between Russia and the EU, which could significantly complicate their relations in the future. Unfortunately, we can not exclude the spread of «zones of suspicion» to the North, if we fail to reach an acceptable agreement on the future of the Arctic.

Fourthly, there are still great challenges facing us regarding a new treaty to replace the 1994 Agreement. It is quite clear that its development and ratification will take several years.

If to summarize, it is possible to conclude that Russia-EU relations will be not easy in near future. Both sides are not interesting in large confrontation, but the number of various conflicts and mutual suspicion will increase.

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Russia



Energy cooperation within the Baltic Sea Region – a Kaliningrad perspective

By Arne Grove

During the years 1996-'98 the Baltic countries studied and discussed the plans for generation and distribution of energy for the Baltic Sea Region (BSR). One of the most remarkable studies was the "Baltic Ring Study" carried out within the framework of cooperation between leading energy utilities in the BSR. Kaliningrad was represented by the local energy company JantarEnerg, at that time a subsidiary of the RAO United Energy Systems. Within the cooperation a number of recommendations were developed.

Since 1998 the international cooperation within the BSR has changed. The Baltic States are now members of the EU. The energy prices increased in all countries. The importance of mitigating climate change has been recognized on the global scene and the need for dealing with energy efficiency on national, regional and local levels in all countries is now high on the agenda.

The key forum for international cooperation on energy issues within the BSR is BASREC, energy cooperation of the Council of the Baltic Sea States. In this cooperation the Russian Federation is represented by the Ministry of Energy of the Russian Federation. On the regional level there is direct bilateral cooperation on energy between Kaliningrad and Lithuania, Kaliningrad and Poland, Kaliningrad and Belarus.

In December 2006 the agreement on integration of Polish and Lithuanian energy systems in 2011 was signed in Vilnius. After the construction of the "energy bridge" between Poland and Lithuania is completed, the "Baltic Energy Ring" will connect Lithuania, Latvia, Estonia, Finland, Sweden and Poland. Therefore, the Baltic States announced their plans to separate their energy system from the Russian energy system and shift to parallel operation with the United Western European Energy System UCTE. *With the implementation of this project energy supply to the Kaliningrad region from the mainland of Russia will be impossible. This situation appears to be a challenge for Kaliningrad.*

In the Kaliningrad region the energy demand has substantially increased since 1998, when the "Baltic Ring Study" was prepared. The demand is foreseen to increase further due to economic growth in the region. The demand is increasing in both the housing and industrial sectors. There have been cases when the electricity supply could not meet the needs of industrial development.

Russian federal and regional energy companies are working together with the Kaliningrad government to develop solutions and plans for the development of energy-generation capacity as well as concept for energy saving.

As a result it was agreed to increase the supply of natural gas provided to Kaliningrad from Russia through the pipeline via Belarus and Lithuania and pipeline capacity itself. The capacity for production of electricity was increased significantly in 2005 with the establishment of a new gas-fuelled power plant with a capacity of 450 MW. Moreover, a new 450 MW block is being build to meet further demand. Later a heating main from the power plant to the district heating network of the City of Kaliningrad will be build to improve the energy efficiency of the plant.

The draft strategy and program for the development of energy-generation capacity in the Kaliningrad region until 2016 includes the mentioned second unit of the gas-fuelled power plant and a nuclear power plant ("Baltic Nuclear Power Plant", 2 blocks each 1.150 MW), as well as a number of combined heat and power plants for cities in the region, which have already district heating networks (450 MW electric power). These plants should use local biofuels (peat and wood) as substitutes for coal. The program also includes plans for the development of capacity of small hydropower (17 MW) plants and wind-power (from 50 to 200 MW).

The level of development of the district heating network in municipal and housing sector in majority of cities of the region

is relatively low, with the exception of the City of Kaliningrad. Boilers work on gas, coal and black oil. The heat losses in generation, transmission and end use of district heating are well known and significant. Lately, a significant increase in housing construction has taken place. Unfortunately, the construction standards for new buildings allow for high energy consumption, unlike in the Nordic countries. The capacity for energy management was increased in the region; *however, energy auditing is poorly developed as a management tool in several municipalities.* Besides, low fuel-prices, lack of technical and legal standards as well as financial resources constitute the main barrier for reducing energy loss within this sector. The capacity to develop bankable investment projects on improving energy efficiency using local and international financial schemes has not yet been developed in Kaliningrad, as well as in other regions of Russia. This also includes mechanisms under the Kyoto protocol.

The region is currently working on concept and plans for energy saving until 2020, which is coordinated with the mentioned general energy planning for the region.

The concept refers to the experiences from the first program for energy efficiency in the Kaliningrad region from 2001 to 2005 as well as to the order of the President of the Russian Federation "On measures to increase energy and environmental efficiency of the Russian economy, 04.06.2008" and decree of the Government of the Russian Federation "On defining the guidelines of the state policy in increasing energy efficiency by using alternative energy sources, 08.01.2009".

To improve the program and energy management the Kaliningrad Regional government is taking active part in "Energy cooperation with NW Russia" program supported by the Nordic Council of Ministers' (NCM) Knowledge Building and Networking Programme for NW Russia. The objective of the program is to facilitate and stimulate transfer of knowledge and development of cooperation between partners from NW Russia and the Nordic countries. As a part of the program, the Nordic Ministers for Cooperation have allocated 2 million DKK to the 'Energy cooperation with NW Russia' program, which is coordinated by the NCM Information Office in Kaliningrad. The cooperation includes study visits, seminars and development of a system for benchmarking energy efficiency for regions of NW Russia based on Nordic experiences. The developed tools can be used for analysis of energy efficiency in preparation of regional and local strategies and plans for energy efficiency.

Besides, the Kaliningrad Regional government in cooperation with BASREC, Baltic Development Forum and NCM is engaged in preparation of a conference in Kaliningrad: Energizing the region - Energy cooperation within the Baltic Sea Region, the objective of which is to discuss energy cooperation development within the BSR and consider its various scenarios.

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Effects of financial and economic instability in Russia

By Lúcio Vinhas de Souza

Background

The financial instability that started in the United States in the summer of 2007 was heightened by a series of developments in the summer of 2008. From a turbulence largely localised in the US, it became a truly global crisis, spreading also to emerging markets that had been initially insulated from the crisis. Russia was one of those emerging markets affected.

This worldwide volatility manifested itself first via a drying-up of international liquidity (which resulted in capital outflows from several emerging markets), and later, as global economic activity slowed, also via a significant fall in commodity prices. Those two elements combined resulted in a major external shock (to respectively its capital and current accounts) to which Russia is still in the process of adjusting.

This article describes in more detail the domestic effects in Russia of those shocks and the policy reactions to them.

Financial effects of external shocks

Arguably the most impressive effects from the external shock to the capital account part of Russian balance of payments are so far to be found in *stock markets*. Russia's main stock markets (the Rouble-denominated MICEX and the dollar-denominated RTS) fell by, respectively, 67% and 78% between the beginning of 2008 and February 2009. Nevertheless, their levels roughly stabilized since November 2008 and have, like other stock markets worldwide, experienced a *relative* recovery since March 2009 (for instance, the RTS grew by almost 30% since). As the trading in stock markets (and consequently the fall) was to a large degree dominated by foreign players, this pattern reflects foreign investors divesting from Russian markets as a reaction to the global credit squeeze.¹ However, concerning the spill-over from financial to real effects, it must be noted that stock markets have a relatively reduced importance in terms of the domestic financing of investment in Russia (during 2007 the issuing of shares financed less than 2% of its domestic fixed investment).

Another aspect of the effects of the global shocks to the Russian balance of payments is to be found in the *exchange rates*. They showed for a long time only relatively small changes, as the Central Bank of Russia (CBR) aim was to stabilize a nominal euro-dollar currency basket (set at 0.45 cents of the EUR and 0.55 cents of the USD). In November 2008, faced with the need to adjust to a terms of trade shock (the fall of oil prices, see below) – which was reflected in a significant reduction of the trade surplus (of 30% in yoy terms in November 2008), and to significant capital outflows (see below), the CBR policy changed towards greater flexibility. It introduced a policy of periodic Rouble “mini devaluations” against the basket, of around 1% per step, which gained speed as the year progressed: from once per week in November 2008, they reached *three* devaluations per week in December 2008, and *four* by mid-January 2009. The total number of devaluations since the new policy was introduced reached 18 by mid January 2009, resulting in a cumulative 25% fall

¹ Non-residences were responsible for 75% of the value of the transactions performed at the largest Russian stock market (the MICEX) during September 2008. By December 2008, their share had fallen to 36%, indicating that those had removed a very significant share of their investment in Russian stock markets.

of the Rouble (23% to the USD, 26% to the EUR). On 22 January 2009, the CBR announced another change, now to an apparent “dirty float” with a wide band (26 to 41 to the basket) within which it would let the Rouble float. However, between 22 January and 2 February, the Russian currency suffered an additional depreciation of almost 10%, approaching the lower limit of the band, where it has stabilised since. The total nominal devaluation of the Rouble is around a third since the fall of 2008.

Very significant *capital outflows* have also been observed: the CBR estimates show a *net* capital outflow during 2008 of USD 130 billion, while hard currency reserves fell by over USD 170 billion from their peak in 2008. Further reserves losses were observed in early 2009, leaving foreign currency reserves in early April at around the still rather comfortable level of USD 385 billion, which is in any case 35% lower than their mid-year peak.² Also, according to CBR figures, Russia still ended 2008 with both a significant trade surplus (at USD 177 billion) and also a current account surplus (of USD 99 billion), so its' external vulnerability should no be exaggerated at this stage.

Among the *direct* effects of the global credit squeeze, the Russian *banking system* has seen its capacity to extend credit reduced, and several banks have been downgraded by international rating agencies. In any case, the (net) reliance of the Russian banking system on foreign finance, at around 13% of assets at the latest available data, is *relatively* limited and concentrated in a sub-set of banks,³ but has been growing very significantly, turning from a positive net position into a negative one by 2003 and increasing almost 4 fold since then (albeit the figures for the first half of 2008 indicate a reduction compared to 2007 end of year figures, showing already the effects of a more difficult and costly access to international finance). Additionally, also here one must keep in mind the relatively reduced importance of the Russian banking system to GDP and equally in terms of the financing of investment.

Real sector effects of the external shocks

Russia is a very important commodity exporter. Energy-related products are roughly responsible for around 60% of its' total merchandise exports. Russia is also an important exporter of products like steel, coal and wood. The direct GDP share of the commodity sector in Russia is above 20%. The budgetary importance of the energy sector is also very significant. The Russian budget –still with a significant surplus of 5.4% of GDP in 2007 and an estimated one of 4.2% in 2008– depends heavily on oil- and gas-related revenues. They are estimated to represent close to one third of total general government revenues, and more for the federal budget (close to half of the total).

Falling commodity prices, especially oil, and their well-documented 75% fall since the summer of 2008, are

² Those figures include the amounts accumulated in Russia's two oil funds, the Stabilisation Fund and the National Welfare Fund (NWF), which together reached around USD 220 billion as of March 2009.

³ Namely, they are largely concentrated in the *foreign banks in Russia –which are mostly EU ones*, who have a share of foreign liabilities which is twice as high as their share of assets (i.e., 40% as opposed to 20%). On the other hand, in the systemically important –and conservatively run– state-owned Sberbank, responsible for over a quarter of the assets of the whole Russian banking system, they are estimated to be as low as 2% of assets.

therefore the most relevant real channels of transmission through which economic instability affects Russia. The retained profits of the commodity sector are a very important *direct* source for investment and for consumption growth in this country.

Hard data on economic activity started to show a truly major economic slowdown only from October 2008 onwards: the GDP growth rate fell from 9.5% in 4Q07 to a still respectable 6.2% in Q308, but other indicators like the “basic sectors”⁴ and industrial production indexes *collapsed* between September 2008 and January/February 2009, from, respectively, +7% to –11.6% and +6 to –13% (albeit those indexes actually *increased* mom in February 2009). Preliminary estimates for the first quarter of 2009 indicate a growth rate of –7%: after a decade of robust growth, 2009 shall clearly be a recession year for Russia (as it will be for the global economy), the real question is how negative it will be.

Policy reactions

Russian policy makers have implemented an extensive set of policy measures. They relate to the provision of liquidity (domestic and external, short-term and long term), to direct support to the stock markets and the banking sector, fiscal support for the maintenance of the level of economic activity and flexibilisation of the exchange rate regime (described above). This policy set is rather similar to what was adopted in many other countries/regions. A rough estimation would indicate that the combined value of all these measures would add up to almost 14% of the Russian GDP, albeit many of those measures overlap and the large majority has a *quasi-fiscal* nature. Also, they are spread out through 2008-2010. In any case, Russia’s still strong fiscal position, large hard currency reserves and low *sovereign* debt (external and domestic) likely make those fiscal efforts sustainable, and the severity and speed of the downturn justifies them as policy choices.

Conclusions

Russia has been very significantly affected by the global financial and economic instability. Arguably for that country, given its relative financial underdevelopment, the main channel of transmission is the real one, albeit the financial channel undoubtedly also has significant effects too. The real channel originates in the fall of commodity prices, which, beyond the terms of trade effects, has direct investment, consumption and budgetary consequences.

The policies used to counteract the downturn are very similar in Russia to the ones pursued in the mature economies of the EU or the US: measures to support and re-capitalise financial markets and institutions, enabling credit markets to continue to work, plus fiscal support packages for the wider economy. Additionally, Russia, a country with a more rigid exchange rate framework than the EU or the US (which pursue floating exchange rates), can also easily use a relatively more flexible exchange rate as part of its policy set. Finally, the fiscal space for budgetary support was significantly larger in Russia than in the EU or the US: Russia entered the downturn from a position of large fiscal surplus and reserves, and low domestic and external sovereign debts. The relative effectiveness of those measures is still hard to judge at this stage (as it is in the US or the EU itself).

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Disclaimer: The views expressed here are those of the author only, and do not necessarily reflect the views of the European Commission, or any other organisation to which he is or was linked to.

⁴ As this index is calculated on the basis of real changes in the production volume of 1) agriculture, 2) mineral output, 3) processing manufacturing, 4) production and distribution of electrical power, gas and water, 4) construction, 5) transport and 6) retail and wholesale trade in Russia, it is considered to be a reliable GDP proxy.

Managing Business in today's crises environment in Russia vs 1998 – a view from the field

By Erik W Helin

In recent months we have all been privileged to read tons of analytical articles of current crises in Russia. Almost without an exception they end up with the same conclusion: it is all about oil and other commodities. With this given cash-flow model and with strong currency reserves, in which every "dollar" in M2 is backed by 1.15 US dollar, many economists agree there is no looming "balance sheet" recession in Russia.

Having said that, there, however, is a difficult period ahead at the micro level.

Many enterprises, their owners and employees are now for the first time facing the cruel side of the market economy; long period of growth, excessive overheating followed by a rapid drop and then, a lengthy downward cycle. The credit is in short supply or very expensive, and without credit, there will not be a growth in demand.

This will not only hit many individual enterprises, but it will drastically change the old industry structures, which has low productivity, high energy consumption or in some other way have internationally non-competitive technologies or locally non-competitive business models. As an example, this applies to machinery and engineering industries.

Today there are actually many modern production assets in Russia, which will weather through the crises quite well by implementing cost savings and productivity measures. There, unfortunately, are not so many internationally competitive manufacturing assets. Russia has developed in past decade to be a good place to produce, but not to manufacture.

Under a positive note, very recently and as a surprise to many, the public debate has emerged between politicians, economists, business society and regional elite how to come out of the crises. Most voices are pulling to the direction that the crises will create an opportunity to push Russian industry structures a good leap forward and depart from its out-dated past.

It goes without saying that the process will be painful and will include many restructurings, consolidations, bankruptcies. Most probably it will result more dispersed ownership structures, because the market is dictated by the equity and investors will follow more diversified and risk-avert policies.

To make comparison between the 1998 and today's situation is not so obvious. Ten years ago the whole market in any industry was small. The customers' number was very limited. The risks at that time were directed almost exclusively to the receivable risks of individual companies. To put it bluntly there was not so much data to analyze than today. The main focus was then to the political instability in the country.

Now the focus is to the large existing market, how its structure will change, demand stimulation, market shares, business models, strategic alliances, how to attract credit, how to improve the usage of working capital, efficiency, M&A opportunities etc.

In 1998 the market was dead or at least in long standstill. Today the market is alive. It just quickly shrank, and will continue to shrink while going through the major reshaping evolution process. The growth figures will be negative or very moderate, but thanks to import substitution like in 1999, the internally driven demand will be large enough to ensure a viable business volumes for many enterprises.

As a general note of the forecasted business volumes in Russia this year, they are at the level of 2004/2005. For good resilient companies that is not a disaster.

As always, the crises will separate the weak ones from the strong ones. In comparison to 1998 there is now a lot more strong ones around. Surely, the quality of the management

and local partners matters more than ever, because the market is volatile, risky and has a high dispersion. The strategic agility is a key requirement for today's enterprise management in Russia.

It is well recognized that the biggest issue in today's crises is its social impact in many Russia's regions. There are about 600 mono-cities, where is only one employer-factory. There are many regions, where most factories are old by any standards and will not be able to produce goods, which enjoy competitive demand. Some regions will be deindustrialized.

For businesses this probably means that we will witness the emerging new labour unions and strikes. We saw after 1998 crises when the young, educated or white collar employees were eager to move to growth centers. Now most probably the blue-collar labour force will be moving from poor regions to growth regions.

When evaluating the lay-offs and unemployment in general, it is important to note that there is and will be a prevailing shortage of skilled labour. There is a good number of skillful top and mid-level business managers, which received their education in 1990's and in 2000's, earned experience and track record in the growth years. But already since 1980's the attraction in job market and accordingly in education has not been to become a skilled worker. In recent years for enterprises in Russia it has not been 'headhunting', but 'handhunting'.

Another factor in the labour market is the drastically shrinking population. Every year 2.000.000 Russians die and 1/3 of them in working age. This very sad fact will diminish the possibility for many being unemployed for long term if the person is willing to relocate or learn new skills.

Russians being creative and resilient people, one could foresee also more small entrepreneurs emerging. In this sense Russians do not differ from many other nations: 11-12% of people are willing to take risks and become entrepreneurs. The crises could act as a stimulus to take the step.

In the respect of the whole business society the difference between 1998 and today is evident. To put it simply, it is developed, self-confident and educated business society, which recognizes and accepts the principles of the market economy. Many enterprises have extremely bright management teams, which are now free from old patterns and can implement the necessary changes to ensure further competitiveness. These teams will act as the locomotives for modernization in the next decade.

The younger ones can now be lead by an example and the people in their 30s and 40s do not want anything else than a longterm prosperity. They know what can be achieved by good education and hard work in the vast domestic market. This experience was not available in 1998.

The business society's new values have been re-formed during the past 10 years.

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Some institutional factors of securing Europe's supply of natural gas

By Miklos Losoncz

The natural gas supply of the European Union depends to a large extent on imports from and through countries whose institutional system is not fully compatible with that of the European Union. With the specific features of the world-wide distribution of proved natural gas reserves, this dependency is likely to grow in the long term highlighting the limits of geographical diversification in imports in qualitative terms from the point of view of the security of natural gas supply. Dependence on Russia, the major supplying country can be reduced-at least in principle-but there is no guarantee that the alternative source and transit countries would be more reliable and less risky in legal and institutional terms than Russia. Under these conditions the importance of qualitative factors-including institutional ones-of natural gas supply will increase not only in the EU's energy relations with Russia but with other third countries as well.

Although following the transition to market economy a rather sophisticated institutionalised system evolved in EU-Russia relations, this does not work too well in the energy sector. Regarding the legal framework of relations between the EU and Russia in the energy sector, three options are available, at least in principle. The first option is the extension of Community law to third countries, more specifically to Russia, the second one is the Energy Charter Treaty itself, the third one is the incorporation of certain principles and provisions of the Energy Charter Treaty in the new EU-Russia Partnerships and Co-operation Agreement. At present it is difficult if not impossible to predict the outcome of EU-Russia negotiations concerning new institutional solutions on natural gas.

Russia is unwilling to accomplish legal harmonisation on the basis of the *acquis communautaire* partly because the Russian institutional and regulatory system is incompatible with that of the EU, partly because of political reasons. As it is well-known, Russia had signed the ECT in 1994, but it failed to ratify it, although it has applied some of its provisions and it has been involved in the Energy Treaty process. Russia's major concern about the ECT relates to the EU's reluctance to apply the multilateral Transit Protocol within its own borders.

The existence of the appropriate legal framework alone does not guarantee the security of supply automatically. The adequate legal background is the necessary but not sufficient precondition of the security of supply. E. g., the Ukraine ratified the Energy Charter Treaty but in January 2006 and January 2008 it did not observe its obligations deriving from the Treaty since it did not ensure transit flows of natural gas. The two cases indicate that the Energy Charter Treaty does not contain efficient sanctions against countries breaching its provisions. In the capacity of a transit country of Russian natural gas, the Ukraine enjoys a monopoly position on which it can capitalise in the future as well. The latest offer of the EU to the debt-ridden Ukraine to be involved in the modernisation of its natural gas pipeline system could be a positive move towards more intensive co-operation. In addition, more transparency is required in energy trade from the part of the Ukraine.

It is fragmented EU natural gas markets that have made possible the establishment and the subsequent development of bilateral relations. The potential of political leverage, too, is based on fragmented and segmented markets. Russia's foreign policy and external energy

strategy have traditionally tried to divide EU member states. Gazprom negotiated with energy companies registered in the EU on bilateral basis and concluded with them long-term bilateral contracts in which the Russian firm fixed the terms of deliveries, prices and the principles of price formation. These contracts are advantageous for Russia since thereby it is potentially possible to apply monopoly prices. Russia's bargaining power vis-à-vis individual EU member states is much greater than that deployable in negotiations with the EU as a unit. In 2006 energy companies of the largest importing countries of Russian natural gas (Germany, Italy, France) renewed their long-term bilateral contracts with Gazprom until 2026-2036.

On the part of the European Union the depoliticisation of EU-Russia relations in the natural gas sector seems to be reasonable strategy. The first, direct pillar of this strategy is focused on external economic policy. Proposals concerning discriminatory reciprocity clauses and ideas raising Russian concerns over political leverage will certainly inhibit progress in bilateral negotiations. The economic interests of Russia should be considered by the EU more than in the past, also by underlining the interdependence of the parties in the natural gas sector. Nevertheless, due to the fragmentation of its natural gas market, the EU cannot "speak with one voice" in natural gas matters.

The second, indirect pillar of a depoliticised strategy is constituted by the accomplishment of the single natural gas market in the EU by the interconnection of the individual markets of the member states aiming at the elimination of fragmentation and by the introduction of the third gas directive including unbundling, etc. The major limits of this strategy have nothing to do with external economic relations, they are associated with internal EU matters. With the emergence of a competitive natural gas market in the EU and the subsequent reduction of dependency on external supply both at the level of the EU and its most exposed member states, the possibilities of exerting political pressure by Russia are expected to diminish over time, whereas the conditions of the emergence of a coherent energy policy may be brought about at the same time. These issues are more or less independent from large scale projects like Nord Stream or Nabucco. Nevertheless, based on energy demand forecast, such projects will be essential to ensure the supply of natural gas in the EU.

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The South-Eastern Baltic Region as a model for European integration and true partnership

By Alexey Ignatiev and Stephen Dewar

The present state of relations between Russia and the EU is poor. A number of issues are involved, amongst which the following are the most significant and/or topical. First, negotiations on a new agreement to replace the PCA were stalled for a lengthy period due to objections from various EU Member States over their bilateral disputes with Russia. The August 2008 conflict between Russia and Georgia set matters further back, while the New Year 2009 interruption to Russia's gas supplies to and through Ukraine, over disagreements on price and outstanding payments due to Russia, reawakened some EU Member States' concerns over Russia's reliability as a principal energy supplier. And so it goes on. Thus, despite the evident successes in achieving agreements in the simplification of visa procedures for certain categories of citizens and the establishment of road maps towards forming four common European spaces, further development of the relationship has basically stopped. The frustrating aspect of all this is that the necessity for more progress is accepted by both sides.

An additional complicating factor is the global economic and financial crisis. Most governments are understandably more preoccupied with getting their countries through these stormy times than treating the EU-Russia relationship as a priority.

Taking all this into account we believe that it is feasible to break the deadlock with a limited, but imaginative, set of concrete actions. It should be limited, since none of the parties has the will or, at present, the capacity to manage anything all-encompassing, but it should be imaginative as we must break out of the confines of current, tired, formulaic thinking. On this basis we propose that the two sides should consider the possibility of speeding up development of integration processes on some of their common border territories where there is a practical basis for the creation of key elements of the European common spaces.

We further propose that what we call the South-Eastern Baltic Region (SEBR), comprising Kaliningrad region and adjoining parts of the EU (three contiguous northern Polish *woiwodeships* and three western Lithuanian districts), should be selected for this role. Already there has been accumulated a great deal of experience of productive cross-border cooperation. This has produced well-established partner relationships and an atmosphere of confidence between regional/local authorities, non-profit organizations, businesses and local communities in all these areas.

As background context, it should be mentioned that in Russia's "Medium-term Strategy towards the EU" of 1999 the Kaliningrad region is defined as a pilot region for cooperation between Russia and the European Union. Later, in 2004, then-President Putin described its mission as setting a pattern for a new relationship between Russia and the European Union. Conversely, for a considerable period of time, the EU has recognized Kaliningrad's special significance by virtue of its geographic location – since enlargement in 2004, as a Russian exclave part-surrounded by EU Member States. Indeed, over the last few years the so-called Kaliningrad factor played a pioneer role in different spheres of Russian-European cooperation. This factor was especially important in concluding the essential approximation of Russia-EU information resources in customs, the agreements concerning visa-

free travel (transit) of Russian citizens through the territory of the EU, while the mechanisms for organizing and financing of cross-border cooperation programs were fundamentally changed based on lessons learned involving Kaliningrad.

Furthermore, precisely for the purpose of common development and integration of the territory of the South-Eastern Baltic region, the two sides - Russia and the EU – have for the first time developed a joint program for neighborhood and partnership, based on true partner principles: a common vision of the shared future outcomes, co-financing and a common decision-making and implementation mechanism. This program with an unprecedented amount of financing (around €188 million) and duration of seven years is to start this year.

Thus, in the Southern-Eastern Baltic Region there already exist the necessary pre-conditions for making the SEBR a successful reality, requiring only the political will from both sides.

Here now are our specific proposals for achieving a common pilot project involving an accelerated creation of essential elements of the common European spaces in this area.

The practical focus of the project should be concentrated mainly on the creation of legal and regulatory conditions for lifting the man-made barriers to cross-border cooperation and the creation of common European spaces, in particular:

1. Common European Economic Space:
 - Development and implementation of the conditions for the creation of the elements of a *Russian-European free-trade zone*, in particular, tax-free goods movement based on a jointly determined list of eligible products/services (and taking into account the free economic zone regime operating in the Kaliningrad region);
 - creation of a common organizational and juridical system for *certification of origin for goods and services*;
 - *harmonization of quality standards*: dynamic extension of all-European quality standards for public and business management systems;
 - creation of conditions for the *free movement of labor* and more liberal regulations covering cross-border work-related migration.
2. Common European Space for Internal Security, Freedom, and Justice:
 - extension of the "*small border movement*" regime to the whole area of the South-Eastern Baltic Region, i.e. covering the three Polish *woiwodeships*, the three Lithuanian districts and the whole Kaliningrad region;
 - Russian citizens who are bona fide long-standing residents in the Kaliningrad region should have a right to obtain *free, multiple-entry Schengen visas* which would be valid only for the SEBR area. For example, on the territories of the EU countries which are members of the euroregions where the Kaliningrad region is a member as well. Citizens of these EU countries should also be

granted with *free, multiple-entry Russian visas* valid just for travel on the territory of Kaliningrad region;

- implementation of elements of a comprehensive approach to border management, in particular, the establishment of combined, joint border check points;
 - liberalization of Russian legislation in terms of the *border zone regime and registration of foreign citizens* from the SEBR on the territory of Kaliningrad region;
 - legalising the possibility of *sailing foreign vessels* (in the first stage only small-sized boats beneath a specified tonnage), including ones under third-country flags, through the inland waters of the Kaliningrad region including the Wisla Bay.
3. Common European Space for External Security:
- creation of conditions for step-by-step demilitarization of all the SEBR territory, to transform it into a *nuclear-free and missile-free zone* of peace and stability.
4. Common European Space for Science, Education with Cultural Aspects:
- creation of common information space;
 - creation of *European innovation park* (based on technoparks in Gdynya, Klaipeda and Kaliningrad universities) focused on developing new technologies in marine area.

There is a strong case for each of these initiatives which, if implemented, would have a highly positive influence on the quality of the relationship between Russia and the European Union.

The practical realization of the project could be implemented in a special sector agreement as an attachment to the new Strategic Partnership Agreement between Russia and the European Union. This sector agreement could also include other areas of potential Russian-European cross-border cooperation with the SEBR being the pilot region for trying them out, for the reasons stated above.

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What role for the EU in Finnish security policy?

By Hanna Ojanen

In the Cold War times, Finland's method of approaching Western integration was a slow and meticulous 'wait-and-see' policy. Finland participated in Western arrangements through complicated methods aimed at preserving the façade of uncontroversial economic policies. It often happened that Finland would refrain from joining an organisation as a full member in order to preserve a greater freedom of action. This was seen as useful for both the preservation of neutrality in the eyes of the Soviet Union and the furthering of specific economic interests. Finland became an almost-member, like through FINEFTA where a regular membership in EFTA was substituted for bilateral treaties with EFTA members, that were for all practical purposes equal in content to the actual EFTA treaty.

What also happened was that in time organisations which at their establishment seemed to have too political a profile became less controversial and Finland was able to join them later. For instance, with the establishment of the EEC and EFTA, the OECD was seen to concentrate on purely economic matters, which meant that Finland could join it, while it had not felt able to join the forerunner, the OEEC. Similarly, Finland joined EFTA in 1986, when it clearly no longer was at the forefront of economic integration in Europe and the talk was of EC-EFTA relations.

In the case of NATO this wait-and-see attitude still resurfaces when it is argued that it would be suitable to wait and see where the organisation actually is going before drawing any definite conclusions as to whether Finnish membership would be beneficial or not. In the end, Finland might join NATO when the organisation no longer is politically controversial – that is, opposed by Russia – and when it no longer is in the forefront of security and defence integration. This would happen when the EU or regional arrangements have reached the same point or surpassed the NATO arrangements.

Are we there yet? At least there has been considerable progress in defence questions both within the EU and among the Nordic countries, so much so that Finland has become again wary of potentially too far-reaching commitments.

Until the common defence clause was inserted into the draft constitutional treaty in 2003, Finland was in the forefront of developing the EU as a security actor. With EU membership Finland had changed gear, becoming a proactive actor in integration. It also reversed its view on the EU's role in Finnish security. Previously security considerations had prevented Finland from joining; now they were seen as a reason for applying as membership would strengthen Finland's security vis-à-vis Russia and open up new security policy options for the country. Security was neither the only reason, nor the most important reason, for joining the Union. Yet, through this new approach, Finland was giving the EU a higher political security profile than arguably any other EU country – in fact, in 1995, the Common Security and Defence Policy did not even exist.

In 2003 however, the Finnish government tried for the first time openly to slow down the development of a

common security and defence policy, proposing a watered-down version of the defence commitment. The end result was obviously a compromise; a defence clause that makes reference to the specific characteristics of the policies of certain member states.

The 2009 report of the Finnish Government on Security and Defence has a much less reserved stance on common defence. Still, the report expresses a certain willingness to take time in order to reflect on the practical implications that the EU defence clause might have for Finland.

The new government report on the EU, due in April, is expected to highlight the EU's centrality once again. The very fact that there is a government report on the EU – the first since joining – is a sign of change or of willingness to change in Finnish EU policies. It is expected that the white paper will suggest Finland is a pragmatic country in a pragmatic Union, situated in the mainstream that favours (or, is thought to favour!) deepening integration and a strong, independent Commission, and that will work with flexible coalitions of countries – including potential new ones if Iceland and Norway were to seek membership.

Yet it might be that the EU is not regaining the central role it had for Finnish security policy in the 1990s. There is now more disarray on how best to prioritise and link the bilateral, regional and multilateral arrangements. Now that the EU really starts being a serious security policy actor, it appears challenged by new alternatives. Firstly, an innovative regional setting where the trust between the participants is high and allows for deeper cooperation and specialisation, and secondly, by the slow "banalisation" of NATO that would make joining it a matter of no more political controversy than joining EFTA in late 1980s.

Interestingly enough it is now the Nordic neighbourhood that offers the hitherto most compelling version of a defence clause. The Stoltenberg Report proposes for the Nordic countries a mutually binding declaration containing a security policy guarantee in where the countries could clarify in binding terms how they would respond if a Nordic country were subject to external attack or undue pressure.

Moreover, the latter half of 2009 under the Swedish EU presidency may give ideas on whether the regional initiatives – be they defence-related like in the Stoltenberg report, or environment-related as in the Baltic Sea Strategy, are there to strengthen the EU and anchor it firmly to Northern concerns – as in the late 1990s – or whether these are signs of a trend of regionalisation setting in, with the gradual weakening of the role of the EU as such in regional, and Finnish, security policy.

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The impact of international financial crisis on capital migration into Latvia

By Erika Sumilo and Madara Apsalone

Since regaining independence in early 1990s Latvia as a small, open economy, has always been dependent on the foreign capital. Rapid economic growth, especially in the last years with GDP increase over 10%, membership in the European Union, liberal investment policies and quite favorable business environment made Latvia attractive to foreign investors. At the same time, extremely fast growth, based on loans, construction, financial intermediation and real estate boom, not balanced by a sustainable development, as well as huge inflation in prices and wages and increasing current account deficit already indicated a sharp economic downturn. Combined with the global financial and economic crisis, currency peg and sharp economic downturn in entire Eastern Europe those factors resulted in the largest crisis since independence, fast falling international credit ratings and, naturally, high foreign capital outflows.

Forecasting an economic downturn after several years of rapid, credit-fuelled growth, Latvia's international credit ratings were placed on negative outlook already in the end of 2007. During November 2008 the international credit rating agency Capital Intelligence downgraded Latvia's long-term foreign currency rating to 'BBB-' from 'BBB+' and its long-term local currency rating to 'BBB' from 'A-'. In February 2009, following agreement of a 7.5 billion-euro loan from the International Monetary Fund and wide debates about the political stability in Latvia, Standard & Poor's further lowered Latvia's credit rankings to BB+. Falling from investment grade to speculative grade is most likely to affect Latvia's ability to attract foreign investors, as, especially in times of the global financial uncertainty, when investors redeem cash and try to reduce exposure to such small and risky economies.

Negative outlook in credit ratings and already foreseeable problems in the economy limited the amount of incoming foreign direct investments in Latvia. Investment stocks did not change, however, and in the end of 2008 remained at the level of previous year (figures 1,2).

Foreign direct investments (stocks) in Latvia

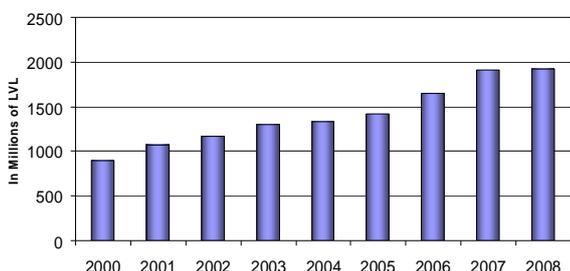


Figure 1 – foreign direct investments (stocks) in Latvia
Source: the Bank of Latvia

Foreign direct investments (flows) in Latvia

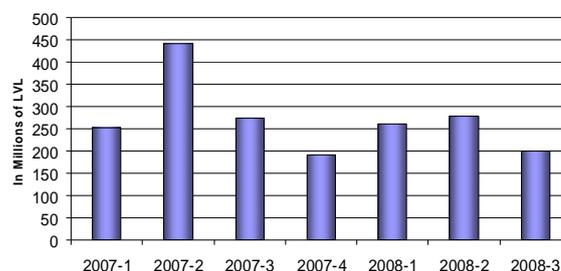


Figure 2 – foreign direct investments (net flows) in Latvia

Source: the Bank of Latvia

Incoming foreign direct investments in Latvia were also supposed to diminish, taking into account that half of investments used to go to financial intermediation and real estate sectors (Figure 3, data corresponding to the third quarter of 2008). Three main foreign investor countries – Estonia, Sweden and Denmark, had concentrated over 40% (over 60% in case of Estonia) of their investment in the sector of financial intermediation, other top investors, among them, Germany, USA and the Netherlands were focusing on the real estate.

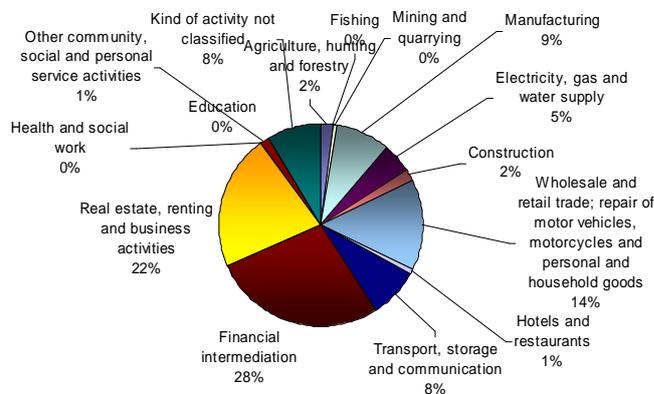


Figure 3 – Foreign direct investment in Latvia (stocks) by kind of activity

Source: the Bank of Latvia

Latvia's ability further to attract foreign investment is therefore affected not only by its credit rating and political stability – currently there is a need for a new strategy, how to attract Latvia's main investors to other fields, how to find competitive advantages that would motivate them to refocus and stay.

Looking at the side of indirect investments and capital flows, most of capital inflows came from banks' long-term and short-term borrowings, as well as a decline in banks' loans and deposits abroad. Most of capital outflows were caused by a decline in non-resident deposits with Latvian banks (10.4% of GDP in the third quarter of 2008).

Figure 4 demonstrates sharp increase in foreign currency capital outflows from Latvia during December of 2008 and January of 2009.

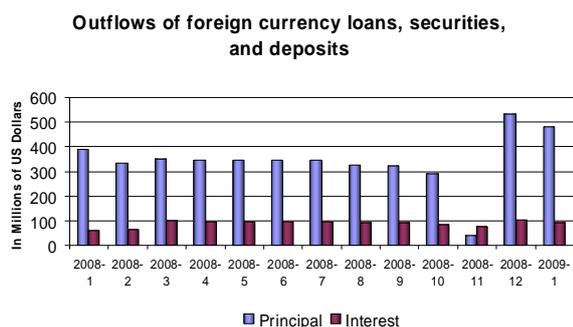


Figure 4 – outflows of foreign currency loans, securities, and deposits

Source: the Bank of Latvia

Latvia's investment market was further challenged, when Parex Bank - the second largest bank by total assets was found heading towards insolvency. The Latvian Financial and Capital Market Commission reported 240 million lat capital outflows from the bank, large share of non-resident capital among it. Parex Bank was nationalized, but rapid capital outflows continued and the government introduced deposit withdrawal restrictions. Consequently non-resident deposits had in general diminished by 19.2 % compared to the end of last year in December of 2008 in Latvia.

Last but not least foreign investors had been affected, either positively though, by the fixed exchange rate of Latvia and the national currency peg. Latvia maintains a fixed exchange rate policy since 1994 and since 2005 the national currency lats is pegged to euro, one euro equaling 0.7028 lats. During the last half year many Eastern European currencies significantly lost their weight: Polish zloty by 28%, Hungarian forint by 20%, Rumanian lei by 17% and Czech koruna by 12%, Latvian lats lost only 1.2%. This has significantly affected Latvia's export ability and currency support has sent Latvia's central bank reserves down 25% last year, currency peg is, in the meantime, in interests of foreign investors in Latvia.

The main issue concerning the currency peg is for how long the Bank of Latvia will be able to maintain the exchange rate. Positions of all three Baltic States have not

changed and they are strongly for keeping the peg. There is an economic rationale, as Latvia is not a net exporter, therefore the price increase for import would be much greater than the gains from export, and as most of the resident credits have been taken in euro. But there are also non-economic reasons to be taken in account, such as the stability of national currency giving credibility to government and trust to financial stability at the national level. Peg is supported by the International Monetary Fund, Baltic States have also expressed their will to join the eurozone in the near future. However, investment environment in Latvia stays very uncertain meanwhile.

What are perspectives of Latvia's economic development in future? Which will be the most supported industries? To what extent will the European Union be willing to risk lowering Maastricht criteria for joining euro against taking the risk of Latvia destabilizing the whole East Europe region? How politically strong and united will the country be to overcome the recession and to what extent International Monetary Fund will be also to suggest the most appropriate policies... those are factors that are the most likely to determine Latvia's attractiveness to foreign investors and prevent it from even further capita outflows.

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From periphery to world politics – the changing geo-politics of the North

By Lassi Heininen

The circumpolar North has been described on a spectrum ranging, from a colonial external point of view and a periphery to an internal image of a homeland of peoples with their identities. In classical geopolitics the North was seen as a reserve of natural resources and a military space for patrolling, training and testing for the sovereignty and economic interests of the arctic states. The industrialized, militarized and divided circumpolar North of the Cold War, however, started to thaw in late of 1980s as a result of increased interrelations between peoples, civil societies and non-state actors. This more human approach of geopolitics in the 1990s meant, on one hand, decreased military tension and increased stability, and, on the other, a raise of wide and deepening international cooperation by the arctic states and those new international actors.

This transformation from the confrontation of the Cold War period into a wide international cooperation can be described to be the endeavour of the post Cold War world society through the sets of interrelated processes of “civilianization”, “regionalization” and “mobilization”. Correspondingly, as a result of this first significant change in circumpolar geopolitics and international relations the main themes of circumpolar geopolitics and international relations in the early 21st century according to the Arctic Human Development Report (2004) are the increasing circumpolar cooperation by indigenous peoples’ organizations and sub-national governments, region-building with states as major actors, and a new kind of relationship between the circumpolar North and the outside world. Further, security in the North is currently implemented by certain special features, such as nuclear safety, the close relationship between the environment and the military, and climate change.

Indeed, Northern-most regions are not isolated, but closely integrated into the world of globalization and geo-economics, and a part of the international community. However, in spite of these points of view, and the discourse on the Arctic as a distinctive region the cold reality is that the circumpolar North is neither a political entity with political unity and economic power nor an international distinctive region. It is a geographical region with a small population, lack of capital and no power centres in a traditional sense, but borders and societies, even nations, divided between eight unified states.

In the international system with armed conflicts and wars, and a state of certain structural inequity, there is a limited space for positive points of view coming from actors, who like Northern populations, are neither states nor intergovernmental actors. However, as a stable, peaceful, advanced and innovative region, the circumpolar North has, or has interpreted to have, some positive developments within the Northern Hemisphere as well as in world politics. Among them are first, it is a highly strategic area due to on one hand, military-political reasons like it is an important bastion area for strategic nuclear submarines, and on the other, its rich energy resources, which emphasizes the importance of energy security. Second, the North has been used as a scientific ‘laboratory’ and is currently seen as a parameter of climate

change and a ‘workshop’ for multidisciplinary research on climate, nature and societal developments as well on new technologies for clean- up of nuclear waste. Third, the circumpolar North is a distinct component of the diversity of a nature on the Earth on one hand, and on the other, that of northern cultures is remarkable.

Fourth and final, within the region, a number of innovative political and legal arrangements have been developed, which is due to traditional knowledge, (potential) innovations and new ideas, certain devolution of power as well as, flexibility and resilience of Northern communities. As a precondition for this, the region as a whole, and particularly the Nordic Region, hold potential to become an example area of non-violent methods of governance.

Neither international relations nor geopolitics, however, remain unaltered, and consequently, the geo-strategic importance of the region is growing, with significant geopolitical, socio-economic and environmental changes occurring in the North with regard to certain factors, such as strategic energy resources and new global transportation routes. Further, there is a growing world wide, even global, economic and political interest toward the Arctic Ocean and the high North of the globe, particularly toward potential rich and strategic resources, much in the shelves of the northern seas, and visions of new global trans-arctic sea routes. Consequently, trans-national corporations (TNCs) have strong commercial interests to become present for to utilize energy resources, though in the North state-owned, national oil and gas companies, such the Norwegian and Russian ones, control most of the reserves.

Final, there is climate change with its multi-functional impacts as a new and significant factor *per se* to change northern geopolitics by bringing bigger risks to the environment and human security, new threats to local autonomy and sovereignty as well as uncertainty into the societies, politics and governance of the region.

As a conclusion, in the manifold growth in its geo-strategic importance, which the circumpolar North has recently witnessed we can find on one hand, continuity of how in the North “space” has been utilized and treated as “non-political” in geopolitics. Unlike, an alternative interpretation of geopolitics emphasizes indigenous peoples as international actors as well the importance of their identities. Final, this kind of critical geopolitical approach means “politicization” of space, which can be seen for example, in external and internal images on the North, and how knowledge and power are used when defining impacts of climate change, such as uncertainty in the North.

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Russian gas supply and common energy policy

By Chloé Le Coq

The January 2009 conflict between Russia and Ukraine was only the latest of Russia's recent and recurring conflicts with its satellite countries over gas dealings. The effects of these disputes reach beyond Russia and Ukraine to European countries that rely on Russian gas transiting the satellite countries for their own gas consumption. A number of these countries are European Union (EU) member states or are on a path toward EU membership. For many in the EU, such conflicts amount to a serious threat of supply disruption and a lack of security of energy supply in the region, with implications for the debate over a common EU energy policy and, in particular, the inclusion of a solidarity rule.

The solidarity rule would mean that EU members would ensure mutual protection against supply disruptions by promising to redistribute energy from non-affected members to affected ones. But is such a rule feasible, given the diverging interests among the member states? This article takes a closer look at this issue.

The unequal effects of Russian gas disruption on EU member countries

Russia provides a quarter of the EU's gas supply. Any disruption in the supply of Russian gas will affect many countries across central Europe, but the effects among countries will vary depending on locations and energy consumption profiles. In general, there are many factors that can influence a country's risk of, and sensitivity to, gas supply disruptions. Le Coq and Paltseva (2008) construct a general index of EU countries' short-term gas risk exposures, the REES index (Risk External Energy Supply index). It combines measures of energy import diversification, political risk in the supplying country, risk associated with energy transit, market liquidity, and the economic impact of a supply disruption for gas. Note that the REES index includes reliance on Russia and on other non-EU suppliers, such as Algeria.

The figure below gives the estimates for the Russian gas supply of each EU member state, which clearly show the differing risk exposures of member states. The exposure to Russian gas is the REES index when only taking account Russia as a gas supplier.

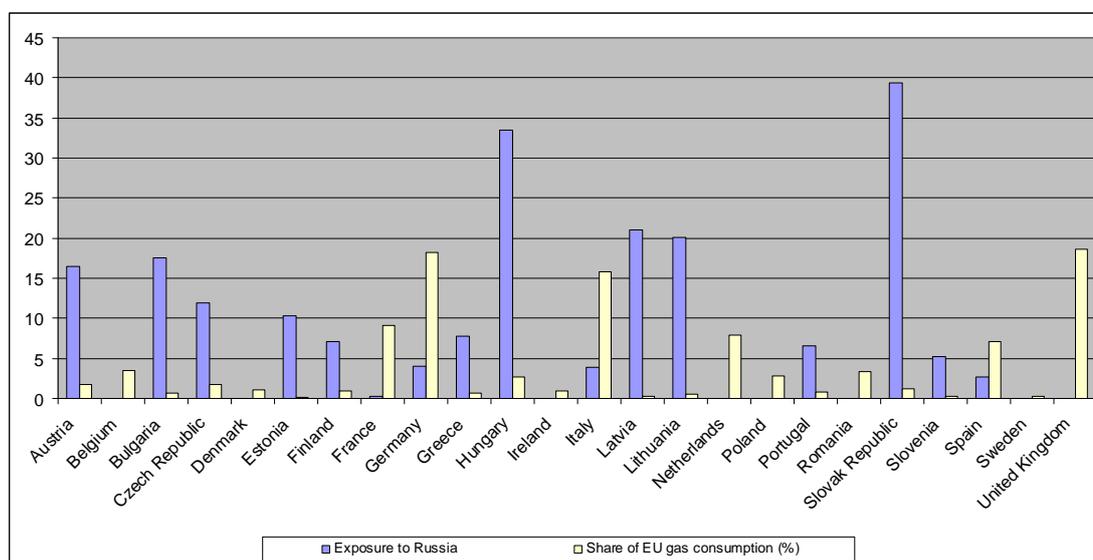
To understand the total EU exposure to Russian gas, such estimates should be compared with the relative gas consumption of each country in the EU. For example, Bulgaria has a relatively high exposure due to its exclusively Russian gas supply. But Bulgaria consumes only 1% of the total EU gas consumption. So, on the EU level, Bulgaria's contribution to European energy risk exposure is relatively low. On the other hand, Germany and Italy have an average exposure but are big gas consumers and therefore are among the largest contributors to the EU risk energy exposure.

In the event of a disruption in the supply of Russian gas, some EU countries might be severely affected, others only partially so, and some not at all. Some could take on the role of alternative gas providers. Because the estimates show the differences in countries' risk of gas supply disruptions, they also reveal the varying motivations among EU members with respect to the solidarity rule.

Consequences for a common European energy policy

A solidarity rule realistically could be part of a common European energy policy, at least in the sense of some EU members complementing each other in terms of supply disruption's risk. If the EU adopts a common policy, member states would share the overall EU energy supply risks. To deal with gas supply disruptions like those of recent years, a solidarity rule would have unaffected member states provide gas to affected ones, by i) using their own sources or ii) using reserves.

There are potential problems at the implementation stage, however. First: with a solidarity rule in place, one group of EU member states would be providers of inter-EU compensatory gas transfers, and another group would be transfer recipients. In the short run, member states would not be able to make big changes in their individual contributions to EU-wide exposure to energy risk. Their individual preferences, therefore, regarding a common energy policy are likely to differ, possibly causing policy tensions. A common energy policy including a solidarity rule, then, should include also a way to compensate the energy donors.



Source: Eurostat and Le Coq & Paltseva, 2008, Measuring the Security of External Supply in the European Union.

Second, a moral hazard problem could arise. The solidarity rule would constitute a mutual insurance system, with member states effectively sharing the costs of a gas supply disruption. This system may make them care less about the disruption in the first place, and could actually lead them to increase (risky) gas consumption. To avoid this problem, a common EU energy policy will need the backing of a strong regulatory agency that takes into account the needs and preferences of individual countries while addressing the EU-wide consumption and energy risks.

See Le Coq and Paltseva (2008) 'Common Energy Policy in the EU: The Moral Hazard of the Security of External Supply', for more discussion of these points.

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This article is based on an on-going project with Elena Paltseva (University of Copenhagen). I am grateful for our discussions on this topic.

Growing volumes of containers and other unitised cargo go hand-in-hand with the concentration of maritime transport in major ports

By Johanna Särkijärvi

Volumes of unitised cargo are increasing in maritime transport in the Baltic Sea, while volumes of bulk cargo are stagnating or even diminishing. Simply put, this means that a growing share of cargo is transported in containers, trucks and trailers. This development has lasted for some time now and it is expected that the unitisation trend will continue in the future. Growing volumes of unitised cargo reinforce the position of major ports, since they have the lion's share of the unitised cargo markets. These arguments are mainly based on the annual statistics compiled for the Baltic Port List 2007 and 2006 and the results obtained in the Baltic Port Barometer 2008. It should be noted that for the time being there is no unified data available on the recent development of international cargo volumes covering whole of the Baltic Sea. Therefore, the effect of current economic downturn cannot be fully evaluated yet.

International cargo traffic can be divided into three groups: dry bulk, liquid bulk and other dry cargo. The majority of other dry cargo is unitised, being transported either in containers or trucks, trailers (ro-ro) or train wagons. In the Baltic Sea ports, other dry cargo was the fastest growing cargo type handled in 2007. Its annual growth reached almost 10% while the handling of liquid bulk decreased by nearly 1% and that of dry bulk by nearly 4%. The fastest growth in other dry cargo occurred in the biggest ports, defined as those which handle over 10 million tonnes of cargo per year. The average annual growth among these ports reached 16% in 2007. Middle-sized ports, handling 5-10 million tonnes of cargo per year, managed to increase their throughput of other dry cargo clearly less, by 6%. The top 5 ports in the other dry cargo segment handled one third of the total of other dry cargo volumes in the Baltic Sea in 2007.

Containers, trucks and trailers form a significant part of other dry cargo. To a large extent, the container market forms a market for the major ports in the Baltic Sea. The biggest ports, measured by total cargo volume (over 10 M tonnes), had a market share of over 81 per cent in international container traffic. They were the fastest growing group among the Baltic Sea ports, with an annual increase of nearly 17 per cent. Middle-sized ports (5–10 M tonne size class) achieved almost the same growth, at over 15 per cent. Smaller ports, in the 0-2 and 2-5 million tonne size classes, also managed to increase their international container traffic, although more slowly, by over 5 per cent and 4 per cent.

In total, more or less 60 ports handled containers in the Baltic Sea in 2007 but the top 20 ports had a share of 93% of the market and the top 5, namely Saint Petersburg, Gothenburg, Gdynia, Kotka and Aarhus, a share of 57%. Altogether, 7.4 million TEU of containers in terms of international traffic were handled in the Baltic Sea ports in 2007. This was over 15 per cent more than in 2006. The top 5 ports managed to increase their market share by 0.8 percentage points between 2006 and 2007. Of the top 5 ports, Gothenburg grew most slowly, by 3.6%, and Gdynia most rapidly, by 34.3%.

Saint Petersburg was undisputedly the biggest container port in the Baltic Sea, with a total volume of 1.7 million TEU in 2007 and 2.0 million TEU in 2008. In 2007, the top three ports remained the same as in 2006, including Gothenburg and Gdynia alongside Saint

Petersburg. During 2007, international container traffic in the Baltic Sea increased most in Saint Petersburg (+247 762 TEU), Gdynia (+158 393 TEU) and Kotka (+110 641 TEU), the greatest fall taking place in Riga (-22 308 TEU), Västerås (-9 189 TEU) and Lübeck (-5 656 TEU). The ports in the top 20 list otherwise remained the same, although in a slightly different order, as in 2006, but Szczecin took Pori's place as the twentieth largest container port.

Alongside containers, trucks and trailers make up a significant part of other dry cargo in terms of international traffic in the Baltic Sea. The overall market for trucks and trailers is more difficult to evaluate than the container market since, in terms of compiling statistics on ro-ro traffic, there are varying practices in the Baltic Sea countries. Nonetheless, it is possible to obtain a good overview of market development if Russian maritime transport is excluded from the analysis.

A total of 7.9 million trucks and trailers in international traffic passed through over 50 Baltic Sea ports in 2007, excluding the ports of Russia. An annual increase of over 10 per cent was recorded. The port of Lübeck/Travemünde maintained its position as the leading port in this traffic segment with an 11 per cent share, followed by Trelleborg and Gothenburg, as in 2006. During 2007, the handling of trucks and trailers grew, in absolute terms, most in Gothenburg (+157 753 units), Trelleborg (at least +133 000 units) and Helsinki (+115 481 units), and fell most in Hanko (-72 555 units), Ystad (-50 795 units) and Uusikaupunki (-15 462 units). The top 20 list was practically the same as in 2006. Over half of all trucks and trailers in terms of international traffic were handled in the seven biggest ports in 2007. The top 20 ports held a majority of the markets with a share of 89%.

The concentration of unitised cargo markets in the Baltic Sea is quite apparent when examining the port statistics from the years 2006 and 2007. The fact that these markets are also the fastest growing in maritime transport implies that the role of major ports is becoming even more important. Many ports in the Baltic Sea expect that some ports will develop into major hub ports in the Baltic Sea region during the next 5–10 years. It remains to be seen whether the current economic downturn will heighten or undermine this development towards more concentrated markets among the Baltic Sea ports.

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The Baltic Port List 2007 can be purchased from the Centre for Maritime Studies (CMS). For further information and subscriptions, see <http://mkk.utu.fi/en/>.

Specific features of inbound cross-border deals on the Russian M&A mid-market

By Sergey Volchenkov

Recent years have been marked by an increasing number of inbound cross-border deals on the Russian M&A mid-market, which testifies to its improved quality, since cross-border deals are normally conducted under international law and exclude shadow instruments.

Despite the growing number of acquisitions of the Russian companies by the foreign investors, several problems impacting such deals remain in place. This raises the question of key obstacles that foreign investors need to be aware of when they make such deals in Russia. We refer to the so-called "country risk" which remains one of the most significant threats to a foreign investor today. One of the most efficient ways for a foreign investor to minimise this risks is to cooperate with a local investment bank possessing sufficient knowledge and experience in advisory of cross-border M&A deals. Experts at such banks are familiar both with the Russian challenges and the requirements of foreign companies.

The author of this article dwells on basic aspects shaping any specific features of cross-border M&A.

The process of acquiring a company may be broken down into the following main stages, each of which presents specific challenges to a foreign buyer:

- Preparation (acquisition criteria, list of targets);
- Deal implementation (conducting negotiations, analysis of target, LOI, confirmation DD)
- Closing (signing of SPA and SHA, control over observance of precedent conditions for closing);
- Integration (the shaping of the seller's business into a structure corresponding to the buyer's parameters and strategy).

The key challenge for a foreign investor at the preparation stage is forming a correct understanding of the general market trends of the particular industry in Russia, its regional specifics. This challenge is of particular importance to strategic investors. According to Mr Vladimir Gorelov, a partner in the Avanko Capital, "in the present economic environment it is the strategic investors who will show most activity among western players, since present conditions put them in the best position to enter the Russian market or strengthen their hold over it". This is why one of the primary tasks at the initial stage is to conduct a strategic analysis of a respective economy branch.

At the deal implementation stage a foreign company may encounter the following obstacles:

1. Non-transparent accounting and various tax optimisation schemes. This problem is a major one which a foreign investor will encounter in 90% of instances. A vast number of tax optimisation schemes are practiced in Russia. Among the most commonly used schemes are "concealed" dividends paid to owners under the guise of "additional bonuses" or "payments for services rendered".

In order to meet this challenge it is necessary to normalise financial accounting when conducting an appraisal of the company's value. A sure indicator of a company employing tax optimisation schemes is its very low profitability on the growing market.

If an acquired holding company has a complex structure (when one company runs several ventures in different areas under a single legal entity) it may have to undergo restructuring at the stage of deal preparation. When restructuring a company it is usually advisable to set up assets in each business area as separate legal entities.

2. Owners of a selling company may not wish to supply full documentation needed to appraise the company at the initial stage of deal negotiations. Additional official inquiries may therefore have to be sent to fiscal and other public authorities in order to obtain the company's official financial statements, titles to real estate properties, etc. Russian legislation allows state authorities to provide this kind of "insider information" on companies. Employing these methods will enable a deal initiator to assess possible risks associated with the

acquired company at the initial stage of negotiations. It is also fairly useful to analyse reputation of the company in question and/or its owner. This service is provided by several Russian consulting firms.

3. In most cases owners hold top-management positions in the acquiring companies. In this case the buyer may face the problem of losing control over the acquired business (when major clients linked to previous owners are lost, state authorities show prejudice to new owners, etc.). Possible solutions to this kind of problem should be built in at the stage of structuring the deal. One possible solution is using "earn-out" scheme whereby part of the deal's overall price is paid over 2-3 years based on the company's performance after its acquisition. This solution may be employed only as long as the current owner retains minority shares after the acquisition. Entering into long-term contracts with current managers may provide additional assurance of the company's future performance.
4. In order to gain full control over a company one as a rule needs to acquire over 75% of voting shares or stocks in it. It is Russia's reality that any significant decision on the company's activity may be taken only by ¾ of votes at the general meeting of share holders. In order to gain operational control one needs to secure over 50% of voting stocks or shares.
5. The problem of excessive political involvement may arise when a deal affects interests of various officials linked to the acquired company. This specific problem is as a rule inherent in deals involving acquisition of large regional players with strong influence on the region's or the city's economy. This feature should be by all means taken into consideration when a deal and its future structure is negotiated. Risks of this order may be minimised if the acquiring party makes an effort to meet regional authorities, makes available its plans for developing the company in question, creating new jobs, etc. These activities should commence only once it becomes clear that the deal can in fact be made.

At the closing stage a contract should be structured in such a way as to ensure current owners' responsibilities for the past periods of activity of the acquired firm. Unfortunately, deals involving payment and transfer of title through off-shore countries are still widely practiced in Russia. This is motivated both by the desire to lower tax burden for the seller and by the possibility to apply foreign laws in order to ensure that seller's guarantees are met, to secure transparency, expediency and simplicity of payments.

In closing it should be noted that each cross-border deal is unique. This makes problems and relations between the buyer and the seller unique for each specific deal. Challenges outlined in this article are in fact the most common problems experienced by western parties acquiring Russian companies which this article's author has encountered in practice.

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System crisis of the Latvian society – the reasons, scenarios of development, possibility of overcoming

By Alexander Gaponenko and Michael Rodin

Introduction. The Latvian society was amazed with sharp political, economic and social crisis. This crisis has obviously expressed system character. The present Latvian authority shows obvious inability adequately to answer difficult calls of the present. In many respects, it is connected with bad understanding of the basic tendencies of historical development and absence of vision of the future. In practical activities the power follows more likely not to pragmatical principles but to national mythology and the ideas introduced from the outside. The main thing now - to refuse protection of narrow national, class, group interests and in every way not to admit immersing of the Latvian society in chaos, to prevent its disappearance from historical arena. Let's consider change of own labor, scientific and technical, capital and administrative resources of Latvia which provide economic development.

Shrinkage of labor force. The population of Latvia all time from the date of independence gaining was promptly reduced, due to the high death rate and low birth rate, and big wave of migration. For the period between 1989 and 2008, Latvia's population reduced by 14.5%, not considering 5% of Latvians who are permanently (often illegally) employed in other European countries. More significantly, the percentage of working population shrunk for the same period by 21.5%, despite the artificial increase of the supply of labor force by means of increase of pension age for both men and women. During the 20-year period, the amount of unemployment has never declined below 7%. The qualitative level of labor force has not improved in the same period. School education was prolonged from 10 to 12 years, but higher education was simultaneously reduced from 5 to 3 years. The range of professional skills, taught in Latvian high schools, did not correspond to the requirements of economy. That was an additional reason for the flight of educated labor force.

Extinction of science. The whole succession of Latvian governments has not displayed any interest in scientific research. Former Soviet research institutions lost their qualified cadres, but a new inflow of specialists did not and could not happen, as financial support of science has been miserable, not exceeding 0.25% of the budget expenses (in the EU, expenses for science amount to 3%, and in the United States 6% of the GDP). Between 1991 and 2008, the number of Latvians, employed in science, shrunk from 31,000 to 4,000. Not a single invention was registered in this period (9). Latvian private companies, with the number of personnel exceeding 250 only in 252 cases (the average number comprising 6.6 persons), cannot afford support of science as well. EU expenses, earmarked for Latvia in the framework of structural funds, have dissolved in the bureaucratic machine of distribution.

Depletion of industry. In early 1990s, the governments of Latvia closed all the large-scale industrial enterprises, including such highly competitive scientific-productive associations as VEF (the once famous camera producer), RAF, and Alpha. Major agro-industrial enterprises were exterminated as well, their lands and technique being distributed among small private farms. In the country traditional branches have practically disappeared: fishery, sugar and textiles manufacture, processing of a skin and shoe manufacture, electronics. The government policy did not support formation of the large enterprises. In Latvia in 2007 from almost 130 thousand managing subjects, 398 enterprises had

occupied only of 250 persons. Average number occupied at one enterprise in 2007 made less than 7 persons. The micro enterprises cannot provide independent accumulation of means and dynamical development. New capital investments in industry have been since insufficient. In 1989 (in Soviet time) capital investments accounted for 24% of the GDP, in 2007, the most successful year for Latvia, they contracted to 19% GDP from which 8% was the share of foreign investments. So, Latvian economy could generate national investments at the level of not more than 11% of GDP (i.e. less than a half of the level of investments in the late Soviet period). Investments were made only in the sectors with rapid return of capital but with a small or zero potential of productive output – particularly, in the infrastructure of logistics, retail trade, and hotel business. In fact, Latvia has been deliberately shaped as an economy of services. Between 1991 and 2007, the share of productive enterprises in GDP reduced from 60 to 25%, while services expanded from 32 to 75%. Thus, the chosen model of national development did not guarantee even simple reproduction of scientific, technological and labor resources. Meanwhile, investment policy was concentrated on attraction of foreign capitals. In 1990, Soviet Latvia's GDP comprised 6.771 billion lats in comparable 2000 prices. This level was overcome only a year after the country's entry in the European Union, due to massive foreign investments, donations and loans. By 2008, the amount of GDP rose to 8.717 billion. However, this figure was achieved by 50% for expense of the real estate market, construction, and commercial intermediation. Not surprisingly, difficulties of borrowing resulted in a 5% decline of GDP within month. In whole, in Latvia there was an irrational structure of economy which cannot provide dynamic and balanced development.

Administrative resources. Administrative forces of the liquidated state enterprises moved to a private sector and provided its rather successful development. The most part of these forces has got the higher administrative, economic or the juridical education has saved up an operational experience in modern, high-concurrence environment. However number occupied with business was in Latvia nevertheless three times lower, than on the average across Europe. Oligarchs and the most part of those who privatized the enterprises on favorable terms differed low level of enterprise activity and the competence. In state sector, because of a policy of ethnic restrictions, appointment of recruits on political, and frequently on family accessories, level of competence of the administrative personnel has sharply decreased. The inability effectively to operate economy has generated desire carefully to regulate all economic activities of the enterprises. The government bodies have unreasonably increased. So, if in 1990 number of Latvian state officials, public management and credit institutions made only 3 % from an aggregate number occupied in a national economy, by 2008 only occupied in the government device made 7,8 % of all occupied. Along with growth of number occupied expenses on its maintenance grew in officialdom also. In 1991 they made only 2, 9 % of expenses of the budget, in 2007 they have already exceeded 12, 3 % of all expenses of the budget. The regulation of all economic life doing impossible business dealing, together with poor quality of the state personnel potential, have led to corruption development, prosperity of shadow economy.

Finishing in the late nineties process of privatization of the state property has sharply raised the question about the further destiny of model of "initial accumulation of the capital". Facing exhaustion of domestic sources of growth, the existing economic model **has increasingly absorbed financial resources from outside**. After entry in the EU, the government, as well as businesses, banks, and households, have been increasingly using relatively cheap access to borrowing. In this connection the stream of the foreign help, investments and cheap credits has been directed to it. These resources have impulse to economy development, but the Latvian economic model used them according to the nature of power elite interests. The powerful part of means from the European funds has been unproductively spent, or directly appropriated by bureaucracy and oligarchy. To foreign investors the highly remunerative state enterprises have been cheaply sold. The certain part of the price underpaid to the state has settled in bureaucracy pockets. Oligarchs have sold to the foreigners cheaply state enterprises. In early 2005, the credit indebtedness of financial and non-financial institutions and households totaled 3.877 billion lats (in then-current prices), or 52.4% of GDP. By late 2008, these figures rose to 14.577 billion lats or 110% of GDP, i.e. almost quadrupled in absolute terms and more than doubled as a share of GDP. Under these conditions, especially in the situation of crisis, return of debts becomes impossible. Overdue debts have already far exceed a 1-2% level which is supposed to be safe. Banks are confiscating property, lands and industrial objects from debtors, but these assets appear illiquid. For this and other reasons, incomes of private banks have collapsed to zero. Foreign, predominantly Scandinavian banks that had excessively pumped money into the Latvian economy, with no regard of its inability to return it back, have also encountered serious problems. Simultaneously, Latvia's external debt was also sky-rocketing: from 25.4% of GDP at the beginning of 2005 to 57.6% of GDP in the third quarter of 2008.

Results of "initial accumulation of the capital". Low efficiency of use of resources of development did not allow providing the stable and balanced economic development of the country. It is visually visible from the analysis of indicators of rates of increase of gross national product. In 1990 of gross national product of the Soviet Latvia, in the comparable prices of 2000, was 6771 million lats. Transition in model of initial accumulation of the capital and rupture of the developed economic relations have resulted, during two three – years, to falling of output of production practically twice. This falling managed to be overcome only in 15 years: a year later after the entering into EU, in 2005, the scope of gross national product of Latvia has reached sizes of 7006 million lats, having exceeded on 3 % an indicator of 1990. From 2005 till III quarter 2008 the involved external resources have provided faster growth of gross national product of the country - on the whole 24 %, in the same comparable prices of 2000, sizes of 8717 million lats. It is separately necessary to note specific model of consumption which has developed in Latvia. The money received by bureaucracy and oligarchy at first from privatization of the state property, and then from use of political resources with a view of personal enrichment, has generated ease of their expenditure. The ostentatious luxury, prestigious consumption became a distinctive feature of the Latvian ruling class. The given class has not been focused on investments into the future of the country. It was promoted by special system of state regulation of consumption: a proportional scale of the taxation of personal incomes, absence of the tax to a capital gain, low taxes to the real estate.

Latvia: interaction of national and world crisis

The economic crisis has begun in Latvia on own basis of that possibilities of model operating in it of "initial accumulation of the capital" have been completely settled.

During recent years, the highest rate of economic growth in terms of GDP in the European Community was achieved by Latvia. Despite reduction of incomes from Russian oil transit, the Baltic republic managed to accumulate impressive gold currency reserves, and to reduce the foreign debt. Pareks Banka, based in Latvia's capital Riga, was the only national banking institution of the Baltic States to develop into a powerful transnational investment bank, extending its influence both to the West and the East.

However, the global economic crisis affected this country most painfully, resulting in massive social unrest and political paralysis. In his public address to his own population, Valdis Adamkus, president of the neighboring Lithuania, tried to explain the social turbulence in both states with deliberate efforts of destabilization, inspired from Russia. However, the Russian political influence in Latvia is less significant than in other Baltic states. In December 2007, local Russian communities complained that they had not received a ruble of support from Russia. It is also noteworthy that Moscow has not used the Latvian crisis for its benefit. Besides, Russia is today concentrated on its own financial problems, emerging from a tremendous decline of oil export revenues.

In fact, the first symptoms of economic troubles were visible in Latvia already in early 2007. They were expressed in a shift in the economic balance that expressed itself in a few branches of economy: real estates, construction, and retail trade. Some of these negative symptoms were in fact presented as success: in particular, the increase of salaries and gross surplus of individual consumption. However, these ostensibly encouraging trends were alloyed with unbridled inflation that questioned the expected entry of the country into the Eurozone.

The anti-inflation program, initiated by the government of Aigars Kalvitis, was ambiguous and inconsistent. Trying to reduce the monetary mass, the government created obstacles for investments in real economy, while financial speculation was still booming. By the end of 2007, inflation was still on the level of 10.1%. In the first quarter of 2008, it rose to 16.4%, and in the second – to 17.7% (21). Restrictions for issuing credits, imposed by the government on the banks, resulted in a rapid contraction of the output of real economy. In the third quarter of 2008, the GDP reduced by 4.5% against the corresponding period of the previous year. The monthly industrial output shrank by 8% between January and August 2008 (22). Meanwhile, unemployment increased by one quarter. Facing an especially significant decline in metallurgy, resulting in a tangible shortage of revenues, the Government increased domestic borrowing. Thus, social instability had been predetermined yet before the international crisis broke out.

Since August 2008, Latvia, as well as other European states, encountered direct influence of the downfall of international stock markets. This influence was indirect, as the national stock market was underdeveloped and the state investments in foreign stocks were not significant. Commercial banks, due to strict regulations, also had not significantly invested in foreign stocks. The delayed debts under the given out credits, according to the Commission on the share markets and securities, have exceeded 15 %, delivery of new credits has practically stopped. Banks have started to take away at debtors of the mortgaged houses, apartments, grounds, production assets. The profit of banks, for the first time for long decades, has fallen to a mark close to the zero. Problems have arisen at foreign,

first of all Scandinavian, banks which persistently pumped up before money the Latvian national economy, without paying attention that the economic model operating in it cannot provide their return. The indicator of manufacture of gross national product in Latvia has fallen for IV quarter 2008 on 10, 3 %, and on all year on 4, 6 % (23). Number of the unemployed by the end of 2008 has grown to 118 thousand persons, the rate of unemployment has reached 9, 9 % from number of able-bodied population (24).

The downfall of the national budget system was triggered by the bankruptcy of Pareks Banka that had been massively involved in international speculative operations. For some reason, the new government of Ivars Godmanis decided to accept 100% of the bank's liabilities that amounted to 1.5 billion. lats, i.e. one fourth of the national budget. In order to compensate the budget deficit, the government committed itself for large-scale foreign borrowing. Simultaneously introduced austerity measures included also elevation of the value-added tax from 18% to 21%, increase of excise taxes, suspension of tax relief for basic consumer goods, along with slashing of budget subsidies for redundancy payments, state expenses for medical treatment, and salaries in spheres of science, education, and law enforcement. At the same time, the state budget continued to invest in ambitious projects like the State Concert Hall in Riga.

It is noteworthy that throughout year 2008, foreign investments in Latvian economy did not significantly reduce: their amount was 11% larger than in 2006. Foreign investments partially compensated the negative export surplus. Lending rates did not outrange the rate of inflation. Thus, the banking system did not yet experience a serious shortage of monetary resources (25).

However the government, being focused on the objective of integration into the Eurozone, strictly pegged the national currency to the euro. This commitment deprived the government of crucial levers of economic regulation. At the first signs of international financial crisis, the population hurried to exchange the greatly overvalued lat for foreign currencies, particularly due out flow of qualified labor to more prosperous European states. Only for two months, between September and November, the amount of foreign currency reserves of the Bank of Latvia contracted by 21%. By spring, all the gold currency reserves would have evaporated. The panic was calmed down only in the end of December, when the government managed to reach an agreement with international financial institutions on new loans amounting to 7.5 billion euros (26).

The problems, related to devaluation of national currency, were thus solved. However, foreign liabilities of Latvia increased from a relatively moderate 57.6% to the critically dangerous 100% of the estimated national GDP of 2009 (27).

The errors in managing the economy in crisis, undertaken by the government of Ivars Godmanis, may be explained by lack of professional qualification and its reluctance to listen to financial experts. The Prime Minister introduced ridiculous initiative, destined for prevention of financial panic and related flight of capital. Insisting that the crisis in fact exists "only in the imagination of people", Mr. Godmanis officially introduced criminal prosecution of any arguments in favor of devaluation. Criminal charges were thus imposed on a university professor who just reproduced a piece for a textbook of economics on the subject of devaluation in a 500-copy local newspaper, and on two musicians who ventured to ridicule the Bank of Latvia in a village club.

Under the pressure of the international financial institutions anxious by irrational use of credits given by them, in

March, 2009 to the power in Latvia V.Dombrovsky' s government has come. However it could not solve a problem of reduction of charges of an unreasonable officialdom and has chosen a way of a rearrangement of burdens of crisis on socially weak levels of population. The decision to reduce wages of teachers, doctors and policemen, children's allowances was accepted, to refuse indexing of pensions, to direct a part of payments to pension funds on a budgeted deficit covering, to cut down expenses on a science, education, public health services. Despite reduced receipts in the budget plans of the further increase of tax loading for business began to be considered.

In fact, the set of measures, introduced by the incumbent government of Latvia, does not significantly differ from the financial policy of earlier governments. The powers of Latvia have been following the same model that exposed its faultiness under unfavorable international conditions. This model, used since early 1990s, is focused on primary (non-equivalent) accumulation of capitals. It was first used for privatization of post-Soviet public property. However, this source of producing capital could not serve as a guarantee of balanced and durable economic development. As soon as the previously (mainly in the Soviet time) created resources were exhausted, this model started to generate systemic errors.

Conclusions. Crisis observed now in Latvia has system character that is simultaneously covers economy, social and political spheres. The given crisis is promptly evolving towards political and economic bankruptcy of the Second Latvian republic. Crisis of the Latvian society carries has the expressed internal reasons. At the same time, influence of global crisis substantially accumulates on processes and structural changes in Latvia. Without being the political actor in the field of the European and global policy Latvia passes more and more under the unconditional external control and goal-orientation.

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Entrepreneurship and the Baltic Rim

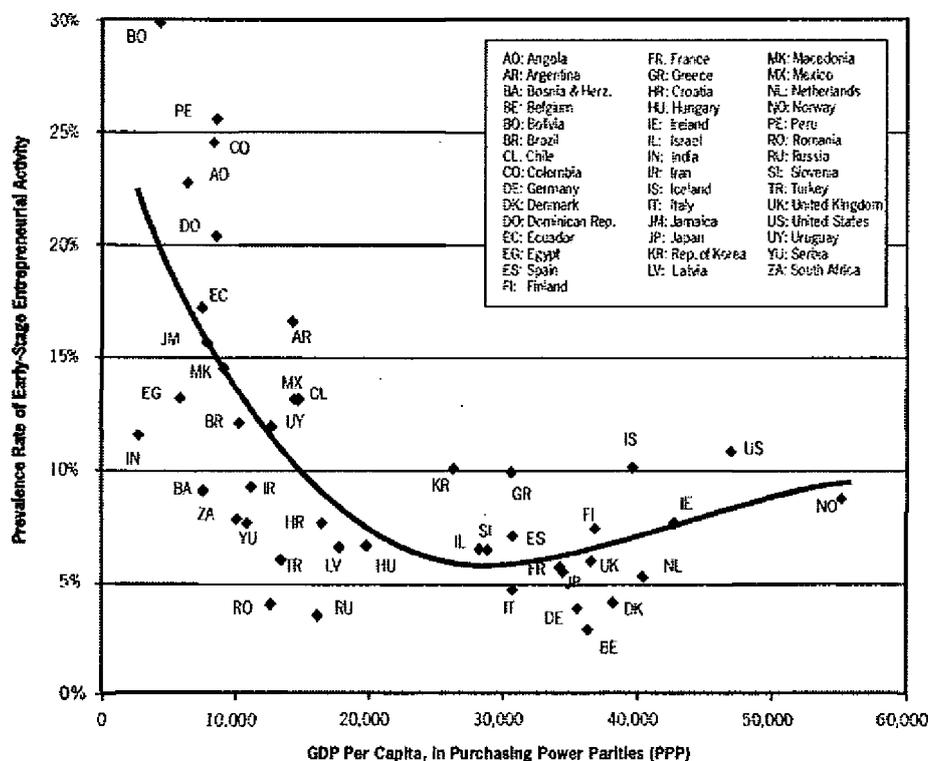
By Jarna Heinonen

The conditions for and nature of entrepreneurship differ across countries. Entrepreneurial activity also evolves in time and is, indeed, heavily embedded in the social, economic and cultural context of the country. Global Entrepreneurship Monitor (GEM) –study conducted in about 40 countries annually takes a broad view of entrepreneurship and focuses on entrepreneurial attitudes, activity and aspirations among adult population. In addition, GEM study provides insightful information on entrepreneurial sector for respective countries.

Unfortunately all the countries in the Baltic Rim are not included in the GEM. However, based on the countries included – Finland, Denmark, Latvia and Russia – it is already possible to demonstrate national differences in entrepreneurship, particularly the fact that entrepreneurship also reflects the phases of economic development of the country. Of these studied countries in the Baltic Rim Denmark and Finland are labeled as innovation-driven economies which are characterized by increasing wealth, a gradual shift from industrial activity towards service sector, and an increasing R&D investments and knowledge intensity opening new ways for innovative and opportunity-seeking entrepreneurial activity. Latvia and Russia, on the other hand, are labeled as efficiency-driven economies characterized by industrialisation and emerging economic and financial institutions to favour large national businesses. Due to increasing economic activity and gradually emerging baking sector the opportunities for the development of small-scale and medium-sized manufacturing sector expand.

Although GEM study provides a number of indexes and figures portraying entrepreneurial activity of the studied countries I concentrate on one example only, namely early-stage entrepreneurial activity (TEA) rate indicating the proportion of people aged 18-64 who are involved in entrepreneurial activity as a nascent entrepreneur or as an owner-manager of a new business. GEM demonstrates a consistent U-shape association between a country's level of economic development and its level and type of entrepreneurial activity. This U-shaped relationship between per-capita GDP levels and TEA rates for 2008 is illustrated in the adjoining Figure.

What does this pattern tell us about entrepreneurial activity? Countries with high TEA-rate and low levels of GDP per capita are characterized by many small businesses and a lack of job opportunities in larger companies. As the economy develops along with industrialization and economics of scale the role of larger companies may increase accompanied by a reduction in the number of new small businesses. The decrease in TEA rate may actually be a good sign if it is accompanied by economic growth and political stability. After some decrease the role of entrepreneurial sector may again turn into an increase as income level increases and countries move along the curve to the right-hand side where wealthier and industrialized countries outside the EU are found. This shift indicates that individuals are capable of discovering new opportunities in the business environment and due to good access to resources they are also in position to exploit the opportunities and start viable new businesses.



Source: GEM Adult Population Survey (APS) and IMF: World Economic Outlook Database (October 2008 edition)

Figure: Early-Stage Entrepreneurial Activity Rates and Per Capita GDP, 2008

Source: Bosma, N. – Acs, Z. – Autio, E. – Coduras, A. – Levie, J. (2009) Global Entrepreneurship Monitor. 2008 Executive Report. Global Entrepreneurship Monitor Research Consortium (GERA). Babson College, Universidad del Desarrollo, and London Business School.

Eastern European countries, Russia and Latvia, are situated at the left hand side, below the fitted curve. The people in these countries are, thus, not as much engaged with entrepreneurial endeavours as some other countries with similar levels of per capita GDP. This may reflect the historical development of the economies. Finland and Denmark, on the other hand, have higher GDP per capita and they are situated further right-hand side, Finland in the curve and Denmark below it. Both so called innovation-driven countries have already faced some increase in entrepreneurial activity along with income increase. Finland ranks higher than Denmark in TEA rate. Actually, in comparison with other innovation-driven economies Finland ranks at least reasonably high in early-stage entrepreneurial activity. The major challenge in Finland and Denmark is an evident lack of innovative and high-growth entrepreneurship.

The association between the TEA rate and GDP per capita is only one attempt to highlight the country differences in entrepreneurial activity. It is also noteworthy that entrepreneurship is not only a function of economic development but also other factors, such as country's historical development as well cultural, institutional, economic and demographic reasons. However, the consecutive GEM studies since 1999 indicate that national changes in entrepreneurial

activity do take place and that policy measures and programmes may contribute to the development. Most importantly, as GEM study has been able to identify relationship between entrepreneurship and different factors, such as economic freedom, competitiveness and the ease of doing business, GEM gives new insights to policy-makers on how to promote entrepreneurship in different economic and social contexts.

Jarna Heinonen

Professor, Director

TSE Entre

Turku School of Economics



Fighting fraud and corruption – the EU experience

By Siim Kallas

The European Commission needs to fight not only corruption but also the suspicion of corruption. In this regard, transparency is a win – win for the administrations and the public alike. I firmly believe transparency to be the key-tool in fighting this double battle.

Fraud with the EU budget is more than stealing money. The fraudster stealing EU funds also "steals" the success of a policy or a project; prevents people from being trained; innovative companies and researchers from receiving support; cross-national connections from being established; to give just a few examples. At times it seems as if the EU budget belonged to no one; as if fraud with European funds only meant taking a bit of money from an anonymous bottomless money pit. This is frightening and entirely unacceptable.

Fraud is a criminal act and unfortunately can never be prevented a 100%. So there need to be effective procedures to minimize the risk of fraud, to prevent any abuse and effective tools to detect and investigate it and to sanction it convincingly. The EU budget amounts to around 120 billion euros annually, spent all over the world. For the biggest spending blocks — agriculture and regional aid covering together over 80% of the budget — some 0.2% is estimated to be affected by fraud, but as this is followed-up closely, most of it will be recovered. Experts see no reason to believe fraud and corruption is more widespread in the EU Institutions than anywhere else. For example, the British House of Lords concluded in a special report that there was no evidence of widespread corruption within the Commission and that the level of fraud against the EU budget is no higher than in comparable public spending programmes, including in Great Britain.

When reflecting on this issue, we see that this high level of suspicion is, however, not surprising. First, to a large extent it relates to the unique governance structure and complexity of the EU.

- Compared to a national budget, much of which goes to paying directly for pensions and public services, the EU-budget is almost entirely composed of subsidies, and those are known to be more prone to fraud than other types of expenditure.
- European Union's decision-making processes are multi-layered and complex. They are different from what citizens are used to at national levels. This can be criticised, but the system has been developed to include checks and balances, balancing genuine EU concerns with important national interests.
- Given the Council of Ministers taking decisions behind closed doors or the obscure mass of 15 000 lobbyists operating to defend particular interests vis-à-vis the Institutions in Brussels, it is understandable the citizens are mistrustful.
- This complex governance structure provides convenient space for anti-EU rhetoric, not least in the form of national authorities blaming unpleasant decisions on Brussels. This all undermines the credibility of the EU.

A further cause of suspicion has been past high profile cases created the impression of significant corruption in the EU Institutions. Here I am referring to the events in 1999 leading to the resignation of the Santer Commission, and more recently (2004) problems in the Commission statistical office, Eurostat.

The fight against corruption and fraud within the EU Institutions and bodies has become an absolute priority for the EU. We have a zero tolerance policy and a fully independent Anti-Fraud Service, OLAF that is in charge not only of

investigating fraud with EU money, but also any wrongdoing or professional misconduct in the EU Institutions. We have an independent Internal Audit Service, a disciplinary office, tough rules on awarding of contracts and subsidies and whistleblower rules.

Over the past 5 years, we have also stressed transparency in decision-making processes and allocation of funds. Transparency plays a huge role in promoting a EU open to its citizens and therewith helps to increase public trust towards the Institutions. The EU needs the latter as it helps to focus discussion on real issues to be resolved at the European level. Transparency also helps to both fight corruption and correct the image of European Institutions as being corrupt.

In particular, over the past 4 years we have worked with the Member States to ensure that the end beneficiaries of all Community aid schemes are publicly disclosed – this includes the Common Agricultural Policy and the Structural and Cohesion Funds. Since the beneficiaries are now public, it is much easier for the public to detect false claims, and alert the authorities.

Increasing the transparency of lobby activities towards the EU Institutions has also been a key objective. Here, we now have an albeit voluntary register of over 900 lobbyists, who disclose for whom they are lobbying and roughly how much it costs. They also agree to abide by a code of conduct.

Since March last year, we have also been looking again at ethics of our 24,000 Commission Staff. I am convinced that one problem we face is that ignorance and distrust of the Commission means that any individual problem here is seen not as an isolated incident – a "bad apple", but rather as symptomatic of the whole organisation. I am sure that the great majority of Commission staff want to uphold high ethical standards – but we need to give them the advice and tools needed to achieve this.

The Commission is now finalising a statement of ethical principles for staff – we have adopted a bottom-up approach, whereby staff are invited to comment on different options, to ensure that the final version has strong support across the Commission – and thus that peer pressure will make it to some degree self policing. Work is also continuing on up-dating rules conflict of interest, and on acceptance of gifts and hospitality. Our objective is to allow the informal contacts of officials with the professional world or civil society, which are vital if we are properly to understand the concern of all stakeholders, while ensuring these contacts in no way compromise the integrity or independence of staff. There is never an easy balance here.

Integrity is a matter for all of us, and not the legislator or the administration alone. Member states and European citizens must develop more sense of ownership for EU money. Fraud with EU funds is not only a problem for the Commission. It is taxpayers' money, it comes out of all our pockets, and we therefore encourage the Member States and national authorities to gain and present assurance for the management of EU funds at all levels.

For a complex governance system like the European Union's, transparency is a win-win situation: it is beneficial for the administration and the public alike. Transparency plays an enormous role in promoting a more citizen-friendly EU and thereby helps to gain public trust in the institutions. The EU needs the latter to dispel misperceptions and focus the discussion on the real issues to be resolved at the European level.

Siim Kallas

Vice-President for Administrative Affairs, Audit and Anti-Fraud

European Commission

Baltic Sea Cooperation towards 2020 – serious challenges but bright opportunities

By Alexander Stubb

In the midst of the economic downturn we must look ahead and keep in sight the long-term challenges for the Baltic Sea region. At the initiative of the European Parliament and supported by the Member States in the region the European Union is currently in a process of producing a strategy for the Baltic Sea. The European Commission will present to the European Council of June 2009 a communication on the Baltic Sea Strategy. The strategy is coming with proposals for action on four areas: the environment, prosperity, accessibility and safety and security.

Finland has been contributing to the drafting process in many ways. Our proposals for measures to be taken within the new framework concern the eutrophication of the sea, maritime safety, innovation policies and safety and security. Finland is looking forward for a speedy start of implementation of the Baltic Sea Strategy of the Union and supporting the incoming Swedish EU Presidency in putting the strategy high on the agenda of the Union during autumn 2009.

We are confronted with an economic downturn that is both sharp and unprecedented in its global reach. We are all in it together also in the Baltic Sea Region. The disparities of our economies have not been a hindrance to cooperation, but have instead contributed to growth by offering good business opportunities. Let us not turn back this opening of the markets by giving way to protectionist measures. The expansion of the "home market" to cover the Baltic as well as the Nordic states has meant a lot to growth prospects of many SME's. I hope that despite downscaling, many of those are able to keep their foothold in the regional market.

It is worth considering that since we are seeing a global downturn, the competition between growth regions for a pole position in the global recovery will be fierce. In the Baltic Sea Region we should keep a calm head and continue to invest in the strengths that we have. The success of our region depends on how we are getting most out of the educated work force, investments in research and development, well functioning public services and infrastructure that is for the most in good shape.

Hard economic times require an ability to cooperate and pool resources. It is not for the governments to choose which are the businesses that will flourish. Some areas where there could be a bright future and even world class excellence for the Baltic Sea region, have been identified by the real actors, namely biotechnology, environmental and energy technologies, maritime sector, tourism and creative industries to name but a few sectors. We should aim at using also EU instruments in the best possible way to foster innovation collaboration and cluster building in sectors like these.

Public finances will be squeezed in the next coming years. This poses a challenge for the financing of environmental protection. But the Baltic Sea can't wait. I would urge for a cost-benefit analysis of the proposed measures needed for the implementation of HELCOM's Baltic Sea Action Plan and for risk assessment on maritime safety. On the basis of careful analysis we should push towards implementation of the most urgent measures. With the HELCOM BSAP and the EU's strategy there is now a momentum for intensified efforts to save the Baltic Sea.

Although the EU Strategy for the Baltic Sea Region will be an internal Strategy of the Union, we need to co-operate with all the coastal states of the Baltic Sea to ensure its success on the regional level. The fact that the EU is paying an increased attention to the Baltic Sea and other northern regions is an opportunity for all the countries of the region, including the non-EU ones.

The European Council conclusions from December 2007 define the Northern Dimension (ND) to be the framework that provides the basis for the external aspects of co-operation in the Baltic Sea region. Northern Dimension is a common policy between the EU, Norway, Russia and Iceland and the ND area covers both the Baltic Sea and Barents regions. The ND can be described as the regional

leg of the EU-Russia co-operation. Russia is a neighbour and a strategic partner.

As to the agenda, the ND is a true reflection of the Peoples Europe. In the Northern Dimension Ministerial Meeting in St. Petersburg in October 2008 we discussed issues that really affect our everyday lives and where we need to co-operate with our neighbours. For instance, a well known fact is that environmental pollution does not recognise any state borders, (or EU ones!) The Northern Dimension Environmental Partnership has carried out large waste water treatment projects in the St. Petersburg area. When the final projects are finished, St. Petersburg will be removed from the HELCOM hot-spots list.

Now when expecting harsh economical times ahead of us, we must constantly keep our head up and look forward. New ideas and new impetus to reinforce our regional identity are needed in order to maintain the unique dynamism, which has marked our region during the past years.

First and foremost, in difficult economic times it is even more important that the Governments do their utmost to create the conditions and necessary prerequisites for economic upturn. I am convinced that the new ND Partnership on Transport and Logistics currently under preparation will have a significant impact on the economic development of the region.

Secondly, it is my firm opinion that we should try to extend the benefits of regional co-operation to an as wide geographical region as possible. I proposed in St Petersburg ND ministerial meeting, that we should engage Belarus to the Baltic Sea co-operation by including it to the ND partnerships. My proposal was well received - it is also worth noting that when the Foreign ministers of the Council of the Baltic Sea States (CBSS) meet in Denmark this June, we will most probably make a decision to grant an observer status to Belarus to the CBSS.

Thirdly, in order to make the best use of untapped potential of the Baltic Sea Region we should have a critical look at the regional co-operation architecture. There are a number of different co-operation structures, which all have their special missions and fields of excellence. Profound changes have taken place on the Baltic Sea region in the past ten years, and I believe strongly, that we should initiate a process of streamlining and sharpening of the mandates and agendas of these regional co-operation structures. I hope that the EU Baltic Sea Region Strategy will for its own part will give a push to this work by helping to focus our internal thinking and enabling us to set joint objectives for these organisations. This work should of course be conducted in a very close co-operation with the non-EU ND partners, which should not be considered as "objectives" of EU actions, but as equal partners.

The CBSS, like the other Northern regional councils, may have their own role in making our visions for the Baltic Sea a reality. Prime Minister of Finland, Mr. Matti Vanhanen at the 7th Baltic Sea States Summit in Riga in 2008 called for a Baltic Sea 2020 vision to be adopted in the next CBSS summit (Vilnius 2010) This vision should comprise issues like the environment and the ecological protection of the Baltic Sea and how to improve the different energy and transport networks in order to create a prosperous and dynamic economic environment. It is for the current and incoming CBSS Presidencies, Denmark and Lithuania, to decide how to proceed with this idea. The next CBSS Foreign ministers meeting in Elsinore in Denmark next June will time wise be a good opportunity to discuss the role of the CBSS in this context.

Alexander Stubb

Minister for Foreign Affairs

Finland

Baltic Sea maintenance and budgetary control

By Ville Itälä

As we all have learned by now due to the ongoing discussions regarding the Baltic Sea and the gas pipes, the Baltic Sea is quite central and necessary for the European Union. However, as any resource, the Baltic Sea cannot be properly maintained without a proper budget and strategy. Last year the European Parliament budget committee tried out an experimental 5, 5 million euro "one-off" for three different projects regarding the Baltic Sea. Finally, after a few years of pursuing the attempt to gain a budget solely for the maintenance of the Baltic Sea, the European Parliament budget committee now has nominated one for the year 2009. Although the monetary value for this budget strategy has not been determined yet, the nomination alone is a huge step forward. The important thing to concentrate on now is to get the European commission's priorities right, and find a clear focus so that the money can be channelled towards useful projects.

Previous actions prove that improvement is possible, as in the past few years the security and pollution problems have made a change for the better. The Mediterranean Sea annually gets over 150million Euros from the EU budget, surely the Baltic Sea is worth at least as much. Hopefully when the budget amount for the Baltic Sea strategy is being determined this will be taken into account.

There already is a remarkable amount of individuals, private companies, and foundations that willingly put in their efforts in order to help save the Baltic Sea, which still is one of the most polluted seas in the world. One of the main problems still are the industrial ships that dump their bilge water into the Baltic Sea, since as these are amongst the most difficult to control. Just as an example, the chicken production houses in St Petersburg alone dump an incredible amount of phosphor pollution into the Baltic Sea. Even though individual charities do on their part as much as they can in trying to lessen the pollution and make the Baltic Sea more economically sound, the projects and charities lack a common denominator. If the individuals were monitored or looked over by one common project or company, it would be easier to deal with the EU-bureaucracies and also channel the funds more effectively towards a common goal.

As well as trying to get the funding for the proper maintenance of the Baltic Sea, I believe that Russia should be coerced into making a deal that on their side promises to try and control the pollution going into the sea in exchange for letting them build the gas pipe under the Baltic Sea. The gas pipe has been the topic of many heated discussion for quite a while now. It has not been confirmed as of yet whether the German company Nord Stream will be allowed to move forward with the building of the pipe line, as the investigations on the safety and the environmental impacts are still up in the air, but just the possibility of the project moving forward has the people up in arms. As much as 70%

of the Swedish MP's are against the project. Sweden and Germany so far are the only countries to receive the permission application from Nord Stream, and Finland and other countries involved will receive theirs during April -09. Even though the company is so optimistic about the project moving forward, that they have already ordered the actual pipes, worries about the environmental and safety implications has the nations involved worried. Hopefully the project will not be realized, but if it is, Russia definitely needs to make a firm promise to do their part in the sustainability of the Baltic Sea. Even though Russia is still at the moment one of the main contributors of the pollution in the Baltic Sea, we cannot forget the areas such as Ukraine and Belarus, that indirectly affect the Baltic Sea pollution levels as well.

Some tangible examples of things already being done for the Baltic Sea, include the HELCOM's Baltic Sea Action plan. HELCOM is a somewhat ambitious program to restore the good ecological status of the Baltic marine environment by 2021, and the plan includes realizing an emissions limit for all the countries involved in polluting the sea. In theory we have the plans needed for action, now we just need to actually make things happen. Each and every one of us is in part responsible for the state of the Baltic Sea, as it is so essential to so many of the European states, now we just need to get everyone to pull their own weight.

Ville Itälä

Member

European Parliament

Finland

Baltic cooperation needs freshening

By Antti Kaikkonen

The Baltic Sea has effectively become the sea of European union and Russia. The European integration and opening up of Russia has steadily built up the regional economy. Connections between the countries have intensified. Transport links are stronger and more plentiful than ever. Budget airlines and affordable ferry connections have enabled both workers and leisure travelers to travel beyond their home countries in large numbers.

The current financial crisis is another example of the importance of regional and global cooperation to solve problems. There simply has to be better collaboration between our countries. Otherwise we might face serious humanitarian and security problems between and inside the countries, also in the Baltic Sea region.

The Baltic Sea is an area of deepening economic cooperation. This should be accompanied by deepening political one. There is an urgent need for the EU members and Russia to solve environmental, energy and traffic questions together. The discussion about the Nord Stream gas pipeline in the Baltic Sea states has shown the interdependence of politics and security and environmental matters.

If the Nord Stream project is realised, the Baltic Sea will become an important transfer route for energy, effectively creating a very strong energy link between the EU and Russia. It is of utmost importance that the Baltic Sea states can develop cooperation beyond the existing ways in the spirit of confidentiality. In the light of recent events in Georgia and the widely varied views toward Russia within the EU, it will not be easy. Moreover, the EU and Russia are tied together by their energy needs. However, this interdependency should not be used as a justification to avoid the difficult problems and sore points of the EU-Russia relationship.

From this perspective, the Swedish decision to select the Baltic Sea as one of the priorities for their oncoming EU presidency is a wise one. The non-paper "A Healthy and Prosperous Baltic Sea Region" assesses the possibilities and challenges for a common EU strategy for the region. The challenge of the strategy is to find the ways of cooperation that will work for both Russia and the EU member states. In this work, we should utilize the experiences gained through the Barcelona Process, and also not to forget the possibilities of the Northern Dimension.

The Baltic Sea region is not lacking in common forums and organisations that facilitate cooperation. The alphabet soup consists of BASREC, BSSSC, CBBS, CCB, HELCOM and UBC to name but a few. However, due to the multitude of actors, initiatives and programmes, there is a need for greater coordination and effectiveness. The problem is one of too much overlapping work and too few concrete results. I think that the cooperation should be reorganised on a new platform. A working title could be the Baltic Sea Union. It could be formed by developing the existing Baltic Sea Parliamentary Conference. We need fewer organisations but more results.

The Baltic Sea Union would create a permanent and functional model for equal cooperation between the EU and Russia. It would also emphasize the equality of the southern and northern EU regions after the establishment of the Union for the Mediterranean. The Baltic Sea and the Mediterranean Unions would be complementary regional structures for cooperation inside the EU and also permanent instruments for external policy. The challenge is to develop tools that do not create new and cumbersome bureaucracy but are effective and flexible.

The council of Europe has recently named me to draft a report on the economic potential of the the Baltic Sea region. The work has begun and the aim is to finish the report by 2010 at the latest. The Baltic Sea states are in widely varying situations but untapped resources do exist. The resources can best be used by cooperation.

Baltic Sea cooperation cannot only be examined from an economic viewpoint, though the economic and employment issues are particularly topical. The ecological and social perspectives should also be taken into consideration.

A central part of the report will be a visit of the economic committee of the Council of Europe to Finland in May 2009. There will be a high level seminar on the Baltic Sea cooperation at the Finnish Parliament. At the same time, the first 60 years of the Council and Finland's 20 years as a member will be celebrated. It is excellent that the Baltic Sea is on the agenda of the Council during the festivities.

Antti Kaikkonen

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Finland



European cooperation crucial as banking sector in the East has to weather global crisis

By Thomas Mirow

The financial crisis that began in the United States in 2007 and then spread to western Europe and beyond is now taking a huge toll on the countries of eastern Europe.

The economies of the former Soviet bloc had finally started to strengthen, the result of two decades of punishing economic reform and sacrifice.

Now the first signs of social unrest are emerging in countries whose people had sought economic, political and social stability. The fruits of those earlier sacrifices are in jeopardy. That earlier growth is quickly grinding to a halt.

The region as a whole could still avoid the substantial contraction that is now inevitable in the more advanced west. But we must seize the opportunities that exist now to ensure that the progress of the past does not become the sustained economic downswing of the future.

The common denominator across the region is that those countries suffering most acutely now are those that have striven hard to open themselves up to the global economy. They are now paying the price.

The region's problems are deeply interwoven with those of the rest of Europe. As demand from the EU dries up, the export-dependent economies of the east and seeing their market place shrink.

It is incumbent upon the economies of western Europe to help to address this situation and to seek a solution that lies in a co-ordinated response from both public authorities and international financial institutions.

The banking sector is crucial to the current crisis and to the region's recovery. As a practical step, there must be close co-operation in addressing both regulatory concerns and providing financial support for parent banks and their subsidiaries in emerging Europe.

For this very reason, the west must embrace an initiative by European banks calling for fast, joint action to support eastern subsidiaries. A worsening crisis in emerging Europe will threaten Europe as a whole.

The vast majority of the central and eastern European banking sector is owned by a small group of European Union-based banks. For years, this has been a source of stable capital flows and proven critical to the success of these economies. Now that parent banks are confronted with the global financial crisis it is crucial that they uphold their commitments to emerging Europe.

The governments in eastern Europe lack the means to finance national rescue packages and at the same time there is a genuine danger that measures introduced in the west will ignore the plight of their once profitable eastern subsidiaries.

The international financial institutions have embarked on joint approaches to tackle the crisis in the most affected

countries. The swiftness of the reply so far has been encouraging.

Within this group, the European Bank for Reconstruction and Development is taking a leading role, especially in providing support for the financial sector in order to maintain a crucial flow of credit to small and medium sized enterprises.

We have decided to expand our business this year by 20 per cent to €7bn and in recent weeks additional funds have already started flowing to systemically important banks Georgia, Romania, Ukraine and Russia. We are also planning a sharp increase in our trade financing to maintain regional commercial links.

Similar initiatives are being taken by the European Investment Bank and the World Bank Group. But much more must be done and a regional approach is needed. Given the enormity of the crisis, it is clear today that every isolated intervention can easily be seen as just a drop in the ocean.

The engagement of the EU and its governments is crucial. We can address the problems properly if the EU, the European Central Bank and the international financial institutions apply their resources in a structured and co-ordinated manner

By agreeing to an increase in investments this year, the shareholders of the EBRD have recognized that this is the time to engage in Eastern Europe – not to retrench.

What is true for the EBRD is true for other investors. The potential in Eastern Europe remains enormous and those investors who stay the course now will reap the benefits of those investments when this current crisis abates – as it inevitably will.

An economically and politically stable Eastern Europe is in the interests of the whole world.

More importantly, the people of Eastern Europe have made immense sacrifices over the last 20 years to prepare a better future for their children and future generations. They deserve this more prosperous future and we need to make sure they are not disappointed.

Communism failed them once. The west must not fail them a second time around.

Thomas Mirow

President

The European Bank for Reconstruction and Development

Regional cooperation that works – the EU's Northern Dimension Policy

By Paul Vandoren

The European Union with its population of 495 Mio people is a global economic power and the world's biggest trader. It is also the world's biggest donor. The EU however also takes on responsibilities to define relationships with the rest of the world in terms of removing trade barriers, develop poorer regions and promote peace and prosperity.

The EU takes a keen interest in cross-border cooperation along its external borders in order to let neighbouring countries benefit from its internal market and to foster stability and growth, which in return also contributes to the EU's security and prosperity. The EU has a wide range of policies and financial instruments available for the conduct of its external relations and in line with the geographic focus of the "*Baltic Rim Economies Review*", I would like to elaborate on the Northern Dimension (ND) Policy, its importance for the Baltic Sea region and EU Russia relations.

Let me start with the importance of the Baltic Sea region, which is of great relevance for Europe's economy and environment. Its nominal GDP in 2005 amounted to 71% of Germany's. It accounts for a little less than half the EU's land area, around a fifth of its population and a sixth of its GDP. It has tremendous potential and is home to an important part of Europe's environmental capital.

As far as Russia is concerned, the EU and Russia are interdependent in many ways. Russia is the EU's third biggest trade partner while Russian energy supplies make up a significant percentage of Russia's exports to Europe and thus a crucial source of income for Russia. Furthermore, the EU and Russia share many contemporary threats to which common answers are needed, such as in the field of security, migration, human trafficking and many more.

On 24 November 2006 in Helsinki, the Russian President, the EU Presidents of the Council and the Commission, as well as the Prime Ministers of Norway and Iceland adopted the Northern Dimension Political Declaration and Policy Framework Document.

The ND not only provides an important platform for discussions with non-member states (Russia, Norway, and Iceland) but also includes concrete mechanisms for practical cross-border cooperation. For example, there are currently two existing partnerships, on environment and on public health, which both function well and bring concrete benefits to the people in the ND region. The European Commission financially contributed to both partnerships together with all countries that are part of the ND policy.

Under the Environmental partnership, which has a fund of grants administered by the European Bank for Reconstruction and Development (EBRD), almost 3 billion Euros in grants and loans have been mobilized for the benefit of a cleaner environment, i.e. to help cleaning up nuclear storages and other dangerous sites in North West Russia as well as infrastructure projects concerning waste and water treatment.

The ND Partnership for Public Health and Social Well-Being is a mechanism for promoting public health strategies in the region by bringing together experts (for example from the Baltic Sea Network on Occupational Safety and Health) on HIV/AIDS, Primary Health Care, Prison Health, Social Inclusion and other thematic areas.

The ND Ministerial meeting in St.Petersburg in October 2008 decided to establish a Partnership on Transport and Logistics. This is of particular relevance given the ever increasing volume of EU-Russia trade. Furthermore, it was decided to launch preparatory work to assess the feasibility of a Partnership on Culture.

What is the added value of the ND policy and its relevance for EU-Russia relations when compared to the general framework for EU-Russia relations as expressed in the 2005 agreement on the four Common Spaces?

The ND policy is a regional reflection of the Four Common Spaces and addresses issues of cross-border cooperation in economically and environmentally important regions such the Baltic and Barents Sea, the Russian Oblast of Kaliningrad and the Arctic and Sub-Arctic areas.

While the priority sectors of cooperation of the ND policy coincide largely with the Common Spaces, the ND policy puts greater emphasis on the environment. In addition, it includes two specific areas that are not mentioned in the Common Spaces, i.e. the protection of indigenous people and public health and social well-being.

Despite some well publicised difficulties in EU-Russia relations, the ND policy has shown that fruitful and concrete cooperation with Russia is possible. It has provided a way to keep Russia positively engaged at a regional level and Russia not only shows keen interest in actively participating in the policy but also demonstrated co-ownership by means of its financial contributions.

From the EU side, ND projects and initiatives are financed primarily by the European Neighbourhood and Partnership instrument (ENPI) from the cross-border financial envelope, and to a lesser extent from the ENPI allocations for Russia.

The implementation of the ENPI cross-border cooperation programmes is due to start in the first quarter of 2009. Almost all of the programmes with Russia are in the Northern Dimension region. EU funding amounts to almost 290 million Euros and Russia committed to contribute with 122 million Euros.

From the experience with the ND policy, we can say that project based regional cooperation has an important role to play in addressing regional challenges and building bridges between people. Projects under the ND policy typically involve a wide range of actors such as regional and local authorities as well as civil society organisations, thereby creating important links and platforms for discussions on issues of common concern.

Finally, let me mention at this point that the European Commission is currently preparing an EU Strategy for the Baltic Sea Region as requested by the European Council conclusions from December 2007. The aim of this strategy is neither to create new structures nor to replace the well functioning cooperation under the ND policy but to focus on coordinating and strengthening the use of existing instruments and policies. This strategy is foreseen to be presented in June 2009 and is mainly targeted at the EU member states around the Baltic Sea, however it will also contain issues that will call for cooperation with third countries in the region, i.e. with Russia. Therefore, we can say that the ND policy will form the basis for the external aspects of the new Baltic Sea region strategy and thus also lay the ground for continued and re-enforced successful cooperation in the region.

The experience with the ND policy shows that this is an area where the interests of the EU and Russia clearly coincide, which inspires confidence for the future in new potential fields of cooperation.

Paul Vandoren

Deputy Head

*Delegation of the European
Commission to Russia*



Against the financial recession with Baltic cooperation

By Ari Korhonen

An economic downward spiral is shaking up the world. The ultimate depth of the recession is yet difficult to predict. It is clear, however, that the effects are massive and far-reaching. The S&P 500 index of the United States' stock market perhaps indicates the historical severity of the economic situation. Measured with this index, the year 2008 was as bad as 1937. So far, there has been only one year in the financial history that has been worse, the year 1931.

The critical financial situation will also have a great impact around the Baltic Sea. We need to discuss and estimate various prospects for the future to foresee and prevent the negative effects. The countries whose economical situation is in some way dependant on the conditions of traffic on the Baltic Sea have an especially important role in the prevention of the negative effects. Also the role of the European Union is very important.

Decrease in transportation and tourism

As the consumer buying power weakens, goods traffic decreases. No investments will be made in new ports or roads during the recession. The development of the capacity of new routes, such as Russian ports, is postponed. As a consequence, much of the traffic to Russia from the west will continue to run through Finland. It is important to take this into account when the Finnish government ponders the traffic investments to revive the economy. It would be sensible to direct the investments at enhancing the conditions of transport and logistics or make them with the environment in mind. The operational conditions of transportation to and from Russia play a key role in coming back from the recession.

Another key factor in the transportation to and from Russia are the formalities at the border. Finland must be active toward Russia as well as inside the EU in promoting the transportation and tourism across the border. It is a question of will and negotiation skills, not of money.

The weak economic situation reduces tourism that has been a growing source of livelihood in the Baltic Sea region. The level of prices in, for example, the Baltic states and Poland has risen rapidly in the last decade as a result of tourism, among other reasons. When the prices go down enough, tourism will begin to recover and speed up the recovering from the recession as well. When the difficult times are behind us, it is important that the tourist destinations, hotels, properties and infrastructure are in good condition and available for tourism.

Is there enough money for a clean and safe environment?

The weak economic situation also affects the environment, both negatively and positively.

The decrease in traffic naturally reduces pollution and the risk of oil spills in the Baltic Sea. Also, the traffic will not necessarily increase very fast as the domestic market and production are the first to recover. As a result of this, transportation of goods from far away is limited especially in the beginning of the new economic growth.

On the other hand, the probability of serious environmental hazards in the Baltic region will grow as a result of the recession. In a poor economic situation there is not as much money for the prevention of the risks as during economic growth. Cutbacks will be made in investments in equipment and the development of systems designed to reduce the load on the environment will cease in agriculture, industry, water purification and transportation. Reductions will be made in development and research.

The right kind of policy in the Baltic region right now is to enhance the working and recovering conditions of the economy and to take care of preventing the environmental hazards. The European Union has risen to the challenge by drawing up the European Union Strategy for the Baltic Sea Region. Implementing the EU strategy and the Baltic Sea Action Plan, financing mechanisms, safety in sea traffic, implementing the EU legislation in new member states and the continuation of the Northern Dimension are the key issues. In addition to the strategy, we need joint measures and funding from the EU to save the Baltic Sea.

We need political decisions and common effort

The citizens of each member state have a chance to influence the policies in the European Union parliamentary elections in June 2009. The substantial policy issues in the European politics are practically resolved between a conservative and a social democratic Europe. Regionally, however, it is in our best interest that all the politicians from the member states surrounding the Baltic Sea push for the common agenda.

In addition to the European Union dimension we also need national decisions that support the realisation of the common policies in a larger extent and at the same time contribute to the recovery of the Baltic Sea region and a cleaner Baltic Sea. This calls for common policies and common effort in the member states even in the harder times.

Ari Korhonen

Secretary General

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The impact of the international financial crisis on the stability of banking systems in Central and Eastern European countries

By Wojciech Kwaśniak

The ongoing crisis of confidence in financial institutions observed in international financial markets, and in particular, the crisis of confidence in banks, has had a negative impact on the stability of financial markets both in global and regional terms.

Such a situation not only leads to the need of non-standard intervention of central banks in providing liquidity to the financial markets but also requires governments of individual countries to take large-scale measures to provide financial support to financial market participants.

The measures aimed at maintaining the liquidity of the financial market and solvency of certain institutions do not, however, eliminate the major risk to economies of individual countries, i.e. the systemic risk aversion of banks. This risk aversion takes the form of limiting the scale of bank cooperation in the interbank market and a radical tightening of lending policy towards enterprises and households.

Such a situation shows that there is a need for a new critical look at the standards and practices existing in the financial markets and the ways of auditing and supervising financial institutions. It also requires a verification of relations within international financial groups between the controlling entities and their subsidiaries.

The present financial crisis has once again demonstrated banks' particular vulnerability to crisis situations and a fast cross-border crisis transmission. This leads to a further deepening of the crisis and considerably raises the cost of overcoming it.

In addition, the financial crisis has confirmed central banks' special role in quickly identifying risks to the stability of the financial system and their leading role in providing banking systems effectively with liquidity necessary for their further functioning.

The transfer of risks through international financial groups is particularly well visible in Central and Eastern European countries. In the last 15 years, a large expansion of international banks through acquisitions of locally operating banks has taken place in these countries. A large group of these banks is systemically important for the stability of the local financial markets and important from the point of view of providing bank loans to national economies. At the same time, these banks represent only a small portion of international financial groups and the banking market of Central and Eastern European countries represents but a marginal part of the whole EU financial market.

The situation where the market was booming and the banking services market was far less developed compared to the developed countries led to a large increase in the lending rate. This was, in particular, the case of the poorly developed market for real estate funding. International banking groups, in their efforts to maximize their short-term financial results, were willing to grant foreign currency loans on a large scale and loans based on funds obtained in the international financial market.

The above bank strategy provided households and enterprises with easy and cheap access to bank loans. However, in view of serious financial market turmoil, this strategy has become, owing to the transfer of risk from controlling entities to their subsidiaries, an additional element increasing financial market instability in the host countries.

There was an abrupt increase in risk aversion in subsidiary banks, notwithstanding their good financial results and the absence of assets whose valuation is difficult. This was followed by banks' demands for public institutions to

take over the whole or some of the risk. It seems that due to a concentrated shareholding structure of these banks the demands can, in fact, be attributed to international financial groups who addressed them to central banks and governments in the countries of their operations. Such demands have probably been triggered by banks' expectations of a support similar to what they have received from public institutions in their home countries, despite the fact that their subsidiary banks do not, in their majority, actually need such a support.

Unlike global institutions, the majority of which had or still have dispersed shareholding, banking systems in Central and Eastern European countries have banks controlled by specific owners, i.e. owners of significant stake of shares. It is them first of all who should be expected to have a positive influence on the prudential and stable management of the bank, and who should provide support if needed. Only when such activities prove ineffective or insufficient should public aid be considered. Therefore, a lot depends on the efficiency of measures taken by governments and bank supervisors that support central banks in the dialogue with the banking system on instruments aimed to provide actual aid to banks, encouraging them to continue the lending support for the economy.

The present international experience shows that an accurate financial market diagnosis, the quality of market supervision and cooperation between central banks, financial market supervisors and governments are of particular importance. These elements may ensure an adequately quick response and lead to identifying risks and restoring the stability of and confidence in the banking system.

Owing to the fact that responsibility for the stability and safety of the financial markets lies within the competence of each country the influence of central banks on banking system supervision should be strengthened under the European System of Central Banks. This applies in particular to banking groups operating systemically and on a cross-border scale that are important for individual national financial markets and the single European market. International cooperation and European solidarity in overcoming the present crisis and maintaining economic growth should be strengthened at the level of governments. The scope of partnership cooperation should also be expanded to control risks in a better way, which will be conducive to a quick evaluation of emerging new threats.

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St. Petersburg's commercial real estate market – some recent trends

By Oleg N. Misko and Sergei F. Sutyryn

At least during last five years St.Petersburg real estate market has been due to several economic and geopolitical reasons one of the most appealing targets for both domestic and foreign investors. Logically enough it has experienced impressive growth. Traditionally market under review is structuralized into three major sub-markets. Namely they are: office premises, retail/wholesale premises, and finally warehouses/logistical centers. These sectors, on the one hand, have their own peculiarities regarding location priorities, level of prices, transportation requirements, etc. This is twice as significant due to a mere size of the city – the largest metropolitan area in Baltic region. On the other hand, all abovementioned sub-markets share some common features in their development. In particular they result from the pattern of regulatory framework – provision of specific land plots, city government approvals with respect to procedures of projecting and construction, etc. Meanwhile the most important common feature is gradually growing deficit of territories suitable according to their natural and legal statuses for respective activities.

In case of office premises aforementioned deficit generated as late as the end of 2007 a new approach in city government policy – relocation of plants and factories from old industrial zones either to outskirts of St.Petersburg or towards Leningrad province. In contrast to first wave of relocation initiatives in 1990s largely initiated by ecological considerations without any serious specific plans regarding disengaged territories, current focus is on construction there new business areas. The latter might be created either via renovation of already existing premises or as totally brand new buildings. It goes without saying that relocation is a relatively lengthy process taking several years. Under the circumstances its impact on respective prices so far is minimal, if any. It is not by chance that just during first 8 months of 2008 monthly rent for square meter of office premises increased about 20% and reached 35 euro.

In case of retail/wholesale premises the need to adjust the policy to the lack of territories ultimately forced city authorities to reject substantial number of small- and medium-scale projects and focus on large multistore so called “multifunctional trade complexes” (MFCs). Being initially introduced into St.Petersburg landscape about decade ago they gradually expanded and by September 2008 account for 3 600 000 sq.m. with about 95% of this total under permanent use. Two large groups of actors operate the market: representatives of large chains (METRO, O'KEY, LENTA, IKEA, etc.) and individual entities (Grand Canyon, Gulliver, etc.) The former is clearly dominated by Moscow and foreign owners, while the latter is shared by locals as well as outsiders. Expansion of MFCs resulted in crowding out of small retail stores. Certain amount of those first and foremost selling basic food mainly to inhabitants of nearby houses is financially protected within the framework of city SMEs support programme.

Finally, in case of warehouses/logistical centers abovementioned deficit reveals itself in a most dramatic way. The total supply equals to as little as 1 429 339 sq.m. including those put into operation in the 3d quarter of 2008. More than that, these are mainly low quality premises with Class C and Class D warehouses accounting for 81% of the overall. Since largely due to transportation constrains no new construction is possible in the downtown and old industrial areas of the city the only promising projects are located in

the outskirts close to main motorways and railroads. It is worth mentioning that many well-known foreign companies are very active here. Another interesting feature of the sub-market under review relates to the fact that respective contracts between the owners of warehouses/logistical real estate under construction and their potential clients tend to be signed at the very early stage, often after construction *per se* is just started.

All discussed above deals with relatively long-term trends. In contrast to that, some new changes resulted from current financial and economic crisis. First of all, it brought contraction of investments into the sector and hence decline in total volume of construction. In particular, only in sub-market of warehouses/logistical centers about 1 000 000 sq.m. of incomplete construction were frozen during last several months. Secondly, there is an evident trend towards increase in length of construction with completion of many projects being postponed in average for 1.5 years against initial schedule. Thirdly, in case of warehouses/logistical real estate and office premises the gap between supply and demand tended to widen. This largely resulted from the fact that the crisis hit construction earlier than other industries. And finally fourthly, due to deterioration of living standards MFCs experienced disengagement of their premises, in particular as long as substantial number of retailers was forced either to quit totally or to diminish the scale of operations.

In general one might argue that St.Petersburg commercial real estate market will suffer from the crisis to the less extent than respective national one. There are two main reasons for this optimism. On the one hand, abovementioned deficit of city premises will by no means disappear. On the other hand, due to the overall high investment potential of St.Petersburg commercial real estate will most probably continue to attract both domestic and foreign investors.

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University of Joensuu as an active partner in cross-border cooperation in Northwest Russia

By Perttu Vartiainen

The University of Joensuu (UoJ) is a multidisciplinary university with over 8 000 undergraduate and graduate students. The UoJ is the easternmost university of the continental European Union, located only 70 kilometres from the border of Russia. Consequently, cooperation with academic institutions in the Soviet Union and Russia has been a natural choice for the UoJ ever since its foundation in 1969. In the Soviet time, the cooperation focused on humanistic studies addressing the common cultural heritage of the Karelian region, which connects eastern Finland and the Karelian republic in Russia. In 1978, the UoJ and Petrozavodsk State University signed a memorandum of understanding on cooperation between the universities – the first one of its kind for both of them.

Following the collapse of the Soviet Union, interaction between the UoJ and its Russian partner institutions has increased in many ways. First of all, the lively exchange of students and academic staff has created a framework for forming sustainable partnerships both at the institutional and the personal level. At the same time, the topics of mutual interest have expanded to cover also the current social, economic and environmental issues characteristic to the border region between Finland and Russia. Secondly, the UoJ has been an active player in implementing the cross-border and neighbouring policies of Finland and the EU. Furthermore, in continuing education and entrepreneurial activities, the university has carried out projects that are of interest to various public and private organizations on both sides of the border. The range of these projects reaches from forestry to legal institutions and customs. Thirdly, the geographical core of these activities now covers the whole of Northwest Russia with St. Petersburg as the main economic and academic hub of the area. This has given impetus to widen these activities to new fields of science and technology in order to reach new synergies between Russian high-level basic science education and Finnish technology-driven research and business expertise.

In its current strategy, the UoJ defines “border studies and Russia” as one of its four strengths and areas of expertise. This expertise rests both on research and teaching relating to state borders and cultural boundaries as well as on applied knowledge in subjects like forestry, business and law. These subjects lie in the core of the current cross-border activities in the border region between the EU and Northwest Russia. In the humanities and social sciences, this border region is also of interest to a wider community of scholars wishing to conduct multidisciplinary, comparative border studies. The leading research institution addressing borders and Russia at the UoJ is the Karelian Institute, which has also gained recognition as the coordinator of several national and European research projects.

Questions pertaining to borders and their formation have shaped the Russian studies conducted at the UoJ. Thus, Russia and Russianness from the perspective of borders and cross-border interaction form a key element in research activities in social, cultural and theological studies at the university. This allows our researchers to assume a special profile both in the national and the wider European context. The university’s expertise on borders and Russia also serves as the foundation for the multidisciplinary competence centre “Europe beyond East-West Division” at the UoJ as well as for the nationally recognized Ph.D. programme “Russia in Europe” coordinated by the UoJ. The three main fields of research of the competence centre currently include “External borders of the EU: Regional Dimensions of the New Neighbourhood”, “Post-Soviet Change, Globalisation and Governance” and “Border, Ethnicity and Identities”.

The UoJ offers several study programmes, study modules and courses whose thematic core is built around borders and Russia. This concerns not only studies in Russian language and culture, but also subjects like history, human geography and forest sciences. In most of these programmes, the language of instruction is English and they also attract international students. The UoJ hosts a growing number of Russian students, most of whom now study in international programmes. One of the most attractive programmes among Russian students has been the International Master’s Degree Programme in Information Technology, IMPIT.

A new major programme for cross-border cooperation in academic studies between Finland and Russia is the Finnish-Russian Cross-Border University (CBU) coordinated by the UoJ. The CBU is a partnership between five Finnish and four Russian universities. In the pilot phase, these universities have offered Master’s degree programmes in six fields of study ranging from business to public health.

In 2010, the UoJ will merge with the University of Kuopio to form a new multi-campus University of Eastern Finland (UEF). This opens up new opportunities to widen our expertise to health sciences, medicine and social work; which all seem to be critical for solving the current social problems in Russian society and border areas in particular.

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The January 2009 Russia-Ukraine crisis and the imperative of bypass pipelines

By Jonathan Stern

January 2009 Russia-Ukraine gas crisis was a seminal event in European gas and energy security history. It marked the end of 40 years of reliable supply of Russian gas to Europe. For a number of reasons – commercial, political and technical - it called into question whether the Russia-Ukraine gas corridor can henceforth be regarded as reliable. Fingerprinting and accusations of blame for this event should not be allowed to obscure the inescapable fact that, for the first three weeks of January 2009, Russian-Ukrainian bilateral relations suffered a catastrophic breakdown, and for two of those weeks Europe failed to receive around 20% of its gas supplies. There is no guarantee that these events will not be repeated.

Those who hold Russia principally responsible for this event will see no remedy other than phasing out European dependence on that country's gas supplies. But given long term contracts with European utility companies stretching out as long as 25 years in the future, and the lack of any immediate (gas or other energy) supplies to replace, even a fraction of those currently supplied by Russia, this is an impractical proposition in anything other than the very long term. Those who believe that the principal problem lay – and continues to lie – in Ukraine and in the Russian-Ukrainian bilateral relationship, may conclude that there are only two options:

- The creation of a consortium of European, Russian and Ukrainian companies which would own and operate the Ukrainian transit network;
- new pipelines from Russia to Europe bypassing Ukraine.

Time for discussion has largely run out. January 2009 abundantly demonstrated was that European institutions – whether the European Commission and its presidency, the Energy Charter Treaty or European gas companies - have no significant leverage over either Russia and Ukraine to resolve a bilateral energy dispute and this is not their responsibility; the same cannot be said of EU energy security crises. For as long as Ukraine refuses to implement a transit consortium, bypass pipelines remain as the only medium term solution.

The Nord Stream and South Stream pipelines have been discussed for some years with both projects having encountered opposition. Opposition to Nord Stream among Baltic countries is well known and has succeeded in delaying the progress of that pipeline. Conspiracy theorists have even suggested that the January 2009 crisis was staged by Russia to rally European Union support for Nord Stream. Without entering into such speculation, it is important to observe that had two Nord Stream and a South Stream pipeline been in operation on January 1, the impact of the dispute would have been reduced to minor inconvenience for the vast majority of European consumers. It is European – and particularly south east European - consumers who suffered severe humanitarian consequences from lack of gas supplies, to whom concern should be directed.

Economic objections to Nord Stream and South Stream can be quickly dispensed with. These projects will of course be much more expensive than new pipelines carrying similar volumes of gas via existing or new land-based routes, but this is largely irrelevant as long as finance can be raised by the commercial partners in these projects. Those who continue to insist that new pipelines should be land-based are unconsciously or wilfully missing the point: the problem

as seen from Moscow is the unreliability of transit countries; Russian export strategy is aimed at eliminating transit countries to the maximum possible extent. While Moscow's position may be considered mistaken, or its own fault, it is a policy which can only have been reinforced by the January 2009 events. Those who further assert that this is "Russia's problem" to solve are also missing a key point: Gazprom is prepared to provide highly expensive alternative pipelines to guarantee European gas security at its own (and its partners) expense. If European Union countries wilfully delay or prevent such pipelines from being built, then the consequences could be seen to be Europe's – just as much as Russia's – responsibility.

Other objections to Nord Stream and South Stream pipelines range from environmental opposition, to accusations that the pipelines will allow Russia to conduct espionage operations against the littoral states, or to isolate individual European countries to make the latter more amenable to political pressure. The resistance of (particularly) Baltic countries, and the political nervousness of all former Soviet states and Warsaw Pact/Comecon member-countries, to any Russian initiative which might seem to place them at an economic and political disadvantage to Russia, is completely understandable. With the Soviet and Cold War eras still fresh in many minds, these countries have no reason to do Russia any favours, and much reason to be suspicious of its motives. However, the world has changed. While nobody is expected to forget history, all of us need to move on. NATO and EU membership have – or certainly should have - provided protection from fears of military and/or economic hostilities.

Governments which retain suspicions about adverse consequences of dependence on Russian gas supplies should extricate their companies from long term contracts with Gazprom, and arrange for alternative gas or energy supplies. Despite continual discussion of these options in a range of European countries, actual results have been extremely modest. This is not a criticism, but an observation that, for the majority of these countries, to replace even a part of Russian gas supplies – either with alternative gas (and LNG) supplies or with nuclear or coal-fired power stations - will be both extremely costly and require at least 5-10 years to achieve. Decisions now need to be taken, but should be taken by national governments about the energy future of *their own countries*, not by governments on behalf of others.

The January 2009 events mean that Nord Stream has ceased to be a "Baltic issue" allowing regional countries a license to delay the pipeline, just as South Stream is not a "Black Sea" issue giving countries such as Ukraine a similar license. These pipelines have become pan-European gas security issues. Individual European governments have the right to refuse to take gas from these pipelines; but they should not prevent others from doing so.

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Forum of gas exporters – design

By Leonid Grigoriev

Gas Exporting Countries Forum (GECF) has been finalized legally by ministerial meeting in Moscow on December 23, 2008. GECF includes main (not all) gas exporters: Algeria, Bolivia, Venezuela, Egypt, Iran, Qatar, Libya, Nigeria, Trinidad and Tobago, Equatorial Guinea, Russia, with Norway (observer) and Kazakhstan (guest). The very idea of creating the special non-governmental organization for natural gas producers is going back to 2001 when it was announced. Producers of natural gas obviously are interested in the exchange and sharing of information about market trends and principles of international pricing rules. Some of these issues were discussed at the meeting of High level in Caracas (Venezuela) on 8-9 of October, 2008.

Extensive media coverage was focused on some statements of some Iranian officials, Russian non-officials, and American and European commentators: is it "Gas OPEC" or not. We argue that GECF has designed as "IEA of exporters – not OPEC". We would suggest distinguishing between the reality of gas industry world and media reaction, sometimes going a too long way to "cartel paranoia".

First limitation on gas cartel is the fact, that it is still not a single global gas market – North America, Pacific and Europe have different system (pipes and LNG mix) and geographical sources of supplies. Supplies are mostly based long term contracts, LNG or pipes regardless. That is a major difference to the oil market. As people in the gas industries say: "nobody produces unsold gas". That reflects the size of the projects – biggest projects in oil are small projects by the gas industry scales. Financial risks are too high and cost recovery periods are too long to gamble on spot prices at the start of the investment cycle. LNG share is growing (10-15% by now), what may create more footing for the output manipulation – "Oil Style".

As soon as the gas infrastructure has been built, the spot pricing is coming into picture. Graph 1 reflects the similar fluctuations in the market with the expected steep decline in 2009. Long-term European contracts were invented in Europe with price formula, based on oil spot prices. This is the major safeguard against the gas cartel in the EU markets since all physical volumes and prices are essentially predetermined for the next 30 years. This feature should be taken into account while discussing the future of gas pricing system. Long-term contracts on net-back formula look rather a fashion of the day. Oil spot pricing gave us for sure the long swings in prices (\$8 - \$145 - \$35 in one decade) and investments, but had not prevented forming the oil cartel.

For mentioned above reasons GECF cannot become the "gas OPEC", regardless what proponents or opponents may say at the outset. In the long run the abolishing the long-term contracts and the domination of LNG on the global market might create the ground for

gas cartel. From our prospective some stability of prices may be helpful for the long-term investments in the global oil&gas industry, especially considering the Energy Saving and Climate Change prevention objectives. IEA was designed for OECD (consumers) countries to understand the global energy markets and to adjust its policies accordingly.

Design of the Gas Forum more resembles the International Energy Agency with the focus on the market analysis and forecasting. There are no quotas or voting procedures for setting output level or price targeting. Critiques of GECF were mentioning investment decisions, but it does not take any organizations for companies to understand the future risks. It is more symbolic than practical issue – gas exporters probably would never be pitched against each other in the blind competition for the sake of creating "consumers' market". Long term investment decisions are determined by price expectations and costs (currently at \$60 minimum for "new oil") and national decisions. For example, Qatar's Government had long ago decided to limit its investment program in LNG by 2010.

By statements of participants at the meeting Moscow in December countries decided on the setting the Head-quarters in Doha (Qatar) – Saint-Petersburg lost the voting - and on the coordination in four areas:

- Relations with countries - gas consumers;
- Exchange of information on forecasts and investments;
- New technologies;
- Cooperation in LNG production.

Gas Forum may give to gas producing countries better understanding of the future gas demand, technologies, legal regimes etc. It may become a partner to the IEA and other agencies in the developing global energy vision for the 21 century.

Leonid Grigoriev

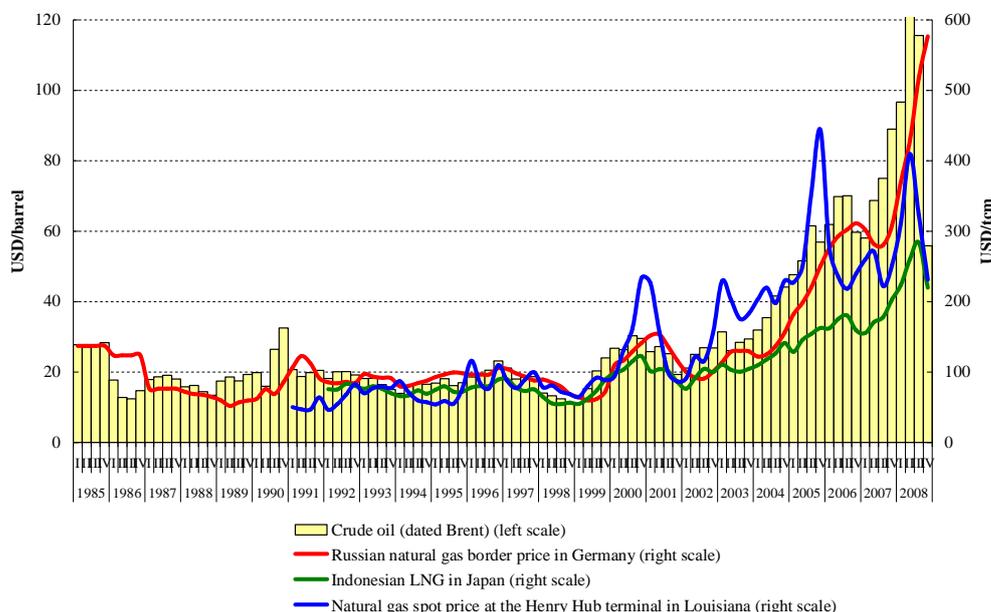
President

Institute for Energy and Finance,
Moscow

Russia



Graph 1. Oil and natural gas prices on main markets, USD/tcm, 1984-2008, annual averages.



Source: IMF

Ukraine's energy lesson to the EU

By Kari Liuhto

The EU's gas reserves are non-existent; around 2% of the global reserves. Despite such a tiny reserve base, gas is a strategic commodity for the EU. Approximately 20-25% of the primary energy consumption of the European Union is covered using natural gas.

The Union's own production takes care of 43% of its natural gas consumption, but the share of the Union's own production is to dive sharply. In two decades from now, the EU will be able to meet only 15% of its natural gas needs, meaning that 85% of the Union's natural gas consumption is soon to be imported.

Russia is by far the EU's main external supplier of natural gas. It accounts for 24% of the gas consumption of the EU27. Norway comes second with 13% and Algeria with 11%. The remaining nine per cent of the EU's current gas consumption is supplied by several countries, mainly by Nigeria, Libya, and Qatar. The natural gas reserves of Norway and Algeria are modest compared to those of Russia. Norway and Algeria together hold less than 5% of the world's natural gas, whereas Russia's stake is 25%, and therefore, Russia has the potential to increase its stake in the EU's gas consumption in the future.

The recent gas dispute between Russia and Ukraine has brought the issue of the reliability of an external gas supply back to the European headlines again. Norway, due to its European values and strong democratic traditions can be considered to be a reliable natural gas provider to the EU, but Algeria's political situation already raises certain doubts. When one evaluates Russia's capability to increase its gas exports, one should not forget that Russia's own gas production declines because the colossal West Siberian fields are depleting and Russia's own gas appetite will begin to grow when its economy has recovered from the current crisis.

One should not forget that Russia is an extremely gas thirsty economy. Close to 60% of the country's primary energy consumption is catered for by gas. Russia should carry out a major energy reform before it can reliably meet the needs of both Russian industries and households and their European counterparts in the future.

When we estimate Russia's capability to deliver gas to the EU, we should remember that the new giant gas fields are far-away and are located in a harsh arctic environment, and therefore, investments climb exceptionally high. For instance, the opening of the Stokhman gas field in the Barents Sea is unfeasible, until oil prices go above \$50-60 per barrel. Presently, the barrel price stands at around \$40 and energy companies are reluctant to invest mammoth amounts of capital in very risky projects. The EU should acknowledge that the opening of the new giant gas fields in Russia will be delayed by several years, even if the global recession will be shorter than is generally expected.

Russia's leadership has stressed that the era of cheap gas prices has come to an end due to major investments required by the new arctic fields. This has been one of the reasons, why the Russian leaders have underlined the importance of freeing the natural gas price from the oil price, which has lately developed very unfavourably for producers. The attempt to strengthen the Gas Exporting Countries Forum, founded in 2001, can be considered as an attempt to destroy the correlation between oil and gas pricing, and hence, an attempt to increase natural gas prices. Even if it is not easy to create a functioning market for natural gas, since gas is mainly transported via pipelines and the gas agreements are usually long-term, the plan to formalise the Forum should finally open the eyes of the decision-makers in the EU member states. The Russian leaders would not spend a considerable amount of

time in strengthening the Forum, unless they consider that it could become a practical tool in increasing natural gas prices. The current gas dispute between Russia and Ukraine could have been predicted long before the issue jumped into the news headlines, since Russia has to justify the need for new gas pipelines, namely Nord Stream and South Stream, bypassing Ukraine. The justification of the new pipelines is achieved by destroying Ukraine's reputation as a credible gas transit country. If Gazprom would truly have been interested in securing the supply for its EU consumers, it would have started negotiations much earlier. Russia's Blue Gold has become the EU's Blue Cold.

The lesson to be learned! Russia's short term goal is to get rid of the transit countries and by reducing the importance of the transit, to force the transit countries into its sphere of interest. This time the operation is not executed with soldiers and tanks, but now the conquest is accomplished by using pipelines and banks, which finance the acquisition of major energy assets in the transit countries. With pipes bypassing Ukraine, Russia wants to close Ukraine's path towards the EU and NATO in particular, and ultimately strengthen its own negotiating power over the Sevastopol military base. The Russian Black Sea Fleet is to leave the base in 2017, if the agreement is not renewed. Moreover, Russia's long term goal is to increase its political leverage towards the EU, particularly towards its biggest members. In order to increase the energy dependence of big member states further, Russia offers those states attractive stakes in major hydrocarbon fields.

The interdependence between the EU and Russia is not sustainable, since the Union becomes more dependent on Russia's energy deliveries than Russia on the European energy market. If the EU follows its current path, the Union becomes, day by day, more addicted to Russian gas. The energy interdependency between the EU and Russia is comparable to a relationship between a heroin dealer and a heroin user. Both of them need each other but at the end of the day the heroin addict becomes more dependent, as long as no alternative is available for the user. In order to create an alternative, the EU should invest in energy savings programs, introduce energy solidarity between the member states and invest more in its own energy production, particularly in nuclear production, i.e. the EU should create an energy policy for itself.

Russia can survive several months without the financial inflows generated by gas exports to the EU, but can European households and industries survive a gas blockade, especially if it happens in the wintertime? This fresh dispute indicates that some countries cannot even survive days, not to mention months of non-supply. The EU countries' energy emergency storages are inadequate to balance their overdependence on increasing energy imports. The Union's overdependence on Russia may turn Nord Stream and South Stream, originally intended to strengthen stability and peace between the EU and Russia, into a political crisis and major conflict. Daydreams might become a nightmare for both the EU citizens and the Russians.

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Living up to our promises – fostering a sustainable Baltic Sea Region

By Mia Crawford and Risto Veivo

For more than 10 years our neighbourhood of the world, the Baltic Sea Region, has had a clear vision of turning the principles of sustainable development into practice. For a decade we have had the strongest commitment by the Heads of Government in all the countries around the Baltic Sea to tackle environmental degradation and socio-economic inequalities and foster sustainable solutions and best practices. For 10 years, Baltic 21 has contributed to advancing sustainable development in the region by coordinating goals and activities, and by servicing as a forum for cooperation across borders and between stakeholders.

However, despite this commitment the overall development of the region is still far from sustainable and many alarming trends point to the opposite direction. The consumption and production patterns of the region are highly unsustainable. The state of the environment of the Baltic Sea is getting worse due partly to eutrophication, overfishing and extensive marine transport. The biodiversity is decreasing both on land and at sea, and socio-economic inequality is a daily reality for far too many. Energy use is at peak levels, while regional car density is increasing. Currently, transport is the most dominant sector in terms of both energy demand and CO₂ emissions in Europe. The key challenge for the success of Baltic Sea regional co-operation and for the development of the whole region is how to turn these negative trends – how to move from declarations to real practise.

Moving from words to actions requires a solid (political) commitment and allocation of necessary resources. On the technical level, the solution lies in the implementation of concerted actions involving different levels of governance and civil society, as well as co-operation across administrative and economic sectors and borders. In order to contribute to the solution, Baltic 21 has promoted Baltic Sea regional Lighthouse projects to demonstrate sustainable development in practice. During the last two years, Baltic 21 has facilitated the development of strategic projects under specific themes. These projects show-case how sustainability can be advanced effectively and concrete results achieved.

In the beginning of 2009, Baltic 21 launched four new projects, addressing topics such as mobilising the bio-energy potential of the region, promoting innovations for sustainable production, balancing urban and rural development, speeding up local and sub-regional sustainability processes. Co-funded mainly by the EU Baltic Sea Region Programme 2007-2013, these new projects have mobilised 80 partners in the region, including ministries, other national authorities and agencies, funding institutions, NGOs, regions and cities, expert organizations, universities and public companies. The project funding of 15 Million Euros is still very modest considering the challenges and potential resources of the region. However, these projects will play a role as catalysts, leading to new solutions, practices and policies, and thereby potentially mobilizing much larger resources and action for change. Project implementation will continue until 2011/2012, and is lead by different Baltic 21 members, representing the multi-stakeholder approach of Baltic 21.

In addition, The HELCOM Baltic Sea Action Plan, adopted in 2007, is soon to be accompanied by national implementation plans. This Plan is the cornerstone and roadmap for the efforts of the region to improve the

environment of its most important shared resource, namely the Sea. Moreover, the Council of Baltic Sea States has identified sustainability as one of its long-term objectives. The European Commission is currently developing the EU Strategy for the Baltic Sea Region, and environment and sustainable development have from the onset been identified as one of its main objectives. The envisaged Strategy will be accompanied with an indicative action plan of some key actions that will, if implemented, contribute to steering the region in a direction towards an environmentally friendly, prosperous, accessible and attractive, as well as safer and more secure place.

Catalysts like the projects of Baltic 21 and others are certainly helpful in showing the ways forward. Solutions on the technical/methodological level need to be developed and demonstrated, and this is best done in multi-stakeholder co-operation such as in the case of Baltic 21. Still, such actions alone do not constitute a sufficient Baltic Sea regional response to the challenges faced. The existing political commitment needs to be strengthened and accompanied by allocation of stronger resources for implementation. In parallel with great economic challenges, the global community is facing an ever-growing challenge of sustaining the livelihood of our planet.

Across the lands and oceans, far and near, people of the world are demanding change. Real change in terms of ensuring prosperous economies, healthy societies and dynamic ecosystems. Baltic Sea Region has repeatedly declared its commitment to sustainability and global responsibility. Indeed, sustainable development needs to be further strengthened as a priority focus for the full range of our collaboration initiatives. Words on papers must be accompanied by real action – action that brings concrete results and initiates change. We must face the odds and turn the trends. Baltic 21's multi-stakeholder network is well-positioned, prepared and willing to contribute to solving the challenges on our path to realizing the shared goal of sustainability.

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GAS-OPEC – cooperation or confrontation?

By Chris Weafer

Russia, Qatar and Iran formally inaugurated a new gas exporters forum in Moscow last December. The intention is to expand its membership to include all of the world's major gas export countries and to establish a permanent secretariat with a fulltime Secretary General. If this fledgling structure does succeed in bringing together the world's major gas producers, and in establishing some common goals, then it may become a catalyst for a substantial increase in upstream gas production, in transport infrastructure and, in particular, the development of LNG to be a more important global energy source. Not only is that environmentally preferable to other energy alternatives, there is also sufficient available supply to achieve the critical mass required. An increased supply of gas globally, especially in the form of portable LNG, would improve energy security rather than place it at risk.

Moscow views this forum as a mechanism to help it advance its goals of attracting more investment funds into its gas industry to substantially increase production volumes over the next two decades and also establishing Gazprom as a major global force in the LNG business. Yes, it would also increase Russia's importance as an energy partner to both western and eastern consumers, but counter balancing this is the fact that, if LNG was more widely available and used in Europe this past January, then the fears over the disruption of the gas flows via Ukraine would have been substantially lessened.

It is also important to focus on why the Kremlin wants to promote gas as a more important factor in global energy, with Gazprom having a central role. It is not the Kremlin's objective to have greater control over energy supplies so as to leverage for political gains or to hold consumer economies hostage. That has never been the case since gas first started flowing from the former Soviet Union and it is not now. Energy, especially gas, is Russia's competitive advantage. It has a lot of it and is well placed between east and west to efficiently export it. The current government has made very clear its long-term ambition to create a more diversified economy in Russia with a higher level of global integration. Bartering energy for increased trade and to increase investment access to the rest of the world is a key part of that strategy.

The mistake that consumer countries made with OPEC was that they viewed it initially as irrelevant, and later as a threat, rather than as a partner. The legacy of that today is that there is relatively little coordination between OPEC and the I.E.A. and that is a big part of the reason for price volatility and supply uncertainties. Consumer countries should not make that mistake with this gas exporters group. By engaging with Russia and its partners in the new gas forum from the outset, including sharing costs and being involved in planning, then a higher level of energy security can be better assured.

If Russia is able to start realizing its long term economic goals, greater global integration would allow the country develop a more stable economic model faster and that would also help the country's social structure develop. The middle class segment today represents only about one-fifth of the population rather than the 60% level typical in developed economies. Greater economic integration would also make the country much more dependent on the countries to which it exports energy. In the recent dispute with Ukraine, Europe had arguably more at stake than Russia. That is because the EU depends on energy imports from Russia to a much greater extent than Russia depends on non-energy trade the other way. There would have been a much different dynamic in that dispute had Moscow more at stake over the short-term.

When Russia first put forward the idea of a more formal gas exporters forum to that set up by Qatar in 2001, western politicians immediately either dismissed it as impractical or viewed it as a threat. Russia's role was particularly viewed with suspicion and has become a focal point of the criticism. That is partly because of the 2006 and 2009 disputes with Ukraine but also because of the history of, e.g. YUKOS and Sakhalin-2. No

doubt, the Kremlin has not done itself any favours with the way that it has gone about restructuring the ownership of assets in the industries it deems strategic. It viewed structures, such as Sakhalin-2, as having been concluded during a period when the country's government was weak and the deal unfairly biased against the state's interest. The legislation governing the future involvement of foreign investors in the country's most important industries, including gas, was put in place in May of last year. The new "rules of the game" are now a lot clearer. International energy companies understand that – Total, StatoilHydro, ENI, BASF and E.ON have been amongst those making deals since – but politicians in many western consumer countries still do not, or choose not to.

To develop the countries considerable gas resources and especially to establish LNG as a bigger portion of the global energy pool will require hundreds of billions of dollars in investment. Russia cannot afford to fund that on its own and nor does it want to. The gas exporters forum will provide a mechanism for creating joint development projects and for greater coordination to ensure that projects are commercial and relevant. Including both gas forum partners alongside industry investors in production projects located in Sakhalin, the Arctic and Yamal Peninsula, plus proposed new LNG plants on the Baltic Coast and Murmansk, will ensure that these can proceed at a faster pace than if Russia was left alone to develop them. That makes a lot of sense not only to the Kremlin but for consumer countries also. That's why the EU, in particular, and other energy importers needs to have a close involvement with the new structure.

Europe currently imports approximately 400 billion cu meters (bcm) annually and 40% of that comes from Russia. 80% of Russia's gas flow to Europe passes through the Ukraine pipeline. By 2020 it is estimated that Europe will need to import approximately 600 bcm of gas because of the growth in demand plus the forecast decline in the region's own production. At least half of that incremental demand will have to be sourced from Russia. The two phases of the planned Nord Stream pipeline are forecast to have a total capacity of 55 bcm while the South Stream pipeline is planned with a capacity of 30 bcm. To fill these pipes, to provide gas to the planned LNG plants and to replace the expected decline in production from Gazprom's existing, aging fields, Russia will need to spend at least \$500 bln to develop new gas fields. Many of these deposits are located in deep water Arctic or off the Pacific Coast and will also require both new technologies and techniques. Russia cannot make this work on its own. It needs the involvement of international energy companies and partnership with other gas producer countries. In exchange Russia will increase investment in production, and help develop export routes, with other gas producing countries. But, with such a huge investment required, Russia and its partners in the new gas forum will also require more assurance on demand. Otherwise we will likely see delays, poor coordination and, ultimately, more supply fears. In a world where energy demand is rising and energy security is the new mantra, it makes a lot of sense for that greater coordination between the consumer nations and those with gas resources.

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Russia

Russia and the European Union – partners in energy cooperation or rivals in “Great Game” confrontation?

By Hanna Smith

The relationship between Russia and the European Union has never been an easy one to analyse. It seems that it is a topic which can never be sufficiently researched. It is an oversimplification to describe the relationship as a good one or a bad one. Perhaps a more appropriate way of describing it would be to compare it to a rollercoaster ride, with some frightening descents, difficult uphill climbs, thrilling loops and steady bends where it is possible to take a breath and enjoy a feeling of relief after surviving a shaky ride. At present Russia-EU relations are yet again resembling a section where there is a scary fall. There are many factors behind this downhill ride, but one factor that plays a serious part in the present increasingly tense situation, possibly in an altogether new way, is the complex issues and competing views over questions related to energy. Headlines like “When Russia turned off the gas to Ukraine, it sent shivers across Europe where customers are increasingly dependent on Russia to keep warm”, are well known to most EU citizens. This report from the BBC in fact relates to the 2006 gas crisis but could just as easily have come from this year’s dispute.

Energy resources bring significant benefits to the Russian state budget. Russia needs to export energy but it also benefits from being able to use its own energy resources for domestic consumption. Russia is an energy resource-consuming country. The EU is an energy importer and many EU member countries are very dependent on Russian gas. The statistics are well known but do very little to help us understand why Russia-EU relations are so fraught in relation to the energy question. Statistics in fact tell us that both Russia and the EU need each other, and that there should be a clear picture of interdependence. Interdependence in international relations encourages cooperation and win-win thinking, but so far there is little evidence that this principle is working in EU-Russia energy relations.

Russian energy policy reached a clear watershed in 2003 with the YUKOS case. Energy became a strategic asset for Russia and therefore state involvement grew and took over the way business regarding energy was dealt with in Russia. This approach was tightly linked with Russia’s determination to achieve Great Power status, the guiding ideological principle of Russian foreign policy. The state’s goal was to help Russian companies attain prominent positions in the world’s top league, while preventing foreign takeovers of Russian energy companies, resources and transport routes. Russia’s role as an energy power started to emerge strongly in 2005. The first incident to cast doubt over Russian motives and intentions in Russia’s energy policy towards the EU was the deal concluded between Russia and Germany on the Northern European gas pipeline in autumn 2005. In the Baltic states and Poland the deal was condemned as a “new Molotov-Rippentrop pact”. On the Russian side, however, the energy minister Viktor Khristenko saw the deal as representing a real option for diversifying supplies of Russian gas. “We need to examine these kinds of schemes for transport across reliable transit territories or through extra-territorial zones for the future” he said in a February 2006 interview with Russia Profile. Russian energy policy did not only include plans for the diversification of supply routes but also sought to abolish energy subsidies to the former Soviet states, at least from those that were openly proclaiming pro-Western policies

and criticizing Russia or otherwise being uncooperative towards Moscow. These countries were Ukraine, Georgia and Belarus. All of them went through disputes in the energy sector with Russia between 2005-2009. Ukraine and Belarus twice experienced disruptions either in gas or oil supplies and Georgia has had problems with both electricity and gas. Some problems have also been experienced in the Baltic states and Poland after they took up membership of the EU.

From the EU side all this represents a very worrying trend. If Russia is capable of using energy shutdowns as a form of negotiating tactic with former Soviet states and in some cases further afield, why should it not hit the EU directly in the end? On the one hand the EU has so far only been affected indirectly since, for example, the gas dispute between Russia and Ukraine in early 2009 was mainly just that - a dispute between Russia and Ukraine. On the other hand the EU is directly involved since it is the biggest market for Russian gas and without the EU’s involvement Ukraine would not hold a strong hand in negotiations with Russia once the gas is turned off. The only way for Ukraine to achieve a stronger position is to make sure no Russian gas reaches the EU countries as long as Russia is not supplying gas to Ukraine. Although Ukraine herself lost a certain amount of credibility through this episode, cutting off the transit of gas to the EU was the only effective way of mobilizing the EU to intervene in finding a solution to the crisis.

Since Russia declared an energy policy safeguarding its national resources from foreign ownership as well as making clear its desire to control all the transit routes and buy into downstream operations itself, the EU has been looking for diversification of energy supplies, has been trying to unite its energy policy and has planned different transit routes bypassing Russia and/or Ukraine. This has created a situation where two parties who naturally depend on each other with good perspectives for cooperation have turned into competing entities with increased suspicion on both sides.

The situation where there are competing projects - Russia has the South Stream (crossing the Black Sea to Bulgaria) and Nord Stream (going under the Baltic Sea to Germany) plans and the EU has its eyes on the Transcaspien (between Turkmenistan and Azerbaijan) and Nabucco (linking existing pipelines in Turkey through to Austria) pipelines - resembles the Great Game between Russia and Britain in the 19th century: instead of being over who controls which territories, it is about who controls which pipelines. All the planned projects still face significant challenges. The only thing that would make real sense is for Russia, Ukraine and the EU to cooperate on different pipelines. Exploring alternative routes so that the EU is not entirely dependant on gas passing through Ukraine makes some sense, but doing so in a climate of recrimination and great power competition which threatens to cut Ukraine out altogether may prove costly. 80% of Russian gas used in the EU comes through Ukraine, which provides the most direct route. Devoting diplomatic energies and financial resources towards Ukraine would be more effective than constructing expensive and complicated new pipelines. With proper investments into the existing pipeline systems and different monitoring systems as well as greater EU-Russia cooperation over Ukraine, the question of EU energy security would be

solved much faster than competing with Russia over different pipeline routes. Constructive dialogue and imaginative thinking over ownership, monitoring, and the source of transit fees, would mean preserving existing supply routes at the same time as exploring others. As Andrew Monaghan from the NATO Defense College in Rome put it "We shouldn't just move away from Russia without knowing where we are going. If we just exchange Ukraine for Turkey, we will still have all our eggs in one basket." Proceeding by strengthening the existing pipelines might leave money over for research on alternative energy sources. The fact remains that Russia is highly dependent on the EU market (note that all Russian plans end up leading to the EU) and Russia does for some years to come at least have what the EU wants and needs. The 19th century Great Game did cause unnecessary wars and suffering and in the end both empires vanished. History should not repeat itself but teach us a lesson. Russia is less of a threat over the negotiating table than in open confrontation.

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South Stream planning started in June 2007: the 900 kilometre (560 mile) long offshore section of South Stream would start from the Beregovaya compressor station at Russia's Black Sea, and would run to Bulgaria's Varna. From Varna, the south-western route would continue through Greece and the Ionian Sea to southern Italy. The north-western pipeline will run through Serbia and Hungary to Austria ending at the Baumgarten gas storage. Russia has signed agreements with Italy, Greece, Serbia, Bulgaria and Hungary. There are however many questions still open. Nord Stream: The deal between Russia and Germany was signed in September 2005. The route is from Vyborg, Russia to Greifswald, Germany. Nabucco: The pipeline will run from Erzurum in Turkey to Baumgarten an der March in Austria. It will be connected near Erzurum with the Tabriz-Erzurum pipeline, and with the South Caucasus Pipeline connecting the Nabucco Pipeline with the planned Trans-Caspian Gas Pipeline. The project is included in the EU Trans-European energy network programme. Trans-Caspian Gas pipeline: The Trans-Caspian Gas Pipeline is a proposed sub-marine pipeline between Türkmenbaşy in Turkmenistan, and Baku in Azerbaijan. According to some proposals it will also include a connection between the Tengiz Field in Kazakhstan and Türkmenbaşy. In this project Iran is in a key position. Before the project can go forward the status of the Caspian Sea needs to be agreed upon.

EU – Russia – the Baltic angle

By Raivo Vare

There are several reasons for the relationship between the European Union and Russia to stay at the top of the agenda. Most importantly, the Russian Federation remains the biggest trading partner and the key energy supplier for the EU, as the considerable Russian economy is a natural target market for European businesses and at the same time the EU is becoming more and more addicted to Russian energy supplies. This codependent relationship is further stressed through the geopolitical situation where Russia is the EU's largest neighbour and the only considerably influential non-EU power in Europe. This leaves no other option than for the two leading players to manage their overlapping spheres of interest – where the Baltic States are faced with being caught in the middle of these two powerhouses.

The bilateral relations between the EU and Russia were supposedly based on a „strategic partnership”, as stressed by both parties during their disputes over common interests and the existence of „shared values”. It has become more obvious in the light of recent events that the balance has shifted from values to just interests, as there aren't, in fact, many values to be shared between a western democracy and a home-made Russian „sovereign democracy”. Therefore the relationship between Moscow and Brussels has hardly ever been the kind one would find between real friends or partners. Instead there have been several examples of constant mutual distrust and frustration both between the EU and Russia and, even more intensively, between the Baltic countries and Russia. Most recently this was evident, for example, in the different positions towards the war in Georgia and its outcome, the Ukrainian situation and the „Bronze Soldier” crisis in Estonia. While many leading continental countries have rather relaxed and flexible attitudes prevailing in their Eastern politics, constant irritations still remain a key element in Baltic-Russian relations.

The European Union is a soft power, while Russia prefers the no-gloves hard-tackle policy, preferring to focus on geo-strategic issues rather than economics, because it holds the second largest stockpile of nuclear weapons in the world, but not sufficient worldwide economic influence as the 8th largest economy in the world (predictably dropping to 13th or 14th position after the 2009 crisis). Russian policy-making style is leadership-driven, interest-based and hard-nosed – a stark contrast to the EU's policy-making through compromises and committees, which the Russians see as evidence of inefficiency. On the other hand, the Russians have mastered the use of this inefficiency and consensus-building practice dominant in European foreign policy and economical cooperation to push through their own interests through bilateral special agreements and well-stimulated personal engagements.

It may be difficult for „Old Europeans” to fathom Russia's true needs and the real drivers behind its interests. But Baltic nations do understand from their own first-hand experiences that it is not always business that comes first in the East. Therefore they are trying to balance the European pragmatic business-driven approach towards Russia. However their historical background makes them highly cautious of the real motivation of their powerful neighbour and its ability to trade off both political and economical interests with other key players. This results in the Baltic countries suspecting an intrigue behind all sizeable bilateral projects with Russia and thus bringing some emotionally justified skepticism into traditionally pragmatic European approaches, which is certainly disturbing the accord in the Eastern policies of the EU.

Undoubtedly it is in the European Union's security interests to have stable, prosperous and democratic neighbours. The „Old Europe” is relying primarily on the soft power of economics to produce security, while countries of the

„New Europe”, especially the Baltic States, with their historical experience and respective complexes and reflexes tend to rely more on NATO.

Although it is obvious that autocratic „sovereign democracy” has finally prevailed in Moscow, the European Union is still continuously attempting to positively engage Russia. This time not through common values, but increasingly through mutual interests as they are understood in the capital cities and corporate headquarters of the „Old Europe”, based on hope that security is best protected by economical codependency, of which the European Union itself is the living proof. Russia has now turned to voicing its support for these arguments, even though based on its different perception of the term „economic security”.

The Russian government has not requested any policy advice or financial assistance from the EU or any other country or organization, at least not until the recent crisis. Russia sees its relationship with the EU just as a tool to strengthen its domestic economy through trade and technology and, to some extent, through investments. The West and the EU in particular have been considered by Russia merely as a „modernisation resource” and an object of its different interests. This is quite bluntly the essence of the present Russian supportive agenda of economical and energy-related interdependency between Russia and the West.

A significant breakthrough in full spectrum of aspects, not merely economical, of the relations between the EU and Russia, including Russian-Baltic relations, should not be expected as long as Russian politics continue to dominate its economics. The current state of Russian-Baltic relations can be described as relative progress, which could develop further due to the impact of the current global economic crisis and current political agenda, but this development wouldn't be too obvious. Russia hopes to impose the sphere of influence in the former Soviet courtyard, using often economic instruments as political tools, for example by turning energy supplies into political instruments, instead of nuclear policy, to pursue its political goals.

The relationship between Russia and the EU and particularly the Baltic countries will remain strained in the future as well, as Russia is not perceived in Europe as Russia identifies itself. Due to its increasing desire for greatness and might, Russia continuously positions itself as a great power-centre and not as a society, leading Russia to pursue rather hegemonic „realpolitik”.

The Baltic angle towards EU-Russian policies is driven by answers to following questions. Whether to put everything in perspective through a security prism or not? Do the Baltic specifics form a part of an united EU approach or are simply overlooked? Would it be reasonable to expect a „win-win” situation in dealings with Russia, as only coordinated approach will stand a chance of success, whereas separate policies will not? The challenge will be to deal with eastern neighbour jointly, requiring in-depth knowledge and understanding of the partner and a lot of wisdom.

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Plus ça Change – infrastructure & energy transit to Europe

By David Dusseault

Delivering the post-mortem

Following the latest manifestation of the gas transit row between Russian and Ukraine last month, many observers and analysts alike have predicted a boom in the business of constructing alternative pipelines as a direct result of both the EU's and Russia's knotty relations with the transit states. Despite the presence of immense common economic and political interests on all sides, a "go-it-alone" strategy is developing among consumer, transit and producing states, which would serve only to enhance the growing cacophony that is today's European energy sector.

Hubris, great intentions, and the road to energy insecurity

It has been reported with surety that Russia vs. Ukraine Part II was precipitated by steep declines in world hydrocarbon prices brought on by Wall Street's financial meltdown. However, besides the usual suspects of global economic malaise, the political and economic dimensions of the resource curse, and the Putin bogymen, substantial structural shifts that occurred back in the early 1990s are the predominant precursors to contemporary policy dissonance.

Europe's initial wake-up call to these structural changes came in early 2006. The first major gas row between Russia and Ukraine was not solely profit-driven. With control over the remnants of the defunct Soviet energy system in flux, a struggle ensued over who pays and who profits from Russian / Turkmen gas flowing through Ukrainian pipelines to European consumers. It is evident that the institutional collapse of the USSR not only created new states, but fractured a unified system of interests based on and infrastructure for the exploration, extraction, processing, transit and distribution of hydrocarbons upon which Europe's consumers were tacitly reliant.

Apart from the institutional adaptations that took place upstream, the EU had its own understanding of the transforming policy environment downstream. Decoupling various components of the distribution and retail sector was seen as politically and economically sound, in that competitive markets made happy European consumers. As long as world prices for oil, natural gas and electricity remained low, the ability to set the energy agenda rested with European consumer states. Consequentially the EU could afford to rely on the market to regulate the energy trade.

However, Europe's liberalisation of its internal energy markets continued under conditions of increasing commodity prices worldwide. Unwittingly the EU liberalisation policy ceded more financial and agenda-setting control upstream to producers such as Russia and Turkmenistan. Simultaneously, the transit states Ukraine, and to a lesser extent Belarus, Georgia and Moldova became wildcards.

For Ukraine, its bickering political elite cannot achieve institutional consensus in order to deal with policy priorities such as energy market deregulation, its flagging economy, the high rate of domestic energy intensity, or its obligations as a trade link between Russia and the EU. In sum, during last month's gas pricing row with Russia, unintended consequences and structural incentives have contributed to Ukraine's proclivity to pressure both the upstream and downstream actors in the pursuit of the domestic elite's short-term political interests.

Pipedreams: et-tu Nordstream?

For all the preliminary bad press Nord- and Southstream received in the media centering on reliability of supplies, overall profitability, technical viability, and associated environmental risks, the implication of the 2009 gas row for individual states may be to seek out partners for alternative infrastructure to diversify their oil, gas, and electricity supplies away from existing options. This may be excellent news for the industries associated with underwater pipeline, or even nuclear power station or LNG terminal construction.

However, the possibility of a steep escalation in an "energy infrastructure race" presents a would-be nightmare for regulators, politicians and businessmen alike. In the rush to gain short term solutions to access, consumers are tripping over themselves seeking any way to link directly to supplies and disregarding the existing interdependence with other consumer, transit, and producer states.

By pursuing expedient unilateral strategies, fundamental questions such as resource finiteness, geographical proximity, prohibitive sunk costs, sufficient numbers of consumers, profitability, regulation, and environmental impact are increasingly ignored. There is a palpable risk that the disparity among the energy poor and energy rich in Europe will grow without a significant commitment to a longer term vision and concerted approach to the energy issue at hand.

Recommendations: more is not better

Despite the unintended consequences of structural changes in the European energy sector, concrete solutions to contemporary challenges such as the transit issue are within our grasp. For a start, the ability of transit states to defect from their obligations as a crucial link in the energy value chain between consumers in Europe and producers upstream needs to be curtailed.

Among all interested parties, the sharing of the financial and political risks while ensuring the continued flow of energy to consumers along the whole length of the value chain is a major priority. The establishment of a transit corporation to directly regulate all aspects of the energy trade among Russia, Ukraine, and the EU is one option.

Another, more problematic area in which the EU must take more responsibility is the reigning in of the "go-it-alone" strategy. Member states must realise that unrealistic expectations for the cumulative success of individual energy policies through endless diversification of supplies or infrastructure may well serve to undermine energy security for the whole of Europe.

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Russia is digging its own grave by disturbing gas supplies to Europe

By Laura J. Rantanen

On this New Year's Eve I was sitting with my friends in a cozy kitchen in St. Petersburg. We were having a nice time drinking Sovetskoe shampanskoe and watching television. The evening news were telling us that Gazprom has threatened to cut off gas supplies to Ukraine at midnight, if it does not receive \$2 billion in arrears and a new supply deal with higher prices is not concluded.

Gazprom officials said they had received a letter from Ukraine's state energy firm Naftohaz stating that if Russia turns off the gas, Ukraine could confiscate Russian fuel bound for customers in Western Europe.

"Ukraine is blackmailing Gazprom, Russia, and Western Europe," Alexander Medvedev, head of Gazprom's export arm, told a news conference with a stern look in his face.

I thought that I had experienced a New Year's Eve just like this before.

No reason to rely on Russia, crisis showed

Disputes over natural gas payment and pricing have become a recurring New Year's ritual in Russian-Ukrainian energy relations. Russian energy giant Gazprom and Ukraine's Naftohaz quarrel about the money owed from the previous year, the price that Ukraine should pay for Russian gas supplies in the coming year, and the fees Gazprom should pay for transporting gas through Ukraine.

In January 2006, the row ended in a sensational three-day cutoff of Russian gas to Ukraine that affected several European states. Then most governments and analysts saw Russia as the guilty party, bullying the nascent democracy in Ukraine.

This time around, it was hard to pity either side. The crisis lasted almost three weeks, and neither Russia nor Ukraine seemed to be in a hurry to make quick amends, although Southeastern Europe was shivering with cold and Gazprom suffered almost \$2 billion losses.

Still, it needs to be asked, why Russia entered yet another dispute that would worsen its relations with the EU?

At the moment, about 60 per cent of Russian government tax revenue comes from energy exports. Russian markets and the stock exchange are founded on the wealth generated by the oil and gas industry. Therefore, disturbances in energy exports, especially to the European Union, the biggest importer of Russian gas, have drastic impacts on Russian economy.

It's clear that ruining its reputation in the eyes of Europe as a reliable gas producer is not in Russia's interest.

Still, it is doing exactly that. Russia is willing to ruin its reputation, as the basis of its decisions regarding energy are political rather than economical. Russia is driven by the need to restore its super-power status and authority in global politics.

This makes Russia unpredictable in commercial issues, and thereby unreliable energy partner for the European Union.

Was Russia's aim a regime change in Ukraine?

Gazprom denies any political motive in the row and says it simply wants Ukraine to pay market prices for gas. However, it was no other than Russian Prime Minister Vladimir Putin who, in a televised meeting on January 5, ordered Gazprom CEO Alexey Miller to cut off gas delivered to Europe via Ukraine.

There are several things that indicate the row was not about gas pricing. Had it been, Moscow could have initiated serious talks about long-term supply contracts, similar to ones it has with its Western European partners, rather than engaging in annual price squabbles. The Kremlin disrupted supplies after the democratic revolutions in Ukraine and Georgia. Russia-friendly states such as Belarus and Armenia can go on paying significantly less than the market price.

The cutoff seems to have had multiple goals.

Ukraine irritates Russia by seeking membership in the NATO, as does Georgia, against which Russia fought a war last summer. Kremlin tries to shake the Ukrainian government, as it wants it to be replaced with a more Russia-friendly regime. At a press conference in January Putin appeared to question the very legitimacy of the leadership in Kyiv. He said that Ukraine's leadership is unable to organize normal economy based on market principals and that there is a political collapse underway in Ukraine. If this was a call for regime change, it follows a similar pattern to Russia's conflict with Georgia, after which Moscow argued that President Mikheil Saakashvili had lost his legitimacy and called for him to be replaced.

Russia wants to discredit Ukraine and Georgia and expose them as unreliable European allies.

Gazprom is in trouble

For Russia, the gas dispute came at the worst time. The effects of the global financial crisis are rippling through the Russian economy. The ruble is being devalued, Russian companies are facing bankruptcy and, according to analysts, the government's huge budget surplus will turn into a deficit next year, if prices do not rebound.

Slumping energy prices have turned Russia and its political weapon Gazprom into a giant with feet of clay. A year ago Gazprom was the third biggest company in the world measured by market value. Now it's ranked 35th. Gazprom has taken big foreign currency loans. In case energy prices don't go up sharply, the company will get out of the red only with governments help.

Gazprom desperately needs the stable income it receives from Europe in order to get on with necessary investments. By now indeed the company hasn't had will to invest in new gas fields and energy infrastructure, and with falling energy prices it doesn't have sufficient funds. Gas it ships to Europe is now mostly produced in the Central Asian state of Turkmenistan. In order to secure long-term rights to that gas, Gazprom has agreed to pay the Turkmen prices that lead to losses in European markets. If Gazprom loses these supplies, it is going to have trouble meeting its commitments to Europe.

It seems that Russia is once again digging its own grave by disturbing energy supplies to Europe. Some analysts say this year's crisis could become a watershed that causes Europe to turn around its energy policy. The EU has grown deeply tired of what has become an annual farce at Europe's expense.

It's about time. Years of talk about energy security have by far generated nothing but hot air. If the EU is serious about energy security, it has to diversify away from Russian supplies as quickly as it can.

As a consequence of the severe damage the latest gas dispute caused in Europe, the EU is now closer to understanding that it finally has to move from words to deeds. Finding new gas suppliers and transit routes won't be enough. It has to introduce an alternative for gas altogether.

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The economic crisis and regime stability in Russia

By Richard Sakwa

By mid-2008 the economic good fortune that had accompanied Putin's presidency gave way to what would clearly be a prolonged crisis, threatening the stability that had been trumpeted for so long as the main achievement of the 2000s. The financial crisis mercilessly revealed not only global inadequacies but also Russia's. While declining economic performance tests any political system, in an unconsolidated democracy performance legitimacy is particularly important.

The price of oil decreased from its peak of \$147.27 a barrel on 11 July to under \$40 in December 2008. With oil and gas revenues comprising one-fifth of Russia's GDP and 50 per cent of federal budget revenues, budget projections were in disarray and the government faces a \$150 billion shortfall in its spending plans for 2009, accompanied by a projected 3-4 per cent budget deficit. The response in Russia, as elsewhere, was more government intervention, including the partial nationalisation of the banking sector and growing protectionism. However, with some \$50 billion committed to help refinance corporate foreign debt through Vneshekonbank by November 2008, the perception developed that the Russian authorities were hurrying to redeploy official reserves to assist the oligarchs and their corporations while neglecting the domestic rouble market. With inflation reaching 13.3 per cent in 2008, instead of the anticipated 8.5 per cent, people's savings were at risk while the cost of living, especially foodstuffs, continued to rise. An open letter signed by Mikhail Gorbachev, Alexander Lebedev and others warned in an open letter on 16 January 2009 that the government's tight control of politics and the economy was only making the crisis worse, and declared that resources were being directed not so much at protecting the interests of a majority of citizens as at saving the assets and property of a narrow circle of influential businessmen.

The financial crisis from mid-2008 had deepening effects on the 'real economy', with cuts in wages, stagnant real gains in living standards and rising unemployment, raising the prospect of a growth in industrial militancy. Unemployment in 2009 was anticipated to rise to over two million, seven per cent of the workforce. In response, on 25 December 2008 the government approved a list of 295 companies of strategic importance that could apply for financial assistance from a specially designated fund of some \$200 billion, designed to reduce the social and economic consequences of the crisis. At the same time, planned cuts to MVD internal troops were abruptly halted on 16 December, although cuts in the regular army continued.

A possible beneficiary of the crisis would be the Communist Party of the Russian Federation, the least co-opted party in Russia. Just Russia was created to tap into neo-socialist sentiments, but not clear whether it will soak up the protest vote and manage protest actions. The CPRF for the first time in many years in January 2009 called for the Putin government's resignation.

The middle class had acquiesced in the government's heavy-handed paternalism when the times were good, but they could now turn against the regime. The possibility of increased labour activism prompted references to the events in Novochoerkassk on 1-2 June 1962, when workers' protests were crushed by the army with the loss of 23 lives and dozens imprisoned. The administration's response to protests, including the brutal suppression of protest actions (against a rise in imported vehicle tariffs) in Vladivostok on 21 December 2008, revealed its fears that the economic crisis could be exploited by an outsider group to mobilise public discontent to launch an orange-style assault on the system.

Already there had been clear signs that official structures and conformist NGOs were being bypassed by the rise of a form of spontaneous protest movements, reflecting in particular the concerns of the aspiring middle class. A new

generation emerged of what the economist Yevgenii Gontmakher dubbed 'new informals' (referring to the original wave of *neformaly* in the early perestroika years), characterised by their genuinely self-organised and non-political nature. The new organisations addressed ecological and housing problems, administrative pressure on small businesses, abuses in the educational sphere, and infringements of the perceived rights of drivers. Most of the new activists were defending property or political gains, and thus reflected the beginning of the political self-organisation of the middle class.

There was a clear threat to the stability of the tandem, and while president Dmitry Medvedev and prime minister Vladimir Putin stressed their unity, Medvedev in early January 2009 voiced discontent with the government's slow response to the crisis. Threats to the system, however, should not be exaggerated, with polls at that time indicating that over three-quarters of respondents approved of the president's performance, while approval for Putin's work as prime minister remained astronomic. In these circumstances, there was not much scope for a colour revolution.

The regime was also cushioned by its gold and hard currency reserves. In ideological terms, however, there was a problem, since the Russian government (like those elsewhere) had taken all the credit when times were good, and it would not be so easy to place all the blame for the crisis on external factors. The longer the crisis lasted, the greater the threat to the regime. The Putin system had been built on a new version of the 'neo-Stalinist compromise', the tacit pact whereby the government promised ever increasing standards of living, pensions, incomes and the like, in exchange for political passivity in the face of state encroachments on political rights and freedoms. In the late Brezhnev years the original version of the compromise broke down when the government could no longer deliver, and this opened the way for Gorbachev's reforms and the breakdown of the system in its entirety. The 1998 crisis had not been so system threatening since it came against the background of an almost permanent crisis since the establishment of an independent Russian state in 1991, whereas the crisis from 2008 revealed the inadequacies of a system that had precisely claimed to have overcome the crisis of the 1990s.

The crisis now meant that Russia's ambitious economic modernisation plans accompanied by assertive foreign policy rhetoric would have to be scaled back. Exaggerated ambitions and expectations were the first casualties of the global financial crisis, and in that sense proved salutary for Russia. In domestic politics the balance between liberal-technocrats and the *siloviki* was threatened, with the latter encouraged to enhance the role of state corporations by consolidating the energy sector in government hands while strengthening the barriers to foreign competition. The crisis, however, offered an opportunity for Medvedev to open up the economic and political system, and to force through long-delayed reforms.

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High-tech response to modern challenges and new opportunities

By Peter Coachman

Despite very challenging business environment and economical conditions of 2008 Technopolis continued its vigorous expansion both in Finland and in Russia and it proves the fact that tough times is the right moment to turn to innovative way of thinking and different business models based on cutting-edge technologies and ideas.

The Russian innovation system has not obviously been formed yet or at least it can't be claimed a working and effective system. Due to a continuous underfunding and general country crisis nothing substantial has been done for years to recreate the innovation infrastructure or mechanisms.

Nevertheless St.Petersburg has huge potential as a science and educational centre. It is one of Europe's leading R&D hot spots and an attraction point for the whole-world R&D community. It's common knowledge that unique research work and cutting-edge technologies in various fields of basic and applied science are developed here.

However high technologies require above-average management. Technopolis sees its role in creating such a favourable and efficient innovation ecosystem which will make the innovative product go successfully through all stages of development from the idea to commercialization and entering international market – that is the key question for Russia and St.Petersburg in particular.

What is done in practise to make this wheel turn? There are three major components of effective innovation system:

1. Ideas
2. Funding
3. Clients.

Technopolis uses its best practises accumulated during more than 25 years of business development activities to connect these three crucial elements and create favourable conditions for their cooperation. Carefully screened and selected innovative ideas grow in our start-up centres, through Technopolis tools they get access to affordable sources of venture capital while wide client network provides an opportunity to promote and sell packaged products in the market.

Serious steps have been taken in 2008 towards creating St.Petersburg innovation ecosystem. In cooperation with St.Petersburg Technopark OJSC, Technopolis launched Technopolis-Ingria incubator which will provide business development services to knowledge-based start-ups, internationalization and growth services to promising young entrepreneurs in St.Petersburg. Simultaneously we launched regular networking events for IT and high-tech companies which bring together the interests of companies, investors and end-users in order to organize mutually advantageous cooperation in this sensitive and highly-specialized environment.

Technopolis is creating a first-class operating environment for high-tech and knowledge-based business which will serve as a platform for their development and internationalization.

In 2008 Technopolis started construction of Pulkovo technopark and already made impressive progress in construction works. Pulkovo technopark is constructed in the immediate vicinity of the International airport creating unique concentration of high-tech business at the crossroads of numerous transport routes. The first stage of technology park totaling over 80 000 m² is scheduled for completion at the end of April 2010. It will offer 23 000 m² of ultra-modern flexible premises tailored to the needs of high-tech companies in design, lay-outs, communication data systems and infrastructure which ensure that no valuable development will be lost of the sight.

Creation of the first Technopolis technology park in St.Petersburg is intended to boost the community's business and innovation dynamics, provide a foothold for new knowledge-based companies to grow and help to transform St. Petersburg into a world class business and innovation hub.

Peter Coachman

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Technopolis

Russia



The economy crisis is the moment of truth for Russia

By Jukka Mallinen

The share of Russia in the world GDP is about 2,5 per cent and it is rather decreasing. The big incomes from raw material export are just a temporary advantage. If Russia is not able to create an innovative economical and social progress, it can fall to the margin.

Economist Jakov Pappé has said, that if now, when world moves over to period of low raw material prices, Russia is not able to increase production, it goes to the road of Indonesia and Nigeria.

Anyway, the Kremlin has in practice admitted, that Russia will not get out of the economic independently. It will wait the rise of the world economy, which then will lift Russia up.

Within the crisis Russia turns out to be more a producer of raw materials. Only the production of oil and gas has grown. All the other branches, investment as well as consumption, have dived.

The share of "the new economics" in Russia is about 3 - 7 per cent, when in the developed countries it is about 50. The Russian economy is still based on Soviet time factories and technologies. It manufactures mostly consumption goods with simple foreign technology.

The new car composition factories etc are even more low degree of production than the export of raw materials. Components, composition lines and technologies, owned and runned by foreigners are just moved inside the custom walls. This does not mean manufacturing progress.

In the current atmosphere of remilitarization and cold war Russia plans to arm itself again to the death. But if raw material resources are an objective factor, deciding for an armament race is not. Particularly the nuclear weapons take a fatal share of Russia's national income.

The Russian economics carries the "gens" of the socialistic command economy. The real competition branches in Russia are just some 5 – 10 per cent. The rest is more or less monopolistic "enterprising", that rather resists development, competition and innovations.

In principal crisis will heal by eating the inefficient and the over-aged. When weak enterprises die, the efficiency and competition ability grows. But in Russia the state financing crisis is directed for political reasons to the monopolistic enterprises - the inefficiency is supported. Market enterprises don't get state support unlike the companies, controlled by the power elite, that swallow the private owners in trouble.

So the process at the moment is interesting and even fatal. Finance minister Aleksei Kudrin, who defends market mechanism, has been able to keep his mind. The oligarchs have got their loans thus avoiding bankruptcy, but now they are in the pocket of the creditor – the state. The "silovicks" (army and intelligence) couldn't yet turn the economical politics to complete state ownership.

Anyway, "the velvet renationalisation" weakens efficiency and competition capacity. It is possible, that in crisis Russia loses the best companies, not the worst. Parallel, the political orders, type of the command economy, ban the cutbacks in enterprises to increase efficiency in the name of employment and social stability.

So strengthens the Byzantine apparatus economy, where state money runs. Innovation economy and market mechanism loses. The weathering of efficiency of "Gazprom" is a good example of this.

The Kremlin declares it's direction to the diversification of economy and to innovations. It promises investments to help structural diversification, high tech economy and contemporary service sector.

But the Decree of President on creation of the national innovation system from year 2002 impends to stay a formality. Decisions on monopolist high tech state enterprises in aviation,

shipbuilding, nuclear industry and nanotechnology don't seem to create innovative production.

Now new national investment decisions are current in Russia. But they will take at least a year as a minimum. Only after that the entrepreneurs can plan their future.

So will the state or the private business be the locomotive for rising from the crisis? Now the state projects and companies have the priority. Money flows to them, although state has never been able to raise the economy to a quantitatively higher level and growth.

Only the private initiation can save the country from crisis - it increases the efficiency and competition capacity.

Now the harmony between state and entrepreneurs is lost. The state don't trust to the entrepreneurs: it considers capital escape from country, caused by economy crisis, as an embezzlement of national economy. Entrepreneurs, in contrary, don't trust the economical policy and legality: they feel, that they are forced to save their capital abroad.

The development visions of Russia suppose the rise of the middle class from the current 20 per cent to 60 per cent of the population. Middle class would be the carrier of the new life: civil society, enterprising, dynamic. It's will, energy, self discipline would reform the country, that today is still characterized by Soviet time paternalism and passivism. Middle class would activate itself for reaching the western quality of life: democracy, legality, security.

But paradoxically the 1990's turned to the most vulgar materialism. Middle class took for it's ideal the consumption, meaning senseless waste and luxury. The trend was not economy, but hysterical consumption and involvement in debts.

The state was fomenting this, too. It's goal was to raise the consumption level, not to build the basics for a welfare state. Corruption and luxurious life of the elite and officials gave the example for the people. Consumption hysteria individualised and atomised more and more the society, that has not ever been. The constructing political potential for creation of welfare state weakened and consumption superseded it values.

Today Russia needs the ethics of work, meaning the classical spirit of Protestantism by Max Weber. Yet, in Byzantine orthodox feudal East the private entrepreneur has always been hard to outline. Independent ownership has no tradition, property has been political, dependent of the will of the autocrat.

Diversification of economy and the rise of the innovation technology depends on the development of the democratic system and civil society. The state should guarantee and activate the freedoms and legacy.

Last year Russia published a draft for the strategic plan until the year 2025. It seems to be based on state centralization, on full control of the Kremlin. But at least it takes the responsibility for the common development of the country. Now it seems to be forgotten.

A "New Deal" for Russia could rise the country from crisis and modernize it. The companies would orientate themselves to the future, innovations, competition capacity.

But this would take power from securocracy, because it would lean on the activity of the population. And "the hereditary of the power" has been the most important value also in new Russia.

Jukka Mallinen

Translator, writer

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Sustainable innovation – what is it?

By Vesa Harmaakorpi

Sustainable development has been one of the hot topics in recent years, maybe the hot topic in the Baltic Sea Area. Sustainability often refers to ecological aspects of sustainability in practical discussion. It is to prevent further pollution of the Earth and save the scarce natural resources for future generations. However, sustainable development has other aspects, including social and economic sustainability. It means that to make sustained progress the development has to be sustainable from ecological, economic and social perspectives.

Innovation is another current hot topic. The innovation paradigm is said to be radically changing. Mainstream innovation was earlier said to originate in science and technology; and especially in science-based technology. However, recent studies in Europe have demonstrated that only a minor part of innovations stems from science and the vast majority have a very practical origin. Besides scientists and technology experts, customers and employees acquire new roles in the future innovation practices.

When the two hot topics are joined together we get a concept “sustainable innovation”. What is this? Hautamäki in his book published by Sitra (Finland) defines the principles of sustainable innovation as

- ecologically sustainable development, that is, innovation towards sustainable development
- participatory innovation, that is, innovation with customers, employees, users and the general public; including development of and respect for partners’ knowledge
- continuous innovation, that is, the ability to continuously regenerate and break boundaries
- global innovation, that is, innovation in global co-operation using knowledge distributed everywhere
- innovative management, that is, management facilitating and encouraging innovation in organisations and society; leading to new management and leadership practices.

Every time we innovate the ecologically sustainable aspect ought to be considered. We already use about 30 % more natural resources than the earth can sustain. Global warming is a real threat. It seems that the old innovation logic: innovation – productivity – growth can no longer be the only logic to follow. According to Hautamäki, the old logic should be replaced by a new formula: innovation – renewal – wellbeing.

Participatory innovation means that customers and employees must be given radically new roles as partners in innovation. The customers must be considered subjects of innovation instead of objects. That does not sound very radical, but it is; at best with the old methods we have only been able to guess the needs of customers. Customers in user-driven “Living Labs” can create completely new perspectives on innovation. Employees outside the actual R&D departments are a vastly unused resource for innovation. Often employees only do what they have been

told to do leaving their creativity outside the company when they come to work. However, everyone should have two tasks in a company: produce goods and services, and think how the goods and services can be improved. Everyone is capable of contributing to the second task if the work culture encourages it.

Continuous innovation means that we must continually create novel ideas. A natural scientist once said “very good scientists get two good ideas in their lifetimes, good scientists get one and average ones none”. Maybe it is due to the differences in definitions, but I strongly disagree. Everybody should generate ideas monthly in order to keep his or her company competitive. However, ideas may be hard to find without new input from different fields of knowledge. There is certainly a need to break boundaries and achieve intellectual cross-fertilisation between innovative partners so as to keep innovation continuous and sustainable.

Global innovation also means open innovation. The leaders of many big companies argue that open innovation no longer gives any special competitive advantage, it is a must. I strongly agree with them; the Schumpeterian creative destruction of today can be outlined by closed and open innovation: companies and industries relying on closed innovation models come under destruction and those relying on open innovation models are creative and thus successful in the future. In spite of this, surprisingly many companies practice quite closed innovation models, perhaps because of the lack of social capital surrounding them. However, sustainable innovation is about open innovation in the future!

The managerial impacts of sustainable innovation are remarkable. Borders/Boundaries in organisations and networks can be crossed/broken by means of creative management. The key notions in this management process are tolerance, uncertainty, interrogation and interpretation. It is more a question of leading interpretative innovation processes than just of problem-solving innovation processes. Managing sustainable innovation can be divided into three components: expertise, creative thinking skills and motivation. Promoting expertise refers to managerial abilities to make possible worlds visible for the innovating partners; promoting creative-thinking skills refers to managerial abilities to break boundaries; and promoting motivation refers to managerial abilities to motivate people with very different backgrounds to focus on the same innovation process.

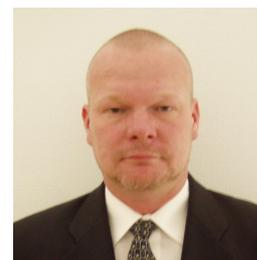
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Is Russian sports economy performing well?

By Wladimir Andreff

The Russian Olympic squad was expected to win 96 medals in Beijing last summer according to our econometric forecast published in the French journal *Revue d'Economie Politique* (n°2, 2008). The prediction was based on two major variables, for all participating countries, that is GDP per capita and population, and some additional dummy variables. The underlying idea was that Russia, despite a stagnating or slightly decreasing population had nearly recovered from its transformational recession of the 1990s in terms of GDP per capita due to seven years of strong economic growth in a row. This must have translated into good Olympic performances. A study by Wolfgang Maennig (University of Hamburg), leaving more room to non economic variables, reached a less optimistic number of 78 medals while Pricewaterhouse, in a report sponsored by the Beijing Olympic Committee, anticipated 79 medals for Russia.

What happened? The Russian Olympic squad left Beijing with 72 medals, of which only 23 gold and Prime Minister Putin officially and loudly made his dissatisfaction explicit. Measures should be taken to improve Russian performance at next summer Games. It is a poor outcome compared to 92 medals in Athens 2004 and 88 in Sydney 2000. It is only during the worst of the transition meltdown that the Russian squad was less performing with 63 medals.

Contrasting with this, Russia increased its sporting efficiency in winter Olympics (16 medals in 2002 and 22 in 2006) and obtained good performances in some professional sports: 19 wins at the World athletics championship, 21 wins at the tennis ATP tour. Even more impressive is the raising status of Russian football clubs in European competitions, in particular Zenith St-Petersburg winning the UEFA Cup 2008.

For economists, sporting performances of a country are to some extent linked to, if not determined by the current state and evolution of the sports sector in the economy. Explaining both professional sports successes and mitigated Olympic results trace us back to the transformation of the sports economy in Russia starting from the former centralized Soviet state-run sport system.

As the whole planned economy, sport fell into a deep crisis in the USSR during the 1980s. Under *perestroika*, reforms aimed at building up new sport facilities and promoting sports goods production, namely in hosting foreign manufacturers (Adidas, Fischer skis and Donnay rackets). Since the state budget for sports was cut, sport federations became more autonomous and constrained to self finance. Sport commercialization and a market sports economy started to emerge in 1988 when professional sport was legalized. In order to match their hard currency needs, Russian clubs and federations opened the door to foreign sponsors and started hosting international sport events. Athletics federation signed a sponsorship contract with Reebok and Mobil, tennis federation with Proserv and Nike, and ice hockey federation with Reebok. New sources of funds sprang up from lotteries, betting and gambling on sporting outcomes (Sportlotto and Lotto-million). "Corporatization" of professional clubs was allowed in 1992. Eventually, *Goskomsport* was dismantled in 1991, putting an end to the most crucial formal institution of Soviet sport.

In the 1990s, state investment in new sport facilities nearly vanished overnight. Many state-owned enterprises, in the red, were hit by restructuring and were no longer in a position to finance sport. Sport broadcasting was not yet up-to-date: an absent source of finance compared to Western sport. With rising poverty and increased income inequalities, sport participation and expenditures declined. The market for sports goods shrunk. Increasing prices for sport shows and events triggered a fall in stadium attendances. A number of high level sportsmen and women migrated toward Western professional sport markets, which impacted on national sport performance,

for instance the Russian football squad never recovered its 1988 Soviet level (Euro finalist).

In institutional vacuum due to weak law enforcement, Russian professional sport was extensively criminalized in the 1990s. Corrupting referees was a common way to fix a match in Russian football championship: most penalties were whistled in favor of a same team. Football attracted investment from oligarchs and even mafia interests. One of the clean football managers, N. Tolstykh (Dynamo Moscow) was offered bribes and threatened to death. In 1997, the commercial manager of Spartak Moscow was murdered soon after the murder of the Russian head of ice hockey federation. Many sport managers were corrupted or murdered. New informal rules were supplanting unenforced formal institutions. President Yeltsin exempted the National Fund for Sports (NFS) from taxation and customs duties on tobacco and alcohol foreign trade. This had transformed high level sport into smuggling and trafficking system; 80% of funds circulating throughout the national football league were dirty money. Mafia was organizing an underground market for doping products as well as illicit networks of sport betting and gambling. New rich people, oligarchs and Mafiosi utilized sport as a room for laundering their newly, often dubiously, acquired wealth.

Eventually, in the 2000s, new trends emerged. Most professional sport clubs were taken over or sponsored by Russian big companies that were flourishing with economic recovery after 1998. Gazprom is involved in seven football clubs including Spartak Moscow and Zenith St-Petersburg, Norilsk Nickel in CSKA Moscow, Lukoil and Aeroflot in Spartak Moscow, Luzhnicki and Norilsk Nickel in Torpedo Moscow, Oleg Deripaska in Samara football club, Vladimir Radionov in Dynamo St-Petersburg, FSB's interests and Fedcom Invest in Dynamo Moscow and so on. Foreign investors are increasingly attracted to sponsor Russian sport federations and clubs in a stabilizing professional sports economy. The best Russian football clubs have now an annual budget over €50 million and start hiring foreign players and coaches. All this means a tighter alignment of Russian professional sports on the Western market model.

The problem remains that a number of Olympic and amateur sports are not yet really aligned to a market sports economy because they do not drag as much money as professional sports. Using indexes similar to the ones of the EBRD and World Bank we have exhibited that sports institutions were not yet aligned on economic institutions in 2004 in Russia (in "The Institutional Dimension of the Sport Economy in Transition Countries" ¹). Overall, Russia's sports economy is not in tune with its renewed political and economic might today. It will suffer a lot in muddling through financial crisis which knocks down the previous economic recovery since fall 2008.

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¹Co-authored with Sandrine Poupaux and published in M. Parent & T. Slack, eds., *International Perspectives on the Management of Sport*, Elsevier 2007.

Baltic States competitive position in the New Century

By Viktor Trasberg

One of the targets of the EU Strategy for the Baltic Sea Region is to make the area more prosperous and the countries development level more equal. The countries in the region should explore in a full scale advantages of deeper regional integration and synergies to increase their wealth and quality of life.

By The World Economic Forum definition, countries ability to provide prosperity to its citizen's depends on their global competitiveness. The key indicator measuring prosperity is GDP *per capita* adjusted on the basis purchasing power. The Forum has developed a Global Competitiveness Index (GCI) and ranks more than 130 countries on the basis of that indicator.

Baltic Development Forum, in turn, brings in its Report out Baltic Sea Region countries competitiveness position as a whole entity and compares it with other global areas. The analyses result is favorable – still our region is one of the most competitive and innovative areas in the world. However, there are still significant disparities in a competitive advantage in different parts of the region.

During the last 5 years, the BSR countries are located rather different positions and demonstrated diverse dynamics in the global ranking. In 2008 majority of the Nordic countries and Germany belong to the top ten of the most complete countries in the world. The Baltic States and Poland are placing positions from 32 up to 54.

As a group, both the Baltic and Nordic countries have lost their positions during the period but the Baltic States are losing their competitive positions rather speedy way.

Competitiveness is assessed as a mix of various factors. Generally, those factors are grouped different factors (pillars) and divided into 3 groups. Namely those groups are as basic requirements for economic activities (like education and infrastructure development), economy efficiency enhancers (like various markets efficiency and their size) and companies' innovativeness.

Estonia is the best in the rank among the Baltic countries (32). The country's advantages are good macroeconomic policies, technological readiness and higher education. The weaknesses are considered as business sophistication and inflexible labor markets.

Latvia as a weakest in the ranking among Baltic countries and ranks on 54 position. The most problematic areas are weak macroeconomic policies, companies sophistication and innovation activities. Latvian strong points are advanced education system, labor markets flexibility and technological improvements.

Lithuania ranks between Estonia and Latvia and its particular weaknesses and strengths are rather similar to other Baltic neighbors.

During the last decade the Baltic countries have increased their prosperity very significantly, even having enjoyed record high growth rates in EU. However, 2008 fast growth turns to a sharp decline. What went wrong and why the Baltic countries have not sustained their growth?

The countries have to realize that latest growth was a result of coincidence unique and favorable factors.

First, the positive outcome of successful market reforms implemented during previous decades. Hard efforts of Baltic nations bring them outstanding prize as increase of the wealth and living standards.

Second, the EU enlargement effect, which opened Baltic countries access to "big markets"; made them attractive to new businesses and investments. Fast integration with EU structures and nearby rich neighborhood definitely supported fast increase of economic growth.

Third, growing incomes and purchasing power in combination with easy access to credits heated up domestic consumption and real estate boom.

However, in the conditions of global turmoil and uncertainty, earlier growth pattern in the Baltic countries is not valid any more. Growth, based on cheap borrowing and domestic consumption, should be replaced by the different growth factors.

To reach a new competitive edge, the countries should "revolutionize" two principal elements of their economic policies. First, to develop new sound macroeconomic regulations, which allow manage the economic cycle in a more sustainable way. That includes efficient fiscal and tax policies in combination with measures to cope with inflation and unemployment.

Second, economic structure should be focused towards more sophisticated and export capable production. Put in simple - economies should move from cheap labor and factor based economies to more innovation and high-added value industries. More than ever before is valid former Estonian president Lennart Meri's well-known phrase - "we should find our Nokia"! Considering that, our Nordic neighbors have demonstrated how to reach highest competitiveness and wealthiest societies in the global world.

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Can we revive a 'Baltic Tiger'?

By Vyacheslav Dombrovsky

Following its accession to the European Union, Latvia enjoyed three years of neck-breaking double digit growth, invoking flattering comparisons with the 'Asian tigers'. Unfortunately, much of the 'tiger' turned out to be a bubble, inflated by the credit orgy of recent years. According to the latest forecasts, Latvia's real GDP is expected to fall by 2.3% in 2008, and by 6.9% in 2009. The authorities adopted an ambitious rescue plan, backed by a 7.5 billion euros loan from the international community, nearly a third of Latvia's GDP. Understandably, managing the crisis will be an important priority for the policy-makers in the medium-term. And yet, the whole debacle also raises some serious questions about Latvia's long-term growth strategy. Clearly, many of the old assumptions are no longer tenable. An advantage of this crisis is that it provides an opportunity to introduce some badly needed new ideas. This is precisely the ambition of this article.

At the risk of oversimplification, I would summarize Latvia's traditional development policy as largely geared towards improvement in the business environment, fostering entrepreneurship and SMEs. In my opinion, which is based on virtually every major survey, this policy has been very successful. According to the World Bank's "Doing Business" 2009 report, Latvia's business environment is ranked 29th among 181 economies. The Global Entrepreneurship Monitor (GEM) also ranks Latvia as a fairly entrepreneurial country. According to the GEM surveys, 6.6%, 6.6% and 4.5% of Latvian adults were involved in early-stage entrepreneurship in 2005, 2006 and 2007, respectively, as compared with the EU-15 average of about 5.5%. Regardless of what the conventional wisdom might be, the evidence says that starting a new venture in Latvia is not such a big problem. However, in spite of its attractive business environment, vibrant entrepreneurial sector, and well-educated work-force, Latvia is doing very poorly by virtually every measure of the modern "knowledge-based" economy. According to the European Innovation Scoreboard 2008, Latvia was the second least innovative country in the EU (after Bulgaria), measured by the summary innovation index. The percentage of Latvian SMEs that introduced product or process innovations was a mere 14.4%, less than half of EU-27 average, and much less than Estonia's 45.8%. Business R&D expenditure was 0.21% of GDP, as compared with 0.54% of GDP in Estonia. Clearly, achieving a measure of success with entrepreneurship is not the end of the story. Something is amiss.

What might be the missing piece of the puzzle? I would like to point to a recent paper by Thomas Hellmann (University of British Columbia) and Enrico Perotti (University of Amsterdam), "The Circulation of Ideas in Firms and Markets" (RICAPE2 Working Paper 30). This paper stresses that production of new ideas entails an important trade-off. On the one hand, elaborating an idea requires sharing it with various persons. A broad circulation of ideas is thus critical for the process of innovation. On the other hand, there is a fundamental problem with the open circulation of ideas, namely that information can be stolen. Often, originators of new ideas have very limited legal means to protect their intellectual property against expropriation by third parties. In this context, firms emerge as a solution to market failure. Established firms provide a

safe idea exchange, serving as incubators for innovation. It is well known, for instance, that most R&D is performed in large established firms. In turn, markets complement firms by completing ideas that could not be elaborated inside firms. Firms incubate ideas, while markets increase their chances of elaboration. This complementarity suggests a natural *symbiosis* of open firms and markets.

Thus, the analysis by Hellmann and Perotti suggests that, as incubators of novel ideas, established firms should be a crucial feature of any highly innovative environment. Could there be a problem with such firms in Latvia? For better or for worse, most Soviet-era giants are long gone and new firms are likely to take time to become large and established. As a rough proxy, I use Business Registry data (provided by Lursoft) on top hundred Latvian firms (by revenues) in 1997 and 2007. Only 25 firms were in both 1997 and 2007 lists. Moreover, some 69% of the new entrants were in wholesale, retail, or construction industries, which are related to the recent bubble and, usually, have little R&D activity. In contrast, the data for U.S. show much lesser volatility. Some 49 firms were in the top hundred lists in both 1997 and 2007. In the absence of more convincing empirical evidence, this may suggest a shortage of established firms in Latvia.

Although explaining the shortage of large innovative firms is beyond the scope of this article, I will attempt to point to a possible suspect. In Latvian context, one obstacle to the growth of established firms might be distortions introduced by wages paid in envelopes, i.e. evading taxes. It is widely known that envelope wages are a widespread phenomenon in Latvia. Employees get higher net incomes and employers enjoy smaller labor costs. Such savings might be substantial as the tax wedge (social security contributions and income taxes as percent of labor costs) in Latvia for a single earner with average income is about 40%. For comparison, according to OECD, tax wedges in U.S. and Ireland in 2006 were 28.9% and 23.1%, respectively.

Envelope wages create a distortion because the technology of tax evasion is not uniform across firms of different sizes. Small firms find it much easier to pay envelope wages because they are many and hard to monitor by the tax authorities. This is not the case for large firms. Thus, small growing firms might face a substantial 'speed bump' as going beyond a certain threshold will strip them of competitive advantage from tax evasion. This might discourage growth and result in a shortage of large established firms. Given that many European countries have comparable (or even higher) tax wedges, but do not suffer from widespread 'envelope wages', there should be much room for improvement.

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Latvia

Business life in a perfect Storm – the first results of a monthly monitoring of the effect produced by the economic crisis on small and medium size enterprises (SMEs) in Russia

By Alexey Prazdnichnykh

The aim of the monitoring project "SMEs Within the Crisis" is to keep a close watch on the changes that occur in the external environment of the SME companies because of the crisis and on the companies' reaction to these changes. During a year the directors of 300 SMEs from various industry sectors in 30 Russian regions will answer every month some questions concerning different aspects of their activity. It'll give us the opportunity to see the dynamics and make certain conclusions about the way and intensity of the crisis's influence on the SMEs. Moreover, through the polling the companies will be able to pronounce their point of view regarding the anti-crisis measures that can support the SMEs successfully. The project is driven by "OPORA" (the non-commercial organization for Russian small and medium business) together with the consulting company "Bauman Innovation".

Nowadays the number of the companies that characterize their state as "good" is almost equal with the number of the ones that find it "bad" – 28% both. The other companies preferred to define it "neither good nor bad". The situation with the businessmen's expectations is worse: 48% of companies are preparing for decline, 25% believe that the crisis isn't going to affect them during the next month, 27% expect growth. The financial crisis provokes changes in the companies' external environment regarding the access to financing facilities, human resources and real estate; the behaviour of the purchasers and suppliers; administrative and criminal pressure. The changes in external environment lead to alterations in some aspects of the companies' activities as well – the volumes of sales and profitability; the number of employees and their salary level; transfer prices and total debt.

Looking at the January monitoring results we can make the conclusion that by now the effect produced by the crisis on the companies' external environment has been ambiguous: the easy access to workforce and real estate can be regarded as a positive trend while the situation with financing facilities, demand, purchasers' debts, suppliers' prices and administrative regulation is becoming worse.

For instance, a most important problem of human resources is becoming less acute: 45% of the companies mention that it's becoming easier to recruit personnel, and only 12% say that it's become harder. Real estate is more accessible now: it's become simpler for 40% of the respondents to find premises for business activities since the beginning of the crisis, and only 17% find it more difficult now. However, the problems of human resources and real estate are still far from being solved: almost half of the SMEs have difficulties with recruiting personnel, and around one third of them – with finding premises. The most serious problem is bad access to debt financing. The situation that had been unfavourable before the crisis has become even worse. It has become more difficult to attract borrowed funds for 76% of the companies; most of them put it as "much more difficult". 87% of the respondents mention growth of loan interest rates for their branches of business. All in all nowadays about 30% of the companies don't have access to debt financing, for other 44% getting it is a big problem.

The deflationary effect of the crisis that can be observed in many countries almost doesn't work in Russia. On the one hand, more than half of the enterprises (65%) mention noticeable growth of prices for goods and suppliers' services. At present the suppliers' prices have been called "rather high" or "very high" by 39% of the respondents; 54% of the companies find them quite moderate. As for the respondent

companies themselves, they aren't eager to lower the prices: only 12% of them declared they would do so.

The situation with demand looks doubtful: though it seems to decline (63% of companies say so), more than half of the companies (69%) estimate the present level of demand as moderate or high. However, 43% of the respondents claim that it's accompanied by the growth of the goods and services' purchasers' debts, which, anyways, hasn't become a serious problem for most companies yet.

Companies react at the alterations in their external environment with changing various performance indicators. Most of them mention the downfall of sales volumes and efficiency (59% and 60% respectively). However, less than one third of them venture upon cutting salaries and reduction of staff (24% and 30% respectively). One third of the companies (32%) are raising the prices.

A little less than a third part of the companies (29%) have debts, most often these are the debts to suppliers (21% out of all or 72% out of the companies in debt). 10% of all the companies admit having wage arrears (that's 33% of the companies in debt). The total size of indebtedness is growing.

At present more than half of the respondents (52%¹) regard cutting their expenses (not connected with employees' salaries) as top anti-crisis measure. Part of the companies is planning to exercise flexibility: change their product proposal or reorient their business (23% and 17% respectively). Such unpopular measures as salary cutting, reduction of staff or production ramp-down are planned by 13%, 12% and 8% of the companies respectively. Only 12% are ready to lower their prices, and only 4% of businessmen prefer to sell their business.

Small and medium business is expecting targeted anti-crisis measures from the government. The companies regard crediting SMEs (43%), tax holidays (42%) and tariff freeze (37%) as most effective ways.

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Russia

¹ The respondents were offered to choose three most preferable measures from the list of the possible ones

Russia's energy supplies and the Baltic Sea Region

By Peeter Vahtra and Stefan Ehrstedt

Russia has significant investments in the Baltic Sea Region (BSR) energy sector. The investments are for the most part made by the state-owned natural gas and oil company Gazprom and by the privately held oil company Lukoil. Gazprom has investments particularly in the natural gas sector of the Baltic countries, Poland and Germany. Lukoil on the other hand owns fuel retail companies in the Baltic countries, Finland and Poland.

Geographically speaking Russian energy investments are concentrated particularly in the Eastern part of the Baltic Sea i.e. in Finland, the Baltic countries and Poland. A smaller yet significant share of investments have been made in the large countries of the Southern shore i.e. in Germany and Poland. However, Russian energy investments are not significant in the Western parts of the BSR in Sweden, Denmark and Norway.

Russia is an important supplier of energy in the BSR. In 2007 Russia delivered nearly half of all natural gas consumed in the region. For instance Finland and the Baltic countries are in practice totally dependent on Russian gas. Even the regions overwhelmingly largest energy consumer Germany imported over 40% of its natural gas from Russia. Russia is also a noteworthy oil supplier for the BSR.

The most important energy infrastructure in the BSR is mostly related to Russia. Gazprom is preparing the Nord Stream –gas pipeline from Russia to Germany through the Baltic Sea. The Northern branch of the oil pipeline Druzhba delivers crude oil to Poland and Germany through Belarus but the pipeline branches leading to the Latvian Ventspils and the Lithuanian Butinge have dried out during recent years. Oil has been rerouted through a new pipeline system (BPS) built in the 21st century to the Russian oil harbour of Primorsk in the Gulf of Finland. Another large oil harbour might be also constructed in Ust-Luga in the same Gulf.

The Baltic Sea Region is important also to Russia

The Baltic Sea Region has become one focal point for the Russian energy strategy. Over half of Russian crude oil is transported to the countries of the region or through the region. The planned gas pipeline Nord Stream would shift the focus of gas exports to the region should it be built.

The strategic goal of Russian energy policy is direct export routes to large energy markets such as Germany and Western Europe. Another goal is to reduce the economical and political influence of the current transit countries used in energy exports.

From the point of view of the Russian energy strategy, Germany is the most important country in the BSR. Germany consumes Russian natural gas more than twice as much as all the other countries of the region put together and is a gateway to the large gas market of Western Europe. Thus the Russian energy strategy in the region is certainly focused in the relationship with Germany which leaves the Russian energy strategy in the other Baltic Sea Region, particularly in the Baltic countries, subordinate to this. The planned Nord Stream –pipeline is a concrete example of this.

Russia's aspirations to transfer the focus of its energy transports to the Northern and Southern parts of the continent are quite obvious. With the development of new infrastructure Russian oil exports has gradually shifted to the Russian ports of the Baltic Sea and the Black Sea instead of former soviet republics.

Western media has shed most light on the transit fee disputes between Russia and the transit countries Ukraine and Belarus. Lately Ukraine in particular has been in the lime light due to the recent halt in gas deliveries which left some European countries in a difficult situation. The reduction of political and economical power of transit countries has also been evident also in the BSR. The oil pipeline system BPS has reduced Russia's dependency on the Baltic Sea Region.

The Baltic Sea region and Russia's global energy strategy

The Nord Stream project should be seen as a part of the country's global energy strategy, which aims at increasing export capacity and, subsequently, strategic options regarding the energy exports in the natural gas sector in particular. Similar to Nord Stream, the planned South Stream gas pipeline in the Black Sea region would sidestep the conflict-prone nations in the Caucasus and guarantee a direct supply route of natural gas from Russia to Europe. Both

projects would serve Russia's energy strategy by increasing the country's supply capacity much faster than its production capacity.

Apart from the gas pipeline projects Russia has additional plans for setting up the liquefied natural gas (LNG) production plants on the Barents Sea and purchasing several LNG carriers from South Korea and Japan. When realised, the LNG production and transportation plans would provide Russia with a new major energy distribution channel and would add considerably to its energy transportation capacity both to Europe and the USA.

From the viewpoint of European energy economy, the development of Russia's energy infrastructure and direct energy supply routes in particular is largely desirable. From the energy security viewpoint the situation is, however, more complicated, since the emergence of new supply routes inevitably leads to more room for strategic maneuvers for the energy supplier and, consequently, weakened negotiation power of European nations. In addition, when we add to the picture the planned infrastructure projects towards China and Far East, the improvement of European energy security appears even more dubious.

Developing the energy supply routes at the cost of production

The gigantic exploration projects aimed at increasing Russia's natural gas production are lagging well behind the planned infrastructure projects. Russia is already faced by the need to import increasing quantities of natural gas from the neighbouring producing countries in order to fulfill its domestic and international supply obligations. Exploration of the giant Shtokman gas field on the Barents Sea has been postponed for the time being; the Shtokman field was initially expected to provide most of the natural gas pumped through the Nord Stream pipeline. According to recent information, Russia's national gas company, Gazprom, is to prefer the development of vast natural gas deposits at the Yamal Peninsula instead. Although the estimated costs of developing Yamal by far exceed those of developing Shtokman, Gazprom will be able to develop the Yamal fields mostly by its own resources and technical know-how. In contrast, the development of the technologically more challenging Shtokman field would require the company to engage foreign partners in the project. However, even according to the most optimistic estimations, first output from the Yamal fields may be expected around 2015, at the earliest.

The increasing domestic demand for natural gas together with the fact that in the light of current estimations, Russia's gas production growth will be significantly slower than the growth of the country's export capacity leads to the situation where the importers of the Russian energy will compete for ever smaller energy supplies. Coupled with favourable development of energy infrastructure, this in turn leads to growing energy policy leverage of Russia. Highlighting this development, the investments of Russian state-owned energy companies over the past years have been directed to foreign energy infrastructure projects and the European downstream sector instead of domestic production.

Russia's current international energy strategy follows the divide and rule –principle. By simultaneous development of its export infrastructure in both Northern and Southern Europe and diminishing the role of energy transit nations, Russia is likely to be ever more successful in entering into bilateral energy supply contracts with the large EU countries. For smaller Baltic Sea region countries this means further erosion of their negotiation powers, which in turn brings the EU further apart from the common energy policy it tends to claim.

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