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Baltic Rim Economies (BRE) review:
A leading virtual discussion forum on the Baltic Sea Region

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 the future, this monitoring may be extended to also cover other Russian regions and countries surrounding the Baltic Sea region and the countries in the vicinity of the region, provided that the financing for the execution of the extended monitoring can be found.

In addition to the economic analysis of the rim currently stretching from the eastern border of Finland to the eastern border of Germany, the Baltic Rim Economies (BRE) review presents expert views. These expert articles have been written by leading European politicians, businessmen, academics and other high profile experts. So far, we have received approximately 250 expert columns. I consider that the BRE has become the leading virtual discussion forum among people interested in the development of the Baltic Sea Region and its surroundings.

As the Pan-European Institute celebrates its 20-year anniversary, it was suggested by several our partners that all the expert articles should be compiled into one publication. Therefore, you will find all the experts articles inside one cover. It proved to be too difficult to find any meaningful way to organise these expert articles in an appropriate manner, except to present them in a reversed chronological order.

I wish this publication gives you an insight into the Baltic Sea region and perhaps inspires you to submit your intellectual contribution to some of the future BRE reviews.

I wish to conclude by saying that the Baltic Sea region is much more than a remote area in Northern Europe inhabited by some 80 million people. This region can form an integrating bridge between the EU and Russia. Should we fail in building such a bridge, the region may turn into an outpost between the East and the West.

Kari Liuhto

Editor-in-Chief, responsible for expert articles

Baltic Rim Economies (BRE) review

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2008

EU Strategy for the Baltic Sea Region

By José Manuel Durão Barroso

The European Commission is preparing a European Union Strategy for the Baltic Sea Region, following the invitation made by the European Council.

The existing cooperation structures in the Baltic Sea Region have already produced numerous studies, reports and action plans. However, actual coordinated and concrete action has been limited to date. The Commission will therefore focus the Strategy on achievable actions built on relevant analysis, in order to address the major challenges the Region is facing.

Action is needed to meet four objectives:

1. To make the Baltic Sea Region a cleaner place. This relates to the environmental status of the Baltic Sea, which has the reputation as suffering heavily from pollution. The Sea is shallow, with very low salt levels, and its only connection to the oceans is the straits between Denmark and Sweden/Norway. This makes it very vulnerable to pollution whether from industry, agriculture or from ships crossing the sea. Untreated, or insufficiently treated, waste water reaches the Baltic from both urban and rural areas, adding to the problems.

2. To make the Baltic Sea Region more prosperous. At present economic development is decidedly unequal in the region. Full implementation of the freedoms and opportunities embodied in the EU internal market directives, active labour market and human resource development policies and harmonised rules on capital movements will stimulate investment both from within the Region and from the outside world. Moreover the area has not yet fully benefited from economic and monetary union (only two of the eight Members States surrounding the Baltic Sea are in the eurozone) so the need to change currency inhibits trade and tourism. Implementation of the Services Directive will also boost the area by reducing red tape both in trade relations and when establishing new enterprises across borders. On top of these passive benefits from membership of the European Union, the investments in business infrastructure, human resources and information technology financed through cohesion policy can have a synergistic effect in equipping the weaker, as well as the stronger economies of the region to succeed in the competitive global environment.

3. To make the Baltic Sea Region more attractive and accessible. This means improving internal and external communications not only within the Region, but also between the Region and the rest of the world – in terms of transport links and information technology. Currently, the population is falling in many parts of the Baltic Sea Region. The Region should be able to maintain its labour force, be attractive to encourage those who emigrated in recent years to return, and even attract skilled new labour from third countries. Regional cooperation in research, education and training and public services is required. Moreover, the resources of the Union, notably through cohesion policy, and the Member States for improving economic infrastructure are already having a transforming effect on the attractiveness of the region. This can only be enhanced through better co-ordination. People can already travel much more easily thanks to the extension of the Schengen area to all the Member States in the region.

4. To keep the Baltic Sea Region safe and secure. In comparison with many other regions of the world, the Baltic Sea Region is relatively safe. To maintain this, cooperation is needed to combat organised crime and also to develop civil protection systems in case of natural and man-made hazards. The improvement of maritime safety, where risks are multiplying due to the ever-increasing traffic flows is particularly urgent.

We do not need to create new financing instruments for the implementation of the Strategy but rather to make better use of existing financing sources. European Union structural funds, other EU financing sources, national funding and loans from international financing institutions are all available and should all contribute. By working together in the preparation of national and EU policies, the Commission, Member States and private partners can create synergies and avoid overlaps.

In the preparation of the Strategy, the Commission needs the expertise of all the concerned parties in the Baltic Sea Region. We are therefore organising stakeholder conferences and a series of roundtable discussions during the coming months, in cooperation with various organisations and local and regional bodies. The aim of these events is to gather information to help improve the Commission's approach and get feedback on the issues presented. The Commission services will participate actively in the discussions and take full account of the positions and results of these discussions as it prepares the Strategy.

The Strategy for the Baltic Sea[1] region shows the direction of European policy development. The territorial dimension of policy decisions is becoming increasingly more important as the added value of taking an integrated territorial approach towards fostering development opportunities becomes evident. In this context, the Baltic Sea Region could become a test case for wider-regional development policy. If the Commission and the regional actors can successfully work together to create the Strategy, and then implement it efficiently, the approach could serve as a source of inspiration for other EU macro-regions in the future.

José Manuel Durão Barroso

President of the European Commission

[1] To follow developments in the preparations of the Strategy, please see the webpage http://ec.europa.eu/regional_policy/cooperation/baltic

Cleaner, safer and brighter future of the Baltic Sea

By Paula Lehtomäki

The Baltic sea is an arena of an active trade as well as an arena for vivid economic and cultural co-operation. All countries in the Baltic Sea region have committed to strengthen the co-operation to maintain the booming economy of the area. Regardless of the flourishing economy, the sea itself is nothing but flourishing. Baltic Sea is more fragile than ever.

One of the greatest challenges for the Baltic Sea region countries is to protect the sea and improve the state of the marine environment in upcoming years. This is one of the highest priorities of the Government of Finland. Our aim is to intensify the EU cooperation and focus on the improvement of environmental safety – hand in hand with the development of economic collaboration. This is the most effective strategy to create a brighter future for the Baltic Sea region: not only for the many species of sea but also for the countries and their future interests.

The good ecological status of the Baltic marine environment requires goal-orientation in all nine riparian countries. We need active implementation and political commitment both nationally and in co-operation in Baltic Sea region. The existing platform for the co-operation is the Helsinki Com-mission (HELCOM), which is the governing body of the Convention on the Protection of the Marine Environment of the Baltic Sea Area.

HELCOM's main goal is to protect the marine environment of the Baltic Sea from pollution, and to restore and maintain its ecological balance. In pursuing this vision the nine riparian countries have jointly established HELCOM to supervise and coordinate the protection of the Baltic Sea.

After a long preparation and a series of negotiations the HELCOM Baltic Sea Action Plan was adopted in November 2007. The Action Plan sets an overall goal of achieving a Baltic Sea in good environmental status by 2021. The programme of actions was approved by every member state and the European Community.

I believe that the Baltic Sea cooperation, in many respects, and the Action Plan as its most concrete outcome, can be observed as a source of inspiration to other organizations and cooperation frame-works addressing similar challenges.

The main challenge of the Baltic Sea is twofold. On the one hand eutrophication and nutrient substances worsen the condition of the sea constantly and on the other hand maritime activities, including the growing maritime transport brings closer the risk of the ultimate threat, a major oil spill.

With regard to the eutrophication the Action Plan proposes country-wise annual nutrient input reduction targets for nitrogen and phosphorus. For the other challenge, particularly maritime safety, we need effective cooperation of the riparian countries,

The transport of oil and chemicals which has increased so dramatically and is still increasing in the Gulf of Finland and the Baltic Sea is heightening the risk of oil spills. The volume of oil consignments in the Gulf of Finland rose from 20 million tonnes in 1995 to 140 million tonnes in 2006. It has been estimated that by 2015 it could be as much as 260 million.

If a major oil disaster occurs, the resources we have at present in the Gulf of Finland for tackling the problem would not necessarily be sufficient to bring the situation under control satisfactorily. Russia's facilities for dealing with oil spills are still fairly poor and the situation in Estonia is not very satisfactory either. Finland and Sweden are reasonably capable of dealing with an emergency but it would not be enough if a large-scale accident happened.

Every action we make costs money, but inaction costs even more. The costly management measures have only partially been effective to improve the status of the Baltic Sea. The information on how much the improving the status of the Baltic Sea will cost is needed as much the hard economic facts about how much it would cost not to remedy the problems in the Baltic Sea.

This evaluation can be carried out in the similar ways as done in the global warming issue by the British economist Nicholas Stern in his report on the costs of climate change. In Finland and Sweden the work towards "the Baltic Stern report" has underway.

Among other policy tools and instruments highly relevant to the Baltic Sea cooperation I would like to stress the impact of our own action. Even the minor actions can generate a major effect. We surely have challenges. The scientists from different fields conclude that air temperature in the Baltic Sea basin have already risen and the warming is greater in the sea area than what is the average global temperature increase.

It would be so easy to renounce climate change, say that our actions are simply not enough, but there is no alternative. I believe that meeting the challenges climate change has created, can also present a window of opportunities for innovations and technological development. Not to mention promoting employment and regional policy goals. This is possible in particular with energy questions, because solutions to those can turn out to be win-win situations.

It would be extremely hard to fight climate change if we wouldn't have any tools to operate. Fortunately we have a kit full of them. The international agreement on the fight against climate change, the Kyoto Protocol, does not cover emissions from international maritime traffic. This has been left for the International Maritime Organisation (IMO) to regulate.

Fortunately within the IMO, there has been headway made with discussions. The greenhouse gas index for ships has voluntary trial use status and talks on possible emissions trading or other forms of financial control between shipping companies and countries are going on.

Furthermore, there is an overwhelming need for international regulation to improve maritime safety and environmental protection. The Baltic Sea is a good example of one where we need special measures to protect what is an exceptional environment. A shallow, cold sea with a low salt content, one that is divided by thousands of islands and is heavily polluted, requires more effective protection solutions than, for example, the open seas of the Atlantic.

Such a commitment can only be truly made if the needs of all major users of the Baltic Sea are considered and balanced in a fair and transparent way. This is where spatial planning comes into the picture, a tool which, similarly to its use on land, is becoming one of the key means for cross-sectoral management of human activities in the sea and coastal areas. Regardless of all challenges I believe that the countries of the Baltic Sea region can look toward the future with confidence and optimism.

Paula Lehtomäki

Minister of the Environment

Finland

Events in Georgia provoke discussions on security in good, old, peaceful Europe

By Jaak Aaviksoo

In April of this year, the NATO member states decided to assure Georgia's NATO perspectives. Georgia's aspirations were handled in the same way as were the Ukraine's. They were not granted Membership Action Plans, for which they had both been applying for some time, the granting of which Estonia and several other member states, especially the United States of America, had been strongly supporting.

The formulation, which reached the final declaration of the Bucharest Summit and stated firmly and clearly the perspective for accession for Ukraine and Georgia, was a compromise between the more cautious countries (mostly Western and Southern Europe) and more energetic countries. This was the maximum that could be achieved at the given moment, both then and today.

Of course, the conviction and resolve of the United States of America, which has strived to create support to the NATO aspirations of Georgia and Ukraine, is quite remarkable. This is based on a simple and attractive principle: those European countries that strive to gain NATO membership should be admitted to the alliance, regardless of their history and geo-political considerations, provided that they meet certain quality requirements. The very roots of this standpoint can be found in the treaty that established NATO, which states that any European country that contributes to the security of the North-Atlantic space and promotes the principles established with the Treaty should be admitted to the most powerful security organisation in the world. Differences aside, all NATO member states share basic values and both Georgia and Ukraine are countries that share this common value base and are prepared to contribute thereto.

Since the Bucharest Summit, but especially since Russia's aggression in Georgia, it has been asked whether such a decision, as that adopted in Bucharest, ehanced the security of NATO and the Central and Eastern European countries and Georgia and Ukraine as two countries striving for NATO membership or whether the decision only served to diminish it. Two political hypotheses, both of which undermine our interests, are currently being circulated. According to the first hypothesis, the promised perspective for accession, given to Georgia by NATO member states, is a political step too short and it rather confirmed to Russia that its immediate neighbourhood is still within Russia's legitimate sphere of interest. According to the second hypothesis, Central and Eastern European countries that have several challenges in their relations with Russia are troublesome as members of NATO and would in the long-term cause even more problems and strain the otherwise good and pragmatic relations between Western Europe and Russia. Therefore, we need to ask even more directly what the consequences of the events in Georgia are for Estonia's security.

For Estonia, the events in Georgia shouldn't, in principle, come as a surprise – due to our historical experiences and developments – since the last war in Chechnya to the war in Georgia and the consequent recognition of Abkhazia and South-Ossetia is just a logical sequence to the chain, which was started by Ivan the Terrible, Peter the Great, Vladimir Lenin and Joseph Stalin. The listed names weren't chosen in random – these are the heads of state that are mentioned most often in an Internet survey conducted in Russia as the greatest historical personalities. The Russian media, which largely reflects and magnifies the opinions from the Kremlin, has mentioned the rebirth of Russia as a "geopolitical subject" as the most important outcome of the war in Georgia. Indeed – the western states are now coming to Moscow to plead, either for a truce, withdrawal of the military troops, or simply adherence to international agreements. This is seen by Moscow as a strategic victory – in comparison to a situation ten years ago where the IMF, EU, Amnesty International or just some of the Western politicians were giving patronising lectures on the meaning of democracy and market economy. The very nature of this "rebirth" is stated by Russia's own self-definition: "We don't need your democracy; we have our own sovereign democracy". Such confrontation is clearly deliberate and visible in practically everything that Russia says or does: the confrontation is uncompromising and principal in nature.

Russia's described self-determination and self-validation, based thereupon, clearly makes geopolitical sense. The status of the USA, perhaps temporarily weakened, for multiple reasons; the continuously growing economic and political self-awareness of the Third World; opposition to a unipolar world order; China and India's forceful demands for their own place and truth; the struggling Near and Middle East; and additionally supported by the oil dollars, have all built the window of opportunities that allow for yet another attempt to reintroduce a supreme statehood. And let us not forget, that Russia has an international, broad audience, while she goes about her ventures. Russia wants to be Russia, to identify itself as a geopolitical subject and have it done based on its best historical experiences. That ambition has considerable domestic support, which is magnified by the systematic and all-exhaustive socio-political manipulations of the Putin-Medvedyev administration. Russia is Russia. Both today and in the foreseeable future, as its today's reality, leaves no alternatives. The first realistic opportunity for westernisation was ruined by the October Revolution and the second by the inability of Yeltsin's administration to share the fruits of the market economy with the majority of the population.

Yet, this is merely a socio-political narrative and already, in the victorious haze of the post-Georgian aggression, there appear many problems for Russia. Massive capital flight, extremely low western business confidence in Russia and the lowering demand for oil because of the almost inevitable global economic recession demonstrate that Russia can talk the talk, but not walk the walk. She is inherently weak, open to the winds and storms of the "outer-world", interlinked with the rest of us. She cannot exist autonomously and independently of the global economy and attempts to tinker with political and administrative borders of neighbouring countries does not come without a heavy price – and more can be expected, if this simple fact is not recognized in the Kremlin.

Russia did not succeed in instilling fear in her neighbours in North-Eastern Europe. In the long-term, we have to consider that staying true to the basic values, as written down in the Charter of the North-Atlantic Treaty, should assure security more effectively than hesitant appeasement politics or the search for beneficial compromises. I am convinced that Estonia's positions, which have consistently served to support the efforts of Georgia and Ukraine, are correct, not merely due to remaining true to ideological principles but also because it increases our national security in the long-term perspective.

In principle, such an aggressive and revanchist attitude is always characterised by a uniform course of events. As such behaviour sees compromise as a weakness, any humouring on principle issues would only contribute to increase the aggressor's hunger. Therefore, one should take the parallel, as pointed out by the Swedish Minister of Foreign Affairs, Mr. Carl Bildt, who compared the aggression and annexation in

Abkhazia and South-Ossetia with the fate of the Sudetes before the outbreak of the World War II. As the Munich Treaties could not avoid the onset of the Second World War in Europe, one could assume that any compromises made now would be as dangerous for Central and Eastern European countries today. Therefore, I do think that the consistent and principal attitude of Estonia and our NATO allies regarding the issue of basic values, including consistent conformation of the sovereignty and territorial integrity of countries, are not issues on which we should seek compromises, as these could become very expensive later. These compromises shouldn't smell of gas or oil.

It has nothing to do with the profits gained or to be gained or the success granted by cheap energy carriers with regard to other partners. It comes, above all, down to the spineless attitude, expressed by such attitude in one-way or another. Spinelessness injects self-confidence and increasing aggressiveness to an aggressor.

Considering everything said above – it's not quite correct to say that the security situation in the world did change considerably after the events in Georgia. It would be more appropriate to say that the situation changed long ago, but now the required changes in understandings and beliefs are also taking place in the western capitals of Europe. Here, Estonia will continue its work to stress the growing importance of the co-ordination of NATO defence planning, while not forgetting the efforts we need to make ourselves and all together to enhance NATO's security.

For me, one the most important outcomes of the conflict in Georgia was the realisation gained at the price of sufferings of the people of Georgia and Ossetia – Russia really is, above all, Russia. Europe has learnt its historic lessons and therefore, a war between Germany and France or, for example, Estonia and Latvia, would be unthinkable – but we can't apply this experience to relations with Russia and vice versa. It is, however, much better and safer to be aware of this difference, instead of entertaining delusions about shared experiences and values.

For these very reasons, I am convinced that Estonia's security political position, supported by our consistent position, which states that the efforts that democratic states make on NATO direction should be supported and the aggressors should be stood up to, has contributed to the improved security of Central and Eastern European countries. Our clear and transparent behaviour has revealed the nature of today's regime in Russia with the related threats. And let's also keep in mind that our sense of threat has been verified – this also shows that we have taken the right way to improving our security.

I would like to end with a brief train of thought, concerning the long-term perspective of the relations between Russia and the Western countries. It's quite obvious that mutual sense of threat is sharper today than it used to be a couple of months ago and while the nature of the sense of threat is conflicting – from one side, above all, physical and, from the other hand, conceptual – this sense of threat is, in fact, real and regrettable. At the same time it seems that the geo-political spectre of threats of Russia and the Western countries, based on wider and, above all, demographic trends, largely overlaps while a number of security threats of both Russia and the Western countries would be easier to manage by co-operation instead of opposition. Therefore, may strategic security partnership, as real and strategic as possible, provide some hope and air for breathing. This would definitely serve Estonia's best interests.

Jaak Aaviksoo

Minister of Defence

Estonia

Gas pipeline to the Baltic Sea - should it come in a civilized way or under the dictate of the big and the powerful?

By Siiri Oviir

During the last decades the European Union's energy policy has been quite dispersed. No unified policy has been developed because of the opposition of a number of big states. Today this topic has become a burning issue as in addition to economic aspects political aspects have come into play. Some states back very strongly the interests of their private sector and in some cases they have even used their enterprises to reach their foreign policy aims.

We are not used to think of energy as part of real politic, but energy resources can be used to fulfil the states' ambitions, to influence leaders of other states or even to threaten them. That is why during the last couple of years energy security has become so relevant in the context of the future Russian-German gas pipeline to be built in the Baltic Sea.

The planned pipeline, which ever route it would take under the sea, will not considerably influence Estonia, my native country, given the present context of gas supplies. However, Poland and the other Baltic States as potential countries of transit would gain a lot in case the 1200 km long under- water gas pipe were built on the land. Estonia is first and foremost interested in avoiding the environmental damage to the marine environment of the Baltic Sea. Among the main sources of threat there are the sunken containers with chemical weapons that can start leaking, intensive traffic and rusty bombs lying on the seabed let alone the interaction with the technical infrastructure. As to the latter the Estlink sea cable is not the most vulnerable infrastructure object in the Baltic Sea, as the optical cable connecting Sweden and Poland has much greater relevance in this respect.

After following the dispute over the gas pipeline one cannot avoid asking the question to whom the seabed belongs. What are the states' duties and rights in connection with the sea? The Baltic Sea and also the territory under the sea have been divided between the surrounding states and are subject to international or national law and there is practically no 'open' sea left in this area. The sovereignty of coastal states applies also to their territorial waters and the seabed. The direction and the installation plan of the gas pipe will have to be approved by the coastal states of the Baltic Sea. It is also up to these states whether and to what extent to allow under water exploration, including drilling the part of the continental shelf in their territorial waters. A number of coastal states in the Baltic region have not given their consent to the above project as the full documentation has not been made available to them. There have already been some cases in international practice where the states have not given a permission to carry out offshore exploration in their territorial waters or in their economic zone to foreign companies. The reasons vary from potential environmental damage caused by the drilling mechanisms to reluctance to share the information about the underlying national interests in a given territory.

The International Maritime Organisation has declared the Baltic Sea a vulnerable sea area yet there is no international treaty that would deal specifically with the question of environmental impact of a submarine pipeline. There are still some international agreements very close to this topic. The Espoo Convention of 1991 foresees international consultations in case of the projects with a cross-border environmental effect. The countries concerned have also the right to participate in the environmental impact assessment. This Convention has taken effect in Germany, Sweden, Finland and Estonia. Russia has signed the Convention. In addition to the rights given by this international agreement the parties have also taken an obligation to protect the environment that may prove to be difficult to fulfil unless they have a full say in the environmental matters. Considering the above the Estonian Government decided not to give permission for offshore exploration in its economic zone to the Nord Stream in 2007. In July 2008 the European Parliament requested the environmental impact assessment of the pipeline project in the Baltic Sea. In this context it remains unclear why the former Finnish Prime Minister and now Adviser to the Russian-German gas pipe project Nord Stream has expressed an opinion that the opposition of Estonia, Sweden and Poland to the project cannot undermine it and the decisions of these three states can be by-passed.

The problem of energy security will remain important both globally and in the Baltic Sea region for a long time to go and I can only hope that the states will be wise enough to avoid a situation where all parties are in conflict with each other.

Siiri Oviir

Member

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Estonia

Baltic security reflections in the aftermath of the Russian-Georgian conflict

By Artis Pabriks

The Russian-Georgian war strengthens the argument that the current Russian leadership prefers an alternative regime to the liberal democratic system. Despite hopeful predictions after the collapse of the Soviet Empire, not everybody in Russia is willing to embrace democracy. This certainly increases the feeling of insecurity among many Russian neighbours. Security is back on top of the agenda in the Baltic region replacing the short period of relaxation after the successful integration of Estonia, Latvia, Lithuania, and Poland into the EU and the North Atlantic Alliance.

Following the collapse of the Soviet Union, Francis Fukuyama published a book on "the end of history and the victory of liberal democracy" as the only valid model of life. Joining the EU and NATO, the Baltic nations saw for themselves the end of the history as end of insecurity and injustice, and the beginning of life as free individuals.

But today like never before, liberal democracies find themselves challenged by successfully developing authoritarian systems. Russia leaders are reminding the world that Russia will follow its own path of development. Factors like high oil and gas prices have successfully allowed Russia to avoid developing a full liberal democracy. More than this, the Russian leadership quite blatantly and aggressively uses energy policy as a means to regain the national strength and "glory" once enjoyed by the Soviet Union. Russia is becoming an increasingly difficult international partner when dealing with the Middle East, Iran or in fact any other issue where consolidated opinion and the action of international institutions are required.

Bearing this in mind, the recent Russian war with Georgia should be judged as a litmus test for any Russian relationship with her immediate neighbours. The war showed clearly that Russia is ready to use military force in her immediate neighbourhood and is ready to interfere in the domestic affairs of others on behalf of Russian citizens, a Russian ethnic population, or any other grounds she can manufacture if she deems necessary. The region bordering Russia is again feeling intimidated by this newly assertive neighbour whose non-democratic political leadership is increasingly overtaken by memories of "power" as a raw tool.

The war turned out to be a strong test for the European Union's ability to find a common point of view and form a common reaction to the new challenges on its borders. The fragmentation of EU opinion showed both the difficulties of collective decision making, and the broad range of differing national interests. Many European decision makers were simply on their holidays and out of touch. During the early days of the conflict a number of larger EU nations were taking pro-Russian stances whilst EU members geographically closer to Russia used every effort to mobilize Brussels against the Russian advance into Georgia. Today, many are convinced that it was actually the visit of the Baltic and Polish Presidents to Tbilisi which ultimately stopped the Russian forces at the suburbs of the Georgian capital. NATO and the Americans were both caught unprepared and politically outflanked.

Many analysts in the Baltic Countries believe the EU has been engaged too little in the Caucasus in recent years whilst Russia has had clear plans using political tools like trade, passports and visas in new more aggressive ways. The European Union was simply behind the Russian political game and proved unable or unwilling to take any real decision regarding Georgian territorial integrity.

Another serious blow to European security was dealt by the Bucharest NATO Summit. Officially NATO announced Georgia to be a future member country but significantly did not expand MAP to Georgia because of resistance from some EU member countries and weak US diplomatic persuasion. Russia correctly interpreted this as a weakness of the Alliance in the Caucasus region and as authority to act and use military force

The war showed that Russia will continue to use the ethnic card aggressively to promote its interests abroad. In all three Baltic countries, particularly in Estonia and Latvia there are a large number of ethnic Russians remaining after the collapse of the USSR. Political integration of parts of this population into the main stream population is challenging. But it is deliberately being made more difficult by a large and consciously aimed Russian economic and media influence on these minorities from across the border.

The mood in the Baltic region about EU and NATO membership can be characterized by the saying of Benjamin Franklin: "If we do not hang together, we will hang separately. The Baltic nations want to be certain they will receive NATO and also EU support in the event of crisis." The striking absence of common EU foreign and defence policy, the continuing political/military isolation of Sweden and Finland, the disagreements about further enlargement and questions about contingency planning within the Alliance worry Baltic nations about the seriousness of these institutions. They want to be sure of serious support regardless if it is the holiday season in Europe.

The Baltic nations are more than anyone else willing to see a good relationship between NATO, the EU and Russia. NATO must re-establish and restate its Article V core values. The EU must prevail not only as a united institution but also as capable, strong, and globally influential union in the 21st century. It must not always yield its interests to those of Russia. The current stance of both organisations towards Russia fail to reflect these goals and the Baltic nations are among the first to worry about this failure. In long term Russia itself would benefit from less appeasing and more value orientated international stance. Maybe and hopefully, liberal democratic system might also fit the Russian people one day.

Artis Pabriks

Ex-foreign minister of Latvia (2004-2007)

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Latvia

Busy Baltic to benefit from global pollution measures

By Efthimios E. Mitropoulos

The Baltic Sea is one of the busiest in the world and shipping activity within it has been steadily expanding, in particular over recent decades. This reflects the dramatic increase in oil transport through the Baltic, the economic prosperity of the Baltic Rim States and the influential role they play in international trade.

Current statistics reveal that around 2,000 sizeable ships are normally at sea at any one time in the Baltic, including large oil tankers, ships carrying dangerous and potentially polluting cargoes, as well as many large passenger ferries. Navigation in the Baltic Sea can be challenging, with narrow straits, winding passages, shallow depths, archipelagos, fishing activity and areas where shipping lanes cross, all adding to the difficulties. But, although a number of shipping accidents do, regrettably, occur in the Baltic from time to time, fortunately, only a few of these incidents have so far resulted in loss of life or serious pollution.

To ensure the safety and security of navigation and the protection of the environment, various measures have been adopted by IMO, by HELCOM at the regional level, and at the national level by the Baltic Sea States themselves. As a result, maritime transportation is generally recognized as the safest, most effective and environmentally friendly way of transporting goods within the region.

However, the increase in shipping activity has, quite rightly, raised concerns about the effect it may have on the environment, particularly on air quality. Exhaust emissions from shipping, due to the combustion of marine fuels that contain a high sulphur content, contribute to air pollution in the form of sulphur oxide (SOx) and particulate matter. These can harm the environment through the formation of smog, acid rain and acidification, as well as adversely affecting human health, particularly around coastal areas with dense ship traffic and busy ports.

Nitrogen oxide (NOx) emissions from ships also cause acid depositions that can be detrimental to the natural environment and contribute to eutrophication. In addition to SOx and NOx, shipping, like other major industries, also contributes to the emissions of greenhouse gases (mainly CO2), volatile organic compounds (VOCs) from petroleum cargoes and, to a lesser degree, ozone-depleting substances.

Globally, air pollution from ships is addressed by IMO's MARPOL Convention (Annex VI), which contains regulations for the pevention of air pollution from ships, an instrument which has been in force since May 2005. Annex VI covers ozone-depleting substances, SOx, NOx and VOCs. And, while air pollution is a global problem, it has assumed a heightened significance for the littoral states of the Baltic, a sea which is almost land-locked. Annex VI, therefore, addresses this and makes the Baltic a "SOx emission control area", demanding, as of 19 May 2006, that all ships operating there either use fuel oil with a low sulphur content (not exceeding 1.5 per cent) or exhaust gas cleaning systems offering equivalent standards.

Just two months after its entry into force, in July 2005, IMO agreed on the need to undertake an extensive review of Annex VI, to take account of current technological improvements and the need to further reduce harmful emissions from ships.

As a result of that review process, in April this year, IMO's Marine Environment Protection Committee (MEPC) approved amendments to Annex VI, which are expected to be formally adopted this month and enter into force 16 months thereafter (i.e. in February 2010). The main changes would see a progressive reduction in SOx emissions from ships, a reduction of the limits applicable both globally and in Emission Control Areas (ECAs) such as the Baltic Sea and progressive reductions in NOx emissions from marine engines. The revised Annex VI will also allow for ECAs to be designated for SOx and particulate matter, or NOx, or all three types of emissions from ships, in the event that the need for additional protection of human health and the environment in the area is demonstrated.

Although Annex VI does not cover the emission of greenhouse gases (GHGs) from ships, IMO has given ample consideration to this matter. Indeed, the Organization has a mandate, through the United Nations Framework Convention on Climate Change (UNFCCC) and its Kyoto Protocol, to pursue the limitation or reduction of emissions of greenhouse gases from ships. To that end, IMO has approved an action plan and is now working towards the establishment of a robust regime that will regulate shipping at the global level and contribute to the deceleration of climate change.

Progress towards such a regime was made during the first intersessional meeting of IMO's Working Group on Greenhouse Gas Emissions from Ships, held in Oslo, Norway, from 23 to 27 June 2008. The week-long session was tasked with developing the technical basis for reduction mechanisms that may form part of the future IMO regime to control GHG emissions from international shipping, as well as drafts of the actual reduction mechanisms themselves, for further consideration by MEPC 58 in October 2008, which, notwithstanding the importance of the Oslo meeting, will have the final, decisive role to play on the issue.

In particular, the Oslo meeting made progress on developing a mandatory CO2 Design Index for ships and an interim CO2 Operational Index, and held extensive discussions on best practices for voluntary implementation and economic instruments with GHG-reduction potential. These efforts are due to culminate with the adoption, in 2009, of binding regulations for all ships, which, I hope, will successfully convey, to the Conference of Parties to the UNFCCC to be held in Copenhagen towards the end of next year, IMO's firm determination to do as much as it can about the environment.

The need for IMO and the maritime community as a whole to act in concert with, and contribute to, the wider international efforts aimed at swift and substantive action to combat climate change under the UNFCCC process, by proactively addressing the principles and objectives enshrined in the roadmap agreed at the December 2007 Bali Conference, is clear.

Nevertheless, there has been a recurrent debate over whether the GHG emission reductions agreed by IMO should apply exclusively to countries listed in Annex I to the Kyoto Protocol (in essence, developed countries) or whether their application should extend to all ships, no matter what flag they fly. The repercussions of that debate extend far and wide.

If reductions in CO2 emissions from ships are to benefit the environment as a whole, they must apply globally to all ships in the world fleet, regardless of their flag. It seems completely incongruous that two ships, carrying similar cargo, loaded in the same port, sailing at the same speed and having the same Baltic Sea destination, should be treated differently simply because they are registered

under two different flags – one the flag of a non-Annex I country and, the other, that of an Annex I country. They would each be releasing the same amount of GHGs, wherever they might sail to. If mandatory reduction measures were applied only to ships flagged in Annex I countries, which in today's shipping reality represent a mere 25 per cent of the world's merchant fleet, the net benefit for the global environment would be minimal and that, clearly, given the global mandate and responsibility of IMO, would not be a satisfactory outcome.

Moreover, if control measures applied only to ships flagged in Annex I countries, there might be a massive and rapid exodus from Annex I to non-Annex I registers, thus reducing even further the abatement potential. IMO should, therefore, develop a regime that will contribute positively, fairly and visibly to the endeavours of the international community as a whole to combat climate change; a regime in which, because of its unique international nature, shipping in its entirety, not a small fraction thereof, engages comprehensively to regulate GHG emissions effectively.

The Kyoto Protocol to the UNFCCC – wisely in my opinion – left the limitation and reduction of GHGs from shipping to IMO to regulate. But Kyoto expires in 2012 and will be replaced by the outcome of the Copenhagen meeting in December 2009. IMO will be reporting to that meeting and I am confident that, following the progress that is expected to be made on this issue by the MEPC in October 2008 and July 2009, we will have a positive outcome to convey, not only for Baltic Sea States, but for the global community as a whole.

Efthimios E. Mitropoulos

Secretary-General

International Maritime Organization

EU focuses on the Baltic Sea

By Jari Luoto

There is fresh interest towards the Baltic Sea. Governments, regional organisations and private actors have activated around the region. Benefits of EU enlargement are especially visible around the Baltic Sea where eight out of nine coastal states are Member States.

I often think that this interest is also driven by a great contradiction: the Baltic Sea region is one of the most prosperous one in Europe and the economy is growing rapidly even if put into a global perspective. Environmental awareness among the population is at a high level. Yet the Baltic Sea is one of the most polluted seas. It is plagued by eutrophication, depletion of fish stocks and the arrival of non-native species through ballast water. As a legacy of wars hazardous substances lie in the seabed.

On a typical day, already as many as 2000 vessels sail the Baltic Sea. This is obviously a sign of good economic growth in the region. The amount of oil tankers demonstrates the growing importance of the Baltic Sea as a route for transporting energy from Russia. It is also true that single hull tankers have vanished from the Gulf of Finland and the number of accidents has been in decline for many years. Unfortunately the continuing strong growth in traffic volume increases the risk of accidents.

Something needs to be done to try to correct the result of decades of neglect. At the same time the region needs to respond to new challenges.

At the initiative of the European Parliament and supported by the governments in the region the European Union is currently in a process of producing a strategy for the Baltic Sea. The mandate given to the European Commission by the European Council of December 2007 specifies a timeframe: the strategy should be presented to the June 2009 European Council, just prior the Swedish Presidency of the EU. Work is in good progress, with wide consultations with stakeholders producing proposals for the strategy.

But here is another contradiction: we have always been good in producing papers and organising ourselves in the Baltic Sea region. A plenty of research material is available on the key problems. What we lack is coordinated action with more ambitious goals than we have set so far in the region. Enlargement of the European Union, which has had an overwhelmingly positive impact for the region, has created new possibilities and potential for cooperation. We have yet to turn all that potential into action. Here the EU's Baltic Sea Strategy can be of great assistance.

What should be the focus of the strategy? I think that the value added from the European Union would come from using the legislative power, programmes and financing in a way that is more focused on the special features of the Baltic Sea region. The region could well use a strategy that is focused on a couple of priorities: the marine environment, maritime safety, energy- and transport networks and internal safety and security. The implementation of the strategy could also mean that the Union has a stronger role in the numerous regional forums.

The strategy should come with an action plan specifying who is going to do what and in what timeframe. We have after all a good selection of tools available. Just think of HELCOM, CBSS, the Nordic Investment Bank, the Nordic Council of Ministers, the Task Force on Organised Crime, to name just a few. Non-EU states in the Baltic Sea region would have to be committed into joint problem solving efforts. This is precisely why the EU has the Northern Dimension with Russia, Norway and Iceland as equal partners.

It will easily take a decade or two before the ecological state of the Baltic Sea can be described as good. But immediate action is needed to attain this goal and prevent setbacks. HELCOM, with all the coastal states as members, has recently adopted an ambitious Baltic Sea Action Plan in order to step up the work for restoring a healthy state of the marine environment.

The steady growth of transport of oil and chemicals constitutes a risk that needs to be reduced by more stringent rules on maritime safety. Finland is putting forward proposals to develop further the Gulf of Finland Mandatory Ship Reporting System and to explore the possibility of extending the system to cover the whole Baltic Sea. At the same time maritime safety in the Baltic might benefit from the several initiatives aiming at creating a real time maritime traffic image for controlling vessel movements.

Economic development, enhanced energy security and the response to climate change go hand in hand in the Baltic Sea Region. Energy security and a better diversity of energy sources require more interconnections within the region and cooperation in building new capacity. The joint task of increasing the share of renewable energy means building sea based wind mill parks in the region. This requires a good amount of Marine Spatial Planning.

When you add the challenges of getting the maximum benefit from the investments in higher education, IT technology and R&D funding in the region, you have recipe for a forward leaning strategy with an ambitious action plan. The EU Baltic Sea Strategy should be seen as a catalyst and a tool for increased and more focused cooperation. The next couple of years will show whether the Baltic Sea States and indeed the whole European Union seize this opportunity and give a big boost for this macro-region.

Jari Luoto

Ambassador for
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A role for the Energy Charter in a new Russia-EU Partnership Agreement

By André Mernier

Negotiations between Russia and the European Union on a New Partnership Agreement to super-cede the Russia-EU Partnership and Cooperation Agreement (PCA) of the 1990s will some day resume. While both parties aim to conclude an agreement which will provide a strengthened legal basis and binding commitments covering all areas of their relationship, energy will remain at the core of the agenda. This should not come as a surprise, since Russia is the EU block's primary energy supplier and energy demand within the EU will continue to rise in the foreseeable future. A highly inter-dependant, albeit at times testing, consumer-supplier relationship now exists between the two sides. The challenge facing the negotiators of the New Agreement will be to make this relationship durable in the long term in order to ensure their mutual energy security. To do this, they will need to structure the relationship through appropriate legal and political instruments so that Russia-EU energy relations will develop as a genuine factor of cooperation, as opposed to a factor of tension.

At first glance, it appears that such instruments are readily available for Russia and the EU to strengthen their energy ties. The Energy Charter Treaty (ECT), a legally binding multilateral agreement which both Russia and the EU signed in 1994, provides the foundation for all aspects of cross border relations in the energy sector.[1] It covers investment, trade, transit, energy efficiency and provides for international arbitration in the event of disputes between its members. There seems little doubt that both Moscow and Brussels endorsed the ECT as the basis for their energy cooperation when the last PCA was being negotiated. Article 65 of that agreement, which applied to energy, made explicit reference to the principles of the Energy Charter at the very outset of the text.

Facts and fallacies

Despite both the originality of the Energy Charter concept in facilitating East-West cooperation in the energy sector, together with the political support enjoyed by the ECT in the initial phases of its development, Russia has yet to ratify the Treaty. This has created confusion about Russia's role in the Treaty and raised questions as to whether Russia is even a member of the ECT. The situation is compounded by the largely ill-informed assertions that ratification of the ECT will require Russia to provide mandatory third party access to its energy infrastructure and open up its energy reserves to foreign investment. Even more critical voices, including those expressing their views in the spring edition of Europe's World, argue that "Russia will not implement (ratify) a treaty that it considers a humiliation because it was written to favour consumers who saw themselves as the winners of the Cold War".

None of this type of speculative, emotionally charged discussion does justice to Russia's realistic relationship with the ECT and the fundamental role that the Treaty can continue playing in the New Agreement between Russia and the EU. Considering a number of key facts in the inter-linkage between the Russia, the EU, the PCA and the ECT may be instructive in this sense. Fact number one. Although Russia has yet to ratify the Treaty, it applies the Treaty on a provisional basis, which means that it has agreed to apply the Treaty's provisions to the extent that they are consistent with Russia's constitution, laws and regulations. While only a handful of ECT members such as Norway and Australia have yet to ratify or apply the Treaty provisionally, Russia's provisional application represents a considerable degree of commitment to the Treaty's binding provisions.

Fact number two. It is true to say that Russia's formal ratification of the Treaty would further consolidate on the relationship between the EU, Russia and other ECT member states. However, the absence of Russian ratification does not interrupt the technical work of the Treaty, nor the Energy Charter process – in which Russia is one of the most active participants. Formal ratification tomorrow would not lead to a different state of affairs for Russia with respect to its ongoing relationship with the Charter process and its obligations under the Treaty.

Fact number three. We should mention at this point that the EU, Russia and all of the other ECT members would not have signed the Treaty and continued to be active in the Charter process had they not accepted the principles contained in the Energy Charter declaration. I refer to universally applicable concepts such as open and competitive energy markets, non-discrimination, recognition of state sovereignty over resources, creating the conditions to stimulate investment flows, consideration of the environment and efficient use of energy. These principles work to the benefit of all parties which is why the great majority of ECT members have seen fit to ratify the Treaty. This includes the European Communities and all of their member states.

Finally, it should be added that the ECT member states, despites the best efforts of Russia, the EU and others, have yet to complete negotiations on new instruments intended to improve upon the Treaty's provisions on transit. While this gives the impression that the work of the Charter process needs to be expanded, it also reinforces the urgency to resolve certain aspects of cross border energy relations – particularly energy transit – within a multilateral as opposed to a bilateral forum setting. It is hardly surprising, therefore, that negotiations on the Energy Charter draft protocol on transit have recently returned to the multilateral level. The Energy Charter process, as the primary international energy institution where Russia is an active member, remains the most adequate framework for energy producers and consumers to iron out any differences they may have in how energy should be transited across borders.

A common denominator for shared principles within competing interests

In the field of energy, it is natural for Russia and the EU to be both competitors and partners. Europe remains the largest single customer for Russian energy exports, on which Russia is no less dependent than Europe relies on Russian energy supplies. Although this creates inter-dependence, it should likewise be accepted that the strategic interests of consumers and producers are not always going to be in convergence. Furthermore, diversification of energy supplies and markets has traditionally been a central tenet of sound energy policies. The prospect of competitive interests – be they with respect to the price of energy or over the direction which export routes should take – is therefore likely.

[1] The Energy Charter Treaty of 1994 is a legally binding extension of the principles contained in the European Energy Charter of 1991, a non-binding political declaration and precursor to the ECT. The ECT came into full legal force in 1998, upon its ratification by the 30th member state.

We should also note that, as was recently underscored by European Energy Commissioner, Andris Piebalgs, the EU and Russia employ two different types of legislations to organize their respective domestic energy markets. This applies particularly to the gas sectors, where the EU internal gas market endorses the fully liberalized model where as the Russian gas sector is largely vertically integrated. This too can create certain strains since the level of compromise that has to be reached extends beyond the supplier-consumer market based relationship, and includes two distinct institutional approaches of managing domestic energy markets.

This backdrop to the Russia-EU bilateral energy relationship creates a rather challenging playing field for negotiators of a future New Agreement. However, the fact that both sides have embraced the principles contained in the Energy Charter – demonstrated by signing the ECT – implies that the common denominator that binds Russia and the EU in the energy sector is stronger than any competing interests which may exist. This common denominator is the Energy Charter, the core principles of which are just as applicable today as they were when the Charter process was emerging during the 1990s. It is the primary functioning instrument of international law which is available to both Russia and the EU through which to institutionalize their energy relations within the framework of a New Partnership Agreement. There are three key aspects to the ECT and the Charter process which both the Russian and EU negotiators should take into account when designing the energy provisions of the New Agreement.

First, the ECT and the principles of the Energy Charter are based on the guiding philosophy of sanctity of domestic energy policies. Effectively this means that members of the ECT are free to determine the structure of their energy markets (be they fully liberalized or vertically integrated), execute domestic energy policies in a sovereign manner, and determine the degree to which they desire to open up their energy sectors to foreign investment. ECT member countries exercise full sovereignty over the development of their national energy resources and are not obliged to provide mandatory third party access to their energy infrastructure. The starting point for any effective cross border energy relationship is offering due respect for alternative models of market organization.

Second, the Energy Charter aims to maintain a balance between the interests of the key stakeholders along the entire energy value chain. This applies particularly to the need for providing an equilibrium between consumers and producers, simultaneously to paying due attention to the interests of transit states. Whilst it has already been mentioned that the interests of energy producers and consumers are not always going to converge, a balanced framework for their energy trade is essential. Such structures, however, should be based on principles shared by both sides. The 51 member countries of the ECT include a good mix of producers, consumers and transit states and the Charter process remains the key international energy forum in which these stakeholders can reconcile their differences. In this context the Charter's role is unique: no other international energy organisation provides a common platform for the development and implementation of binding disciplines among these diverse groups of stakeholders.

Finally, and perhaps its most notable contribution, the ECT aims to create a level playing field for all of its members, based on a common set of rules and practices acceptable to all. Nowhere is this more important than in the energy sector, where a fine line exists between commercial and political decision making, and where the sheer size of investments together with ecological considerations brings with it exposure to enormous risks. With respect to the Russia-EU energy relationship and a New Partnership Agreement, the fact that intensive interdependence juxtaposes two highly distinct organisational approaches to domestic energy markets, elevates the ECT to the closest instrument we have in forging a 'common energy space' underpinning an effective Russia-EU bilateral energy trade.

The founders of the Energy Charter concept intended for it to work in a neutral manner, based on common principles to create the foundation for effective cross border energy relationships in Euro-Asia. The negotiators of the ECT designed its instruments to reflect this neutrality and placed it within a binding inter-governmental framework of 'soft-law'. The Energy Charter process, which is based on the provisions of the Treaty, incorporates the necessary flexibility to give the relationship truly durable character, reducing risks and promoting trade and investment along the way. Taken together, the instruments and experience of the Energy Charter provide the most practical and the most realistic platform for the ongoing evolution of the Russia-EU energy relationship. The Energy Charter should form the soul of any bilateral energy deal within the framework of a New Partnership Agreement between the EU and Russia, ensuring that the playing field between remains level, rather than challenging.

André Mernier

Secretary General

Energy Charter Secretariat

Finland is facing major energy decisions

By Timo Rajala

Energy investments are being made in Finland and all over the world at an increasing speed. Many countries find themselves in the same situation as Finland; electricity consumption is increasing, imports are decreasing and existing capacity is becoming obsolete.

Finland wants to continue these investments. The industries are exceptionally unanimous in their wish to change over to emission-free electricity production during the next 20 years. They will volunteer to make the necessary investments, worth billions of euros, largely without government subsidies. The gain would be self-sufficiency in electricity production. Thereafter the use of electricity for heating or even electric cars would be acceptable and would slow down climate change. The new capacity built would also curtail price increases and reduce the costs levied on companies by emission trading.

In this difficult economic situation companies are looking for strong signals to indicate that Finland will provide favourable operating conditions in the future. The secured availability of energy at competitive costs would be an incentive for companies to develop and invest in Finland.

It poses a political problem that nuclear power has a prominent role in future electricity solutions. At least two new nuclear power plant units will be needed by 2025 in addition to the Olkiluoto 3 plant presently under construction. One of these would have to be built already before 2020 to help Finland to fulfil its emission reduction quota.

When we are now thinking of the future energy solutions in Finland, one factor causing confusion is the EU liberalisation package. There is talk in the EU about liberalising the market, but in practice regulation is on the increase. The EU has set exact percentual goals for emission reductions, energy conservation and the share of renewable energy. It restricts the decision-making options of the member states drastically. There has been a tradition in Finland that the industries and politicians seek the best national solutions in close co-operation and then commit themselves to these. The best national solution now is a model emphasising nuclear power, but it doesn't fulfil the EU equation with the three variables.

The grip of the EU on national energy policies has continued to tighten. This is somewhat peculiar, as energy policy does not fall within the authority of the EU but should be decided on by each member state independently. The EU has circumvented the problem by directing energy solutions in the name of environmental policy.

What is guiding the EU decisions and actions? Has it consistently concentrated on averting the climate change? As a consequence of the EU emission trade the carbon dioxide emitted carries a price now, at least in energy production and heavy industry. There is also a political agreement on the setting of emission limits on sectors outside the emission trade, e.g. traffic.

The country-specific obligations for renewable energy are at odds with this goal. Nearly all the member states have such heavy obligations that their execution is both unrealistic and unreasonably expensive. The essential criterion for decision-making in the EU energy policy has been lost, i.e. the cost-effective reduction of emissions. Member states have no alternative but to use enormous resources for renewable energy. What if the same resources had been applied to other means of reducing emissions?

There is a political wish now to force companies into renewable energy generation through legislation. Manufacturers of equipment and other actors selling services are naturally enthusiastic about this. The situation is a tricky on, though, because in order to get investments countries are likely to start competing in who grants the most generous subsidies and thus triggers rapid investments. Sellers of equipment will take advantage of the heavy demand and the customer's paying capacity. The customer can afford to pay because the subsidising level is high.

The capacity of the EU has weakened. In addition to renewable energy, the EU has also on its plate many other massive and ambitious legislative projects. Their preparation has, however, proceeded slowly. One example is the so-called third liberalisation package, which contains stipulations on the ownership of power transmission grids. After their summit in June 2008, the energy ministers announced publicly that a successful compromise on the issue had been reached. However, the European Parliament did not accept this compromise and the whole package is now threatening to collapse.

There is reason to ask whether the EU should reduce the quantity of legislation and improve its quality. The combat against climate change is a global problem and the EU should concentrate on finding a global solution. The member states should be allowed to decide independently on the most cost-effective ways to avert climate change.

The EU has now begun to stipulate the energy solutions of individual member states and is in actual fact setting limits on the total consumption of energy. This is only a short step away from the stage where the EU sets a production ceiling e.g. for Finland's energy-intensive industry. If, for example, the Finnish steel industry increases its energy consumption by one megawatthour, Finland will have to invest further in renewable energy owing to its EU obligation. Implemented with wind power, this would cost 250 million euros. Should the same steel mill in-vest in Hungary, the obligation to increase the share of renewables would cost only one third of that sum.

Finland has the opportunity to shift to nearly almost completely emission-free electricity production quickly and, from society's point of view, economically. For its part, this would help to secure access to competitive energy to the Finnish industry and economy. The price of energy and the costs of emission trading would be considerably reduced. We in Finland should be allowed to decide on this independently.

Timo Rajala

President, CEO

Pohjolan Voima

Finland

Environmentally friendly for sustainable growth

By Karlis Mikelsons

Latvenergo Group is the leading energy utility in Latvia and is the leader of energy generation from renewable resources in the Baltic countries and the European Union.

Latvenergo Group has started its business activities in 1939 by construction of Ķegums hydropower plant. Currently Latvenergo Group includes five subsidiaries: Augstsprieguma tīkls AS (TSO), Sadales tīkls AS (DSO), Latvenergo Kaubandus OÜ, Latvenergo Prekyba UAB, and Liepājas enerģija SIA.

Latvenergo Group generates its electricity and thermal power in three Daugava hydropower plants and Riga combined heat and power plants, as well as Aiviekste hydropower plant, Ainaži wind power plant, and Liepājas enerģija SIA facilities .

The Daugava hydropower plants is comprised of Ķegums HPP with a total capacity of 264,1 MW, Pļaviņas HPP, capacity 868,5 MW, and Rīga HPP, capacity 402 MW. Approximately 71% of the total electricity produced by Latvenergo is generated at Daugava hydropower plants. Due to significant portion of the overall power supply amount generated by Latvenergo hydropower plants, the total power supply output depends heavily on the water level in the river Daugava; therefore, the annual volume generated by hydropower plants may vary between 1800 GWh and 4500GWh.

Latvenergo AS has two large combined heat and power plants: Rīga TEC-1 (CHPP) and Rīga TEC-2 generating both electricity and thermal energy. Annually, Riga CHPP produces approximately 30% of the total quantity of electricity generated by Latvenergo and 70% of total heating energy supplied to the City of Riga's centralised heating supply system.

In 2005, the 106 million euros* reconstruction of Rīga TEC-1 was completed. Rīga TEC-1 has two gas turbines, one steam turbine, and two water-heating boilers for centralized heating system. Rīga TEC-1 electric capacity is 144 MWel, and the heating capacity - 377 MWth. Rīga TEC-2 is the largest combined heat and power plant in Latvia, with electric capacity of 330 MWel, and heating capacity of 1148 MWth.

Latvenergo Group invests in modernizing its generating facilities and increasing production volume using state-of-the-art, environmentally friendly technologies.

Since 2007 up to spring 2010 Pļaviņas HPP is undergoing the second largest reconstruction, the total investment for the project amounting to 29,6 million lats. The resulting increased capacity and efficiency of three hydroelectric generating units will allow an average annual increase in electricity generation by 30 GWh and will extend units' utilization period by at least 30 years.

Currently, Rīga TEC-2 is under reconstruction. As a result, a new combined cycle power generating unit will enter service in the middle of 2008 which will be capable of operating in both co-generation and condensation mode. In co-generation mode, (gross) fuel utilisation efficiency could reach 88% and 57% in condensation mode (external air temperature 0ºC). This fuel efficiency will allow to triple the amount of electricity generated per unit of heat used, and also will minimize the environmental impact of the plant.

After the reconstruction the electricity generated in cogeneration mode will increase, on average, from 820 GWh to 2200 GWh a year, supplying Latvia with additional 1400 GWh annually.

After the completion of Rīga TEC-2 reconstruction it will become the most modern combined heat and power plant in the Baltic region, enhancing the energy supply independence of Latvia and generating electricity in the most efficient and effective way.

Considering the fact that Latvia is the first country in the Baltics where electricity suppliers face the free-market situation, Latvenergo has become a dynamic company and successfully works in competitive environment; our market share is 96% (of the total electricity consumption in Latvia).

The electricity supply market is quite different in the three Baltic States, as in Estonia it is completely closed, and in Lithuania non-functioning. Therefore, Latvian companies do not have an opportunity to work in the neighboring markets which bars steady development of the electricity supply market in the region.

We have started working at the development of interconnection with Scandinavia because Latvia and the Baltics in general need new interconnections with Western Europe. The new network would open electricity supply from Scandinavia, increasing the safety of electricity system in the region and diversifying the supply.

Especially important for the Baltics would be the interconnection with Sweden, both for the development of electricity supply market and for providing the lacking capacities. Even though a 350 MW cable from Estonia to Finland makes it possible to buy electricity at Scandinavian electricity stock exchange *Nordpool Spot*, the capacity of the cable is insufficient for creating real market with Western Europe.

Launched in 2006, the new under-sea electrical cable *Estlink* connected the electrical supply network of the Baltic States with Northern Europe, allowing Latvenergo Group to buy and sell electricity at *Nord Pool* stock exchange. This created a different outlook for the Baltic States that did not have a direct connection with electric power systems of Central Europe before and were relatively isolated from electricity networks in Western Europe and Scandinavia.

Developing interconnections with Scandinavia, opening up the electricity supply markets in Lithuania and Estonia, and creating a common Transmission System Operator (TSO) for the three Baltic States is crucial for the future development of the Baltic region. Common TSO in the region would facilitate better planning of power systems development and attract new investments, as such TSO would operate on a larger scale and solid financial standing.

By taking these steps the Baltic States would solidify their position in general and would more successfully integrate into the Scandinavian electricity supply market, thus creating a unified region around the Baltic Sea.

Karlis Mikelsons

President, CEO

Latvenergo AS

Latvia

*1 EUR = 0,70 LVL

Nord Stream - making more European energy solidarity possible

By Reinier Zwitserloot

Wintershall is proud to participate in the Nord Stream project. Nord Stream stands out from many other pipeline projects as an European project by its very structure, being realized in partnership with Gazprom, E.ON Ruhrgas and Gasunie, all of them international energy companies with great technical expertise. With its first pipeline grid scheduled for commissioning in 2011, a transport capacity of about 27.5 billion m³/ year of natural gas will be created. With the second phase being completed in 2012, that transport capacity will be doubled. This goes along with investments of 7.4 billion €.

But why does Europe need Nord Stream? Why is there no reasonable alternative guaranteeing European energy security? A focus on the global energy market gives an unequivocal answer.

As the world's second largest consumer of energy and the largest energy importer, the European Union (EU) possesses an important competitive advantage: about 80 % of the world's reserves of natural gas and crude oil are in a radius of about 4500 km of the EU. This is particularly important in view of both the rapidly rising demand for energy globally and the efforts of emerging economies like China and India to make up for their lack of raw materials by securing direct access to oil and gas reserves. One thing is for sure: Europe must be proactive. Energy security is not just going to come knocking on Europe's door.

Another fact has to be accepted: European supply cannot be guaranteed solely on the basis of renewables. According to the latest reference scenario of the International Energy Agency, the proportion of fossil energies in Europe will remain stable at about 80% until 2030. Thus fossil fuels are the backbone of European supply security for this generation and the next. Among fossil fuels, natural gas stands out because of its high energy efficiency and its relatively good environmental properties. The increased substitution of natural gas for other fossil fuels has made the biggest single contribution to reducing CO^2 emissions in Europe since 1990!

However, the contribution of natural gas to climate protection will only be brought to bear if Europe succeeds in meeting its growing need for gas imports. With EU production set to fall by 100 billion m³ by 2020 and demand forecast to grow by about 100 billion m³ at the same time, the EU faces the challenge of securing access to new natural gas reserves. An impartial view at the world map clearly indicates where additional gas can come from: Norway will on the whole merely be able to maintain its share of European gas supplies until 2020. Africa will be able to increase gas deliveries in the longer term, but it will by no means be able to fill the looming import gap. LNG will make a note-worthy contribution to the EU's gas supply, but intense competition for LNG is also expected. The Caspian Sea Region including Iran and Iraq does, indeed, have major reserves of gas, but it will not be able to make up for the import deficit. With up to 30 billion m³, at the most just 5% of the overall requirements of the EU-27 could be covered via the Nabucco project in 2020.

Hence it is clear that a really substantial increase in gas imports cannot realistically be achieved without Russia: Russia has the world's largest proven natural gas reserves and is also "within pipe-line distance" for Europe. Forecasts predict that Russia will be able to increase its gas exports to the EU from its current level of 130 billion m³ to around 190 billion m³ by 2020, so by 50%. That increase cannot be achieved without a transportation network expansion. The Nord Stream pipeline will contribute to that expansion, creating a diversification of existing import routes from Russia to the European Union. Nord Stream certainly does not see itself as competition to other major pipelines like Nabucco and doesn't make these superfluous either. The realization of all these pipeline projects is essential for securing Europe's supply. Despite its enormous proportions, the Nord Stream pipeline would "only" be able to cover about 8% of the EU-27 gas demand in 2020. Nonetheless, the additional volume liquidity of 55 billion m3 brought into the European market will have the important effect to help buyers, even if they are not interested to buy Russian gas, to get gas from other sources at reasonable conditions.

Transporting gas over offshore pipelines is an environmentally sound and safe method of transport, as decades of experience with the complex network of underwater pipelines in the North Sea have documented. As an offshore pipeline, Nord Stream will avoid environmentally sensitive areas such as forests as well as populated areas. Compared to an overland alternative, Nord Stream not only represents the "shorter" route with lower operating costs, but also – due to the small number of compressor stations necessary – lower CO2 emissions during operation.

Because of its overwhelming importance for supplying Europe, the Nord Stream pipeline was included in the Trans-European-Energy Network's (TEN-E) list of "priority projects of European interests" in June 2003 (reconfirmed in September 2006).

One fundamental aspect, often forgotten in the current debate, needs to be highlighted: Nord Stream offers opportunities for solidarity in energy supply throughout Europe. For Poland, e.g., the construction of the Nord Stream pipeline with its onshore links in Germany (OPAL and NEL) will provide several possibilities for connecting the Polish and the German pipeline systems. This would firmly integrate Poland into the European pipeline grid, since the German gas pipeline system today is already linked directly to the major European transit pipelines from the North Sea and is also networked with the European trading points for natural gas in Belgium, the Netherlands and the UK. Only by providing infrastructure, material chances for solidarity in energy supply throughout Europe can become reality!

Reinier Zwitserloot

Chairman of the Board of Executive Directors

Wintershall Holding AG

Germany

Current and future activities of Lietuvos Dujos AB

By Viktoras Valentukevicius

Brief company profile

Lietuvos Dujos AB owns 99% of Lithuania's natural gas transmission and distribution system. The company is in charge of a safe operation and development of the system. The core activities of the company cover natural gas imports and sale to customers, provision of natural gas transmission and distribution services, a well-balanced development of Lithuania's natural gas supply infrastructure. In all, Lietuvos Dujos AB operates 1.8 thousand km of natural gas transmission grid, and 7.5 thousand km of natural gas distribution grid. The company supplies natural gas to companies of Energy Sector, Industrial Sector, Agricultural Sector, Small Commercial Sector and to household customers. The company is also engaged in natural gas transmission on transit to the Kaliningrad Region of the Russian Federation. Lietuvos Dujos AB has more than 540 thousand customers, it employs over 1800 staff members. Lietuvos Dujos AB continues running the natural gas business which in Lithuania dates back to 1961. Following the privatization of the company, which was carried out in two stages, the results of the company started to improve rapidly: the restructuring of the company has taken place, the debts of the company have been settled, the know-how and the company management based on western standards have been adopted. The year 2002 saw the coming of the first strategic investor E.ON Ruhrgas AG, holding a 38.9-percent stock into the company, and the year 2004 saw the coming into Lietuvos Dujos AB of the other partner, the natural gas supplier Gazprom OAO, holding 37.1- percent stock. The privatization gave the company a long-term gas supply agreement, stability, modern-style management, also, the financial situation of the company has been stabilized, bright prospects for development and investments have opened up. It is already four years that AB Lietuvos Dujos has been working under the management of the world famous and highly reputable energy companies. The state of Lithuania holds a 17.7-percent stake of the company, whereas 6.3-percent of the shares of the company are held by small investors.

The priorities of the company include a consistent development of natural gas market, a methodical expansion of the natural gas infrastructure, stable and safe gas supplies to customers, strengthening of the customer and public relations, an efficient management of the company, a rational use of resources, securing that professional standards are met in all activities undertaken by the company and ensuring high quality of works carried out.

Natural gas business prospects and plans

As the demand for natural gas is on the increase, it is ever more important not just to make adequate forecasts of natural gas demand in the future, but also to give our attention and efforts to maximizing the efficiency with which this green fuel is used. It is especially important when we see the rapidly growing demand for natural gas in Europe and efforts of other countries to secure natural gas supplies based on long-term agreements. The price dynamics we have been seeing for some time past makes us reassess the impacts to natural gas consumption forecasts and to review our investment plans, too. On the basis of the Customer Demand Analysis it may be presumed that in 2015 gas consumption in Lithuania will come close to 5 million cubic meters.

No less ambitious are the company's development plans: over the past 5 years Lietuvos Dujos AB has invested over LTL 550 million (EUR 160 million), and over the next 5 years our investments into the renovation, development and our system performance security enhancement is projected to approach LTL 1 billion (EUR 290 million). Out of the pending projects we may single out the construction of a new Gas Compressor Station which is needed for the further enhancement the capacities of gas transit to the Kaliningrad Region, which at the same time will upgrade the security of our gas supplies to our customers in Lithuania due to Lithuania's growing demand for natural gas. Also, it is planned that over years to come, each year, several thousand both households and industrial companies will become customers of Lietuvos Dujos AB; it is planned that the existing natural gas systems will be developed and modernized, quite a lot of towns and settlements are still waiting for their turn to get connected to the natural gas grid.

Business environment is still complicated

The mission assigned to Lietuvos Dujos AB by the National Energy Strategy is loaded with the greatest responsibility of all. The company is expected to secure continuous and reliable natural gas supplies not only in the short-term abut also in the long-term. Therefore, the necessary preconditions for a successful performance of the company include not merely huge investments (we talk about millions) and competent staff but also a soundly based and stable legal regulation. The new Law on Natural Gas enacted in the beginning of 2007 distorted the principles of the EU Gas Directive. Instead of the implementation of the ideas of the market liberalization, the common EU internal market conditions and the so-called energy exchange among the member states, total regulation and isolation have been prescribed. An obvious contradiction can be easily seen: the current version of the Law on Natural Gas fails to secure the transparency, safety and reliability upgrading, the significant investments into the creation of alternatives and the benefits to customers that are being declared. On the contrary, the provisions of the Law are in conflict with the international Gas Sector practice, they stall the process of the gas system development of Lithuania and even the gas supplies security enhancement projects provided for by the National Energy Strategy.

Viktoras Valentukevicius

General Manager

AB Lietuvos Dujos

Lithuania

Russian gas can unite Europe - if we allow it

By Seppo Remes

The Russian Federation has the world's largest gas reserves; over 30% of the world's gas. It is also the world's largest gas producer, with roughly 670BCM of annual production. This position is not going to change in the foreseeable future. All decisions concerning these reserves are fully in the hands of the Russian Government.

Russian gas reserves are mainly located in the northern part of Western Siberia (Urengoi, Yamburg and Medvezhie are the biggest fields). Gas has been recovered for decades, mainly in Cenomanian structures, which are "convenient" because they are almost pure methane and easy and cheap to process (basically, just take away the water), because of the small depth of deposits and because of the natural pressure of gas flows. The fields are rather close to each other, which lowers infrastructure costs. There are estimates that fields' overall costs are as low as USD 1/boe (barrel of oil equivalent).

However, things are set to change. Firstly, drilling must gradually go deeper to more difficult Valanginian and Achimov structures, which is roughly 3-4 times more expensive. Secondly, new gigantic fields must be opened to production, which fundamentally increases capital costs in fields and in infrastructure (especially Yamal penisula, starting with the giant Bovanenkovskoye field). The estimated cost for the Yamal peninsula first and second phase fields is roughly USD 35-40bn between 2009-2020, increasing the production to 300BCM/a (UBS Investment Research estimates). The majority of the cost is the pipeline from Yamal to Vologda. Gazprom can probably finance this fully from its profits. Thirdly, now all these costs must be covered by investors; previously the burden was shared by the Soviet state. Actually, the most difficult problem is how to optimize the opening of the new fields whilst also decreasing volumes from old fields to match the existing trunk pipeline and storage capacity. It is obviously efficient to open new gas storages to pump gas there in low consumption summer time, and thus decrease the need for additional, very expensive trunk pipeline capacity during peak winter consumption. Fears have been expressed within the Russian Government that investments have not been sufficiently large.

Gazprom's perhaps most important asset is its 159,000km trunk pipeline system, with 41.000MW of compressor stations and 65BCM underground storage (almost 15 years' worth of Finland's gas consumption). It has been estimated that the value of these assets alone, calculated as a replacement cost, is around USD 500bn, which is more than twice Gazprom's market cap. (at end of August).

Aside from its pure gas business, Gazprom is a very important financer of the Russian budget; it also makes it possible to keep domestic gas prices at lower levels via profits from gas exports. Gazprom also fulfills some social tasks, such as the like USD 1bn investment program in the gas distribution network to households in smaller towns and villages (domestic prices do not cover the investment costs; sales will be loss-making). The government's control also prevents any price dumping on export markets: all exports are done by Gazprom's daughter company, Gazexport. And one cannot forget the political aspect: it gives the Government the possibility to differentiate prices downwards to customers/countries it considers to be constructive and friendly towards Russia. However, I believe that this "discount policy" to many CIS countries during the last 10-15 years has been a mistake and has cost Russia so far at least USD 50-100bn. And I at least have not heard one grateful word back from them;– on the contrary, there has been harsh criticism when prices were drawn to market levels. Imagine that during 15 years the Finnish paper and pulp industry had been selling its products, on a government recommendation, with very large discounts to other Finno-Ugrian countries, Estonia and Hungary!

Domestically, the basic dilemma for the gas industry is how to improve its efficiency and keep investments at very high levels. I do not believe that today's situation is optimal. The Gas Reform must introduce real competition to the sector, which first of all means real, fair, non-discriminatory access to trunk pipelines – not only on paper but in real life, with transparent rules adequately monitored. At the same time, tariffs must be at levels enabling Gazprom to maintain the system in good order. The Reform must also guarantee reasonable, profitable price levels on domestic markets. From the viewpoint of financial markets, Gazprom is not ever likely to get properly valued if it continues to be one huge "black box", where the efficiency of different core businesses is impossible to estimate.

Monitoring of fair and non-discriminatory access to pipelines can be arranged in different ways, for example, by setting up a government entity – like the System Operator in the electricity sector. This can also be done via non-governmental organization, where all producers, including Russian oil companies have representation. In both cases, it would be more effective to have a separate business entity, the Gazprom Pipeline Company for example, as a 100% Gazprom subsidiary, but with separate accounts and IFRS books. A more radical option would be to fully spin-off transportation from production and sales. There are clear signs that steps towards opening up Gazprom pipes for other producers are taking place, mainly because of the conflict of interests between Rosneft and Gazprom.

Domestic prices must be gradually drawn up to export net-back price levels (price at border minus transportation cost and export tax). The Russian Government has promised this for 2011. Because of very high international gas and oil prices, it is probable that the implementation of this decision will be delayed and in 2011 the level of domestic prices around Moscow will be only USD 110-120 per 1000m3 (today's net-back price would be around USD 200). Now prices around Moscow are USD 50-60 per 1000m3. Full net-back pricing will take place probably 2013-2014. As a separate note, this is much more than the EU agreed during WTO negotiations with Russia.

Both pipeline access and price increases provide an incentive to other gas producers. It is important to use the gas produced by oil companies more efficiently (typically, most oil fields also have gas and vice versa). And it is important to get new gas companies into business to focus on small and medium sized fields where the gigantic Gazprom is not at its best.

Gazprom is a huge company with a market cap of over USD 200bn (at end of August, andat highest over USD 300bn). It is *the* Russian gas company, but it is also a big oil company, the biggest Russian electricity company and a lot of more (which is not core business and should be gradually divested). It is too big a company to be adequately and transparently valued by the markets. I am convinced that it would be better both for Gazprom and the government, as well as other Gazprom shareholders, to have a deeper understanding of each of its businesses. In some cases it could mean a quite clear separation of the

businesses with IPOs and/or partial sales; and in some cases perhaps the separation of businesses into separate legal entities could be enough (for example Gazprom trunk pipelines). I am convinced that the target of USD 1,000bn market cap for the whole group is only achievable with these actions

Aside from the above discussed domestic gas industry issues, there are extremely important international aspects. Gazprom receives some 70% of its income from exports, where it has monopoly rights. Gas prices on regional European markets are market driven. Gazprom is just a price taker; marginal prices are determined by more expensive Norwegian and North-Sea production. The half-hidden logic behind the Energy Charter is to create competition between different Russian gas producers on EU markets. However useful dreaming might be, we won't see this happen: Russia will in future continue to control, or at a minimum, coordinate its gas exports to prevent any potential dumping and consequently, the massive loss of tax revenues to the government. At the same time, I don't deem it impossible to have a system, where export quotas (physically or financially) are distributed in proportion to each gas producers' share in overall Russian gas production, but at the same time, sales would be channeled via one organization, be it the Gazprom structure or some to-be-created structure.

The basic dilemma between Europe and Russia is the nature of supply contracts: are they long-term contracts or not? This is a question of price, but also, more importantly, the question of security of supply and the question of the financial cost of enabling new pipeline investments. In all these aspects I have never understood the EU "hostility" to long-term contracts. Let me explain: Firstly, spot prices can only be an efficient price setter in the short term. Secondly, they are quite easy to manipulate (this is a very oligopolistic business). Thirdly, and most importantly, Europe will inevitably run into a gas deficit because it is either impossible or too expensive to finance tens of billions of new pipeline investments without any long-term take-or-pay supply contracts. In fact, Gazprom (and other producers) could just sit and wait until prices are extremely high because of the worsening deficits, and earn wind-fall profits when prices inevitably sky-rocket. And to dictate whatever price for any new additional gas supply. Fourthly, in this case we would be in a deficit situation for years, because investments take a minimum of 4-5 years to take effect.

Surely the best model would be the combination of long-term and spot markets, where the latter plays a role of keeping swing producers in business and cutting unnecessary over-investments, thus keeping also gas prices at lower levels. This needs effective regulation and regulators (public and self-regulative structures), large enough storage capacities inside the EU (for all producers, including Gazprom) to react effectively into demand changes and also certain political guarantees that long-term contract terms are also valid after 20-30 years. Increased storage capacity for Russian gas would also greatly improve the supply certainty and would thus be one of the policy focuses.

Another issue often discussed is the security of supply for Russian gas deliveries. Technically, economically and politically, the more different pipeline routes, independent from each other, from Russia to EU there are, the better the security. Clearly, both North Stream and South Stream will improve the supply security; any risk management professional can confirm this. I also don't know any laws of chemistry or physics – or politics - that require that every pipeline in Europe should go via one certain country. Surely, at the same time, environmental procedures and requirements must be followed –not because of political populism, but for the environment.

The more we have pipelines going from Russia to EU, and the more we have Russian gas storage in the EU, the better. It is also good if Russian Gazprom is involved in the distribution businesses in Europe: this just makes the integration more valuable for the company. Also, politically the effect is the same. Both markets should be open for foreign investments: inside Russia for EU companies, especially in gas production, but also in gas processing, trading and distribution; inside Europe for Russian companies in production, trading and especially in storage and distribution. If parties want to put upper limits or restrictions on foreign ownership, it would be a reasonable compromise. Foreign ownership of trunk pipelines and certain strategic gas fields is a very sensitive issue for Russians. At the same time, Russian ownership of certain trunk pipelines in Europe is at least as sensitive issue for Europeans. Gradually, the trust and good track records would push away negative presumptions and full liberalization of ownership could be put on the table. Russian gas can become one of the most important single elements of unifying Europe, and of integrating Russia and the rest of the Europe. But this is only possible if we put aside biased presumption of Russia as "the bad guy", being guilty before she has even done anything.

Seppo Remes

Member of Board,
the Federal Grid Company, Russia

Member of Board,
RusHydro, Russia

PGNiG - trying to be one step further

By Aleksandra Mierzyńska and Krzysztof Parkoła

Polish Oil and Gas Company (Polskie Górnictwo Naftowe i Gazownictwo - PGNiG) is the leader of the Polish natural gas market, as well as the only vertically integrated gas company in Poland. Formation of the PGNiG Group has enabled coordination of the upstream and downstream operations – from exploration and production to storage, trade and distribution of gaseous fuels.

PGNiG as a state-owned company was established in 1982 and then in 1996 transformed into a State Treasury stock company. Its Capital Group includes 57 specialized companies dealing with specific activities, such as gas distribution and sale, crude oil and natural gas exploration, geophysical and geological research, drilling services, etc. PGNiG business focuses on exploration and production of natural gas and crude oil, followed by gas sales to both industrial customers and around 6.5 million individual customers. The company produces oil and gas from domestic sources, but it also imports gas from Russia, Ukraine, Germany and from countries of Central Asia. Moreover, gas storage is an important part of PGNiG activities. The company owns six underground gas storage facilities of a working capacity at the level of 1.66 bcm, which represents 13.5% of the annual gas consumption by PGNiG customers.

The company owes its competitive edge on the gas market (which is now in the process of deregulation), chiefly to the natural gas and crude oil production. The core business of the PGNiG Group includes trade and distribution of natural gas. Following the separation of its gas trading business from the operation of the gas distribution network – completed in 2007 – the entire trading business has been taken over by PGNiG, while distribution is now handled by six Regional Gas Companies belonging to the PGNiG Group.

Given its revenue and profit streams, the company ranks among the largest and most profitable enterprises in Poland. In 2007, it posted PLN 16.7 billion in revenue and PLN 916 million in net profit. With the headcount of approximately 30 thousand, PGNiG is also counted among Poland's largest employers.

Sustainable value growth and minimization of the operating risk are a key strategic objective for PGNiG. It requires from the company continuous business development on the Polish and international markets as well as securing energy environment for Poland. Therefore, strategic priorities of PGNiG include:

- Extending the value chain, to include all activities from exploration and production to sales to customer service;
- Securing uninterrupted supplies of natural gas to our customers;
- Creation of diversified and stable portfolio of natural gas sources;
- Development of trading activity;
- Development of R&D activity.

The PGNiG Group launched projects designed to diversify supply sources in order to become independent from natural gas supplies originating from a particular direction or a particular supplier. Our strategy is focused primarily on balancing natural gas supplies from the eastern direction with an increased volume of natural gas imports from the north and a concurrent increase in domestic gas production. As to achieve this goal, in 2007 PGNiG acquired a 12% interest in the license covering the Skarv, Snadd and Idun fields on the Norwegian Continental Shelf. The company's aim due to the annual production from the NCS fields is 0.5 bcm of natural gas and 0.4 million tones of crude oil. PGNiG also made another important step on the way to secure natural gas supply from Scandinavia to Poland by acquiring 15% in Skanled Consortium, which is developing the Skanled gas pipeline from Karsto in Norway to Sweden and Denmark.

In terms of domestic production, PGNiG plans to increase natural gas production from current 4.2 bcm annually to 4.6 bcm in 2009. Crude oil production will almost double in 2013 and reach 900 thousand tones (in 2007 it was 528 thousand tones). The key project for the crude oil production increase is development of LMG (Lubiatow-Miedzychod-Grotow) field in Poland. Resources of the this field are estimated at 7.25 million tones (53 mboe) of crude oil and 5.5 bcm (35 mboe) of natural gas.

PGNiG owns all domestic storage facilities connected to the gas distribution system. However, the current storage capacities allow the Group to store only natural gas reserves that can be used in case of short disruptions of supplies or to balance seasonal demand peaks. In order to fully meet the demand during abnormal peaks the company plans to expand working capacity of underground gas storage facilities to 2.8 bcm by 2012. Three from existing six underground gas storage facilities will be extended and also three new ones will be build in central and northern Poland.

The Group conducts exploration and prospecting work both in Poland and abroad in countries such as Pakistan, Libya, Egypt or Denmark. PGNiG work in that area involves mainly exploration of geological structures for natural gas and crude oil deposits. The exploration and prospecting for deposits comprise a study of historical data, geological analyses, as well as geophysical and drilling research. The work is conducted by PGNiG and its exploration, geophysical and geological service subsidiaries.

In its future actions, the PGNiG Group would like to concentrate even more on exploration activities – the Company considers to buy gas deposits in Pakistan, Libya or Norway. However domestic market will remain a priority for PGNiG.

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Poland

Profiling as a key success factor in modern university strategies

By Tapio Reponen

Universities are facing several challenges at the moment. Globalization, freer markets for research and education, shifting demographics meaning fewer young people in industrialized countries, diminishing public financing and students' loss of interest in studying for several years are all changing the environment radically. At the same time the quality of research is improving in many developing countries and younger people there are increasingly interested in studying in respected western universities. Consequently there are global structural changes in University markets.

Markets will become more and more fragmented in a way such that there will be global players offering their services worldwide, both through distance learning using a variety of e-learning technologies and through personal customized lecturing. There will also be smaller specialized universities to meet the demands of focused customer groups. These smaller units need cooperation, networking, joint efforts and even some ownership arrangements.

In this new environment the role and importance of strategic thinking are strengthening, as universities have to position themselves in more competitive markets. Universities need a strategy generation process of an expert organization, where a shared view of the strategic objectives and their implementation could be achieved. The viewpoint of an academic leader is the following: How should we bring about the changes that are required?

The first stage of the strategy process is to define the business we are in. Based on this definition the goals of the strategy should be specified, operationalized and made explicit to the personnel. The difficulty lies in balancing the multiple goals of the modern university environment. Meeting the strategic objectives often requires the focusing and concentration of resources and efforts. The problem is how to motivate different groups of personnel to implement actively a focused strategy of conflicting desires.

The theoretical background should be in interactive strategy generation and knowledge creation. Knowledge generation is considered a process that leads to action being taken on the part of individuals involved. Strategy planning should be an interactive learning process to create a shared vision of linking operational objectives and available resources. To illustrate this development in the following there are some thoughts on the strategy of Turku School of Economics and Baltic See region as one of its focus areas.

Shaping the future, Turku School of Economics (TSE) is a university of economic science specialized in the development of business knowledge and advancement of entrepreneurial activities:

- TSE's internationally recognized research activities target business development and the knowledge that drives it.
- The university offers broad-based training in Turku and Pori. Studies include a comprehensive choice of economic sciences, other business and finance-related subjects and foreign languages.
- The broad-based activities include also continuing and adult education services, executive education, research and development services, recruiting services among others.

Turku School of Economics has three focus areas, of which one is business knowledge in global environments. Through an interactive strategy process we have concluded that Baltic Sea area is one of our key areas. We put much effort on that research and we are convinced that this definition of policy is successful. Our way of thinking got confirmation on October 1st, when we signed a three year contract to coordinate Council of the Baltic Sea States' (CBSS) EuroFaculty project.

In this framework our Pan-European Institute (PEI) is a leading unit in Finland in the study of Baltic Sea Economic Region, especially Russia. All Europeans are important collaboration partners in its operations, but PEI has an active role in promoting a wider Europe and supporting its success.

In the present economic development a natural cooperation between Baltic countries and with Russia has a lot of potential. Finland has some strength like early adoption and even pioneering use of technological innovations. We are known for our strong mobile communications industry. In a business school it is possible to combine business knowledge and technological innovations. Our role is to help in implementing new innovative operating models.

Tapio Reponen

Rector

Turku School of Economics

Finland

Germany and the Baltic Sea Region - challenges and opportunities for cooperation on energy security

By Markus Ederer

Regional cooperation in the Baltic Sea area is a success story. Following the fall of the Iron Curtain, the links that had historically been so strong around the Baltic Sea were imbued with new life. This was very much thanks to the Council of the Baltic Sea States. Germany has thus from the outset been a firm supporter of the reform and further development of this organization, a reform adopted by the CBSS this June at its Riga Summit. We want to strengthen the Council of the Baltic Sea States as a model of regional cooperation. It is a motor of our cooperation in the Baltic Sea Region – fuelled by an unparalleled wealth of contacts in the political, business, social and cultural fields. The Baltic Sea Region is a leader as regards competitiveness and innovation; our volume of trade is constantly growing. Another factor that will in future contribute to this success story is the initiative launched by European Parliament members from the Baltic Sea States and Sweden to enhance northern Europe's integration with the rest of the EU by means of cross-sectoral cooperation. Germany is thus very pleased that Sweden intends to make the EU Strategy for the Baltic Sea Region one of the priorities of its EU Presidency in the second half of 2009. We should not however forget to involve Russia as an important Baltic Sea State and CBSS member as well as Norway and Iceland as important regional stakeholders.

Our cooperation in the Baltic Sea Region has engendered considerable trust between us, it has brought us, the partner states, closer to each other. In our daily work together, many regional interests and projects crop up that we as Baltic Sea States share and could promote together. These include the development of trade and the maritime economy, infrastructure and transport, ecological sustainability and the improved use of the region's potential in the fields of education, research and technology, as well as the promotion of exchange between civil societies.

We need to significantly step up cooperation on energy policy. Energy security for the Baltic Sea Region is inseparably linked to European energy security. Even today, the EU is the largest internal market in the world with almost 500 million consumers. Even today the EU is the largest and most attractive gas market in the world. And it is widely expected to remain so until far into the future, since our demand for energy continues to rise. A study conducted by the German Institute of Energy Economics (EWI) and Prognos estimates that the EU will need an additional 150-200 billion m³ of gas in the period to 2020. We should therefore work together to guarantee energy security for the Baltic Sea Region and the European Union for many years to come. We thus need to jointly exploit new sources, fund new pipelines and infrastructure projects, further increase the energy efficiency of our economies and practise a level of energy solidarity with each other that is worthy of the name.

A sustainable architecture for pan-European energy security should be based on the following pillars:

Firstly, energy security is only possible if we work with one another and not against one another. For this reason we must forge a cooperative framework that balances the interests of consumers, transit states, producer countries and business. This must involve the European Union, but should also include our neighbours, whom we should bind more closely to us by extending the Energy Community and further strengthening the principles of the Energy Charter Treaty.

Secondly, Russia will remain Europe's main energy supplier for the foreseeable future. But it is not correct to say that the dependence between the EU and Russia is unidirectional. Some 80% of Russian energy exports go to Europe. And energy exports account for approximately 60% of the Russian budget. Russia thus needs us as long-term, steady consumers, just as we need Russia as our supplier. In addition, the Russian economy is in urgent need of modernization, and it cannot make lasting progress on this front without European technology, without European know-how. It would thus be more accurate to talk of a bidirectional dependency. We should shape this mutual bond to ensure that it is to our mutual benefit.

Thirdly, diversification of supply routes and energy sources remains one of the main priorities. The Extraordinary European Council of 1 September 2008 invited the Council and Commission to examine initiatives to be taken to this end. The Nabucco pipeline remains a key project, participated in by RWE, one of Germany's largest energy companies. Therefore the European Union, the Member States and the Commission should underscore their interest in the realization of the Nabucco project even more clearly than they have done to date.

Fourthly, energy solidarity in Europe is the current watchword. We understand the Baltic States' desire to address their unidirectional dependence on Russia as their oil and gas supplier and to tackle their energy-policy isolation on the north-eastern fringes of the EU. We therefore welcome and support the proposed plan for a Baltic energy network and the greater integration of the region's countries into the EU grid. The question of gas storage is also moving up the agenda, especially in the context of the EU Commission's second strategic energy review, which is due to be presented in November. For 2009 we support the initiative of pooling EU funds for energy projects in the Baltic Sea Region in a new regional development fund for energy in the Baltic.

Fifthly, de facto solidarity on energy supply issues is not a one-way street. Energy solidarity should always operate in both directions. We therefore hope that German and European energy-policy interests will be given fair consideration by our neighbours. In this context, we must be able to rely on projects that were agreed in the framework of the Trans-European Networks as a contribution to EU-wide security of supply really being implemented.

These include, in Germany's view, the Baltic pipeline, which has drawn much criticism, above all from the countries of the Baltic Sea Region. It is important for us to repeat that the Baltic pipeline is, firstly, not a purely German project, and secondly, that it is not a "political" project, but rather is being implemented as a European energy economy project. The Baltic pipeline is part of the Trans-European Networks. It will increase European energy security, since it will cover part of the rising demand for gas in the EU. Natural gas from the Baltic pipeline will be delivered to Germany, but also to France, Great Britain and the Netherlands. At the same time, Germany has always made it clear that it takes seriously the concerns of all Baltic Sea states, be they political or ecological.

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Russia's ability to use its energy might

By Jyrki Terva

In the end of 2005, Russian president Vladimir Putin introduced the concept of Russia as an energy superpower to the public. In January 2006, the gas crisis happened in Ukraine. The decision made by Gazprom to close the gas valve resulted in a drastic weakening of Russia's image in Europe and elsewhere in the world as a reliable energy producer. Also recently during the war in Georgia in August 2008, there were renewed fears that Russia might cut its energy exports to the West.

What would be the possible effects of this kind of energy embargo on Russia itself? At the moment over 50% of Russian government tax revenue is generated by energy exports. Russian markets and the stock exchange are built on the foundation of wealth generated by the oil and gas industry. Thereby it is clear that in the event of disturbances to energy exports, negative impacts would be felt in the very foundation of the Russian economy. The stock market would collapse and the effects of capital flight would be felt in the real economy as well.

It is safe to state, that disturbing energy exports is not in Russia's interests. Instead, the ability of Russia to use its energy might revolves around three basic factors: the ability to control energy transit routes and distribution channels, the ability to make deals on energy supplies and the ability to control and finance energy production.

New transit routes to bypass old ones

Control of the energy transit routes would guarantee Russia the independence required by its proposed energy superpower status. In the current situation this is not the case. Russian energy exports are currently dependent on Soviet era oil and gas pipeline infrastructure that resides in Ukraine, Belarus and Central-Asia.

To change the situation Russia has started to build new transit routes. The new routes bypass the old routes through the sea areas in the North and in the South of Europe. The routes in the North are the Nord Stream gas pipeline crossing the Baltic Sea and the new oil terminals in Primorsk and Ust-Luga in the Gulf of Finland. In the South the routes are the Blue Stream and South Stream gas pipelines crossing the Black Sea, and the Novorossiysk oil terminal on the Black Sea coast.

Russia has also repeatedly announced that it will not ratify the European Energy Charter Treaty. The treaty would require Russia to open up its pipelines to non-native companies. In contradiction to the treaty, Russia wants to retain its monopoly of the Central-Asian energy transit routes. All current pipelines from Central Asia, especially from gas rich Turkmenistan, go through Russian territory.

The goal to control the value chain in European energy markets

Out of the Russia's energy companies, Gazprom and Lukoil have stated that they aim at controlling the whole value chain of their energy products starting from energy production in the fields to delivery to the end consumer. Russian companies often accuse the European Union for protectionism in its energy markets. A special target for criticism has been the energy market reform of the EU, which aims at separating production, transport and retail to be owned by different companies. The reform effectively prevents the control of the value chain.

Contracts on energy deliveries are a central instrument for Russia to influence relations with certain importing countries. Oil is sold through traders with short term contracts whereas gas is sold with long term contracts of 25-30 years. Russian oil is mainly being traded in the London raw materials exchange. Russia's own oil exchange was established on Putin´s initiative in Saint Petersburg, but so far the traded volumes have not reach considerable levels.

Gazprom is the market leader of gas trade in Europe. The most important long term contracts were renewed with the main European customers in 2006. Gazprom has been very successful in making deals in recent years. Export revenue of the company has seen steady growth.

Old technology prevents adjustments in energy production

As with the transport infrastructure, the production infrastructure in Russia is also inherited from the Soviet era. Technology has been upgraded to make production in the old oil fields more efficient, but the fundamental technological solutions are still out of date. Therefore, the ability of Russian energy companies to adjust their production is weak, in comparison to Saudi Arabia's ability to adjust its production according to the market situation.

The bulk of Russia's oil production originates from the fields of West-Siberia. Production from the old fields is static at its current levels. New investments are starting to be realised in East-Siberia, but the long term results of the new investments are highly dependent on oil price developments. The primary market of East-Siberian oil is in China.

Current gas production as well as new investments are located in Yamal Peninsula in the West-Siberia. The Schtokman field is also prepared for production, but Yamal is the first priority of Gazprom for the simple reason that the current transport infrastructure is starting from Yamal. Investment decisions concerning Schtokman are supposed to be made in September 2009.

The lack of available gas storages is affecting the ability of Russia to adjust its gas production. Therefore the gas reserves that are used during the winter heating season are being spent often too quickly. Similarly during the summer, gas production can often not be kept on-stream due to this lack of storage. Gazprom is addressing the issue by building new storages for the gas in Austria and in Saint Petersburg.

Risks to the Russian energy might

Choices made by Russia which have been reflected in its energy policy in recent years appear contradictory. Russian energy companies have successfully increased their income generation and renewed contracts with their main European partners. At the same time Gazprom´s efforts to control its distribution channels in Europe have been mostly unsuccessful.

Russia has also not succeeded in its goal to increase independence from the traditional transit countries for its energy transportation. New transport projects, including Nord Stream still entail many factors of uncertainty. At the same time relations to the old transit states of Ukraine and Belarus have been strained.

In gas production the most challenging years for Gazprom will be 2010-2015, when it is likely that domestic production will start to decrease at the same time when domestic consumption will continue to grow.

In the current situation, Russia's ability to use its energy might depends heavily on the continuation of high energy prices. The new projects which are planned demand huge investments, which are possible only if energy prices stay at their current high levels.

Lower energy prices due, for example, to the global economic slowdown could drive Russia's current energy policy into a dead end. However, if energy prices will continue at their present high levels, the situation might change to be more favourable for Russia in 5-10 years. This will require that the new proposed investment projects for energy production and for transit routes start to bring results.

Jyrki Terva

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Consulate General of Finland in Saint-Petersburg

Activities of the Polish Energy Group

By Tomasz Zadroga

Who we are

The Polish Energy Group (PGE Polska Grupa Energetyczna) is the largest energy group in Poland involved in the generation, distribution and sale of electricity. The PGE Group is comprised of more than 100 subsidiary companies. The holding company is PGE Polska Grupa Energetyczna S.A., which is a 100% state-owned company.

The PGE Group has its origin in the establishment of Polskie Sieci Elektroenergetyczne S.A. (**"PSE S.A.")** in 1990 as a result of the major restructuring of the Polish energy sector. PSE S.A. was a major energy company, active mainly in electricity transmission and wholesale trade. In 2004 the activities of the Transmission System Operator were legally unbundled from PSE S.A. with creation of a subsidiary company. Since 2007 the Polish TSO (with its transmission assets) has been a separate company fully-owned by the Polish State.

In May 2007 the majority of the shares in two groups of power generation and distribution companies were transferred to PSE S.A. by the State. PSE S.A. changed its name to PGE Polska Grupa Energetyczna S.A. Moreover, pursuant to the requirements of EU law, the activities of the Distribution System Operators were legally unbundled from other activities through the creation of separate companies. Simultaneously, the integration of similar activities being conducted by different companies in the PGE Group started. This integration process is a major part of the current development of the PGE Group.

What we do

The PGE Group was established as one of four energy groups in Poland, within the Governmental Programme for the Power Sector Restructuring, as a result of the consolidation process in the Polish power sector. The current activity of the PGE Group covers five business lines: mining (lignite) and electricity generation (lignite-based and coal-based, including power and heat cogeneration); wholesale trading of electricity; retail trade (electricity and heat); distribution of electricity; and generation of electricity from renewable energy services.

Generating more than 54 TWh annually (approximately 40% of the total electricity generated in Poland) utilising its 12.3 GW power generation capacity (more than 35% of the total installed capacities in Poland), the PGE Group trades in electricity on the wholesale market and provides **a safe and stable supply of electricity** to its approximately five million customers in Poland. The PGE Group's share of the retail electricity market is approximately 26%.

The PGE Group consists of two large lignite mines, more than 40 power plants and combined heat and power plants (CHP) (including renewable, hydro and wind power plants), eight Distribution System Operator Companies, eight electricity Retail Sales Companies, an electricity wholesale company and enterprises operating in other industries (including the telecommunications industry). Hard coal and lignite are the basic fuels used in the power plants of the PGE Group.

PGE's mission is **to build the Group's value by meeting the energy needs of customers**. In order to meet competition requirements and secure a high level of customer service, PGE's priority is to be customer-oriented and provide customer satisfaction.

Potential of the PGE Group

The financial potential of the PGE Group allows it to undertake necessary investment projects which are of a critical significance to Poland's **energy security**, and hence Poland's economic stability and sovereignty. The market potential of the PGE Group makes it possible for the Group to successfully compete in the CEE region, while providing a guarantee of a competitive structure of the market in Poland, which translates into the competitiveness of the entire economy.

The Polish power sector today is facing major challenges. It must ensure Poland's energy security and meet the challenges of the country's growing economy, while meeting increasingly strict environmental standards.

In response to the new challenges and requirements, the PGE Group is embarking on activities in the field of new power technologies. These activities include participation in the Clean Coal Platform, as well as preparation of the Nuclear Energy Development Programme in Poland.

The good financial performance (2007 EBITDA of PLN 4.7 billion) reported by the companies of the PGE Group in recent years has been made possible by our business being focused on building value. In the power market not only price but also the quality of customer service are the key competition factors. Therefore, the PGE Group is implementing a programme aimed at standardisation and continuous improvement of the quality of the services provided.

Development of the PGE Group

One of PGE's key strategic goals is to create value for the shareholders through **continuous development of the Group**. The largest investment project currently under construction is the new 858 MW power block at Belchatow power plant. PGE intends to dedicate significant resources for the modernization and construction of the electricity network and generation infrastructure, which will allow it to take advantage of the emerging integrated market in Europe.

Tomasz Zadroga

President and CEO

PGE
Polska Grupa Energetyczna S.A.

Poland

D-6 development - dialogue with the local communities and the government

By Yury S. Kadzhoyan

LUKOIL places a strategic emphasis on its operations in the Baltic Sea region.

It is a key export corridor used to export Russian oil and petroleum products to Europe. This fact contributes to integration of production, transportation, refining and distribution facilities into a single production chain.

Based on the vertical integration principle, LUKOIL has been making investments into development of transshipment and distribution facilities in Northwestern Russia. The Company owns two transshipment terminals on the Baltic coast: one in Izhevskoye settlement, Kaliningrad Oblast, and the other in Vysotsk port, Leningrad Oblast.

Moreover, LUKOIL operates an extensive distribution network in Northwestern Russia, Finland, Lithuania, Latvia, Estonia and Poland. To ensure supplies of petroleum products to this network, the Company has been considering an option of purchasing refining facilities in the Baltic Sea region.

Continental shelf development is yet another most important area of LUKOIL's operations in the Baltic Sea region. In 2004 LUKOIL-Kaliningradmorneft, one of LUKOIL's subsidiaries, started production at D-6 field located 22.5 km off the shore of Kaliningrad Oblast.

It was for the first time that LUKOIL had been engaged in a complex construction of field facilities. A modern steelworks factory with the state-of-the-art equipment was built to construct the offshore ice-resistant fixed platform.

We are currently using the engineering solutions that were first implemented in the Baltic Sea for development of the Caspian fields. The steelworks factory was used as the groundwork for construction of the offshore ice-resistant fixed platform (LSP 2) which is to be installed at Korchagin field in the Russian sector of the Caspian Sea.

The European community was concerned about the D-6 project from stage one. Few believed that offshore drilling would have no adverse environmental impact. At that time we were facing two challenges: one was to come up with the engineering solutions which could minimize the hazard of environmental accidents and the other one was to convince all concerned parties that the project posed no threat to the unique Baltic environment.

It is still difficult to say which of the tasks was more complicated. Nevertheless, both of them were successfully accomplished.

From the technical point of view, the project is secured against any environmental safety related problems due to its closed oil gathering, transportation and treatment system. Produced oil is treated to comply with the stock-tank oil parameters at onshore facilities, as opposed to being treated on the platform itself, which happens in other parts of the Baltic Sea. Oil is fed to the shore via a subsea pipeline which considerably reduces the risk of oil spill accidents.

The "zero discharge" production drilling technology is also completely safe. It involves transportation of all household and production waste onshore for further processing and disposal.

To control the environmental state at D-6, LUKOIL-Kaliningradmorneft is performing 24-hour satellite monitoring of the Baltic Sea. More than three million tons of oil has been produced here over four years of the field's operation. And still there has not been a single case of environmental pollution.

In 2006 LUKOIL-Kaliningradmorneft completed certification of crude produced at D-6. Now, if there is a need to identify the source of oil pollution in the Baltic Sea, it suffices to compare the samples of oil slicks with the data contained in the respective certificates to exclude D-6 platform from the list of suspected pollution sources.

Today neither the European governments, nor the environmental organizations are concerned about LUKOIL's operations in the Baltic Sea. Moreover, our company's experience in terms of safe operation of offshore fields has been highly rated by HELCOM, the Helsinki Commission. The "zero discharge" requirements became part of the new "HELCOM Baltic Sea Strategy" signed by the ministers of the member states in Poland in November, 2007.

This story of success was made possible due to close cooperation with the local communities and the government, discussions on the company's stance and project details, and constant progress reports.

We managed to effectively communicate with representatives of the European Parliament, Euroregion Baltic, the already mentioned Baltic Marine Environment Commission also known as the Helsinki Commission, Ministry of Environment of Lithuania, the press and electronic mass media of Germany, Spain, France, Poland, Estonia, Latvia and Lithuania.

Such communication was largely possible due to visits paid by European representatives to the production facilities of LUKOIL-Kaliningradmorneft i.e. D-6 offshore ice-resistant fixed platform, Romanovo oil gathering unit and integrated oil terminal in Izhevskoye settlement.

In October 2004, soon after the field was put into operation, Kaliningrad Oblast hosted official delegations of HELCOM, the Latvian Ministry of Environment and representatives of the European mass media.

As part of such visits, they had an opportunity to find out for themselves how concerned LUKOIL was about its industrial and environmental safety, and have their questions answered first-hand, i.e. by experts immediately responsible for operation of production facilities. The result was that the Baltic Sea shelf development dialogue became more professional and relevant.

The most valuable lesson we learned in the course of D-6 development is that only those projects which meet the interests of all parties concerned, whether those of the investor, the local communities or the government, can become a success.

Yury S. Kadzhoyan

Director General

OOO LUKOIL-Kaliningradmorneft

Russia

Estonian oil shale sector undergoing changes

By Janek Parkman

Oil shale, just like coal, is also a sedimentary rock the resources of which in the world are very vast. Still, compared to coal, the energetic value of oil shale is several times lower. Oil shale, just like coal, was used quite extensively in many countries of the world until the middle of last century. When oil and natural gas were widely taken into use the importance of coal in world energy decreased and the importance of oil shale disappeared almost completely. Today, the almost centennial use of oil shale has remained only in two countries of the world. These countries are China and Estonia.

In Estonia where there are no resources of oil, natural gas or coal either, the use of oil shale in the beginning of last century was the only possibility to cover domestic energy needs. During the time when Estonia while being one of the Soviet republics could freely use a part of the oil and natural gas of the whole Soviet Union, the importance of oil shale use decreased. As an independent state Estonia has to pay market price for import fuel and therefore domestic energy resources are increasingly more important. Today, oil shale is the most important energy source of Estonia and its importance increases in line with the worldwide price increase of fuels. In 2007, 19 million tons of oil shale was mined. Oil shale electricity covered more than 95% of Estonia's electric energy. Shale oil received from oil shale treatment covers 100% of Estonian boiler plant needs that operate on liquid fuel. Oil shale is also used as raw material for cement and chemical industries. All these products are also exported to other Baltic Sea countries.

Concern about greenhouse gases is diminishing the solid fossil fuels based energy production. The use of Estonian oil shale for power generation is diminishing for the same reason and by 2015 the production output of oil shale electricity will probably diminish twice. However, as the demand for liquid fuels is constantly high, Estonian manufacturers of shale oil are increasing their production outputs. If, 400 000 tons (2,5 mln bbl) of liquid fuel were manufactured from Estonian oil shale in 2007, then according to certain forecasts this output may reach up to 1,7 million tons (10,5 mln bbl) by 2015. This output would cover the whole Estonian need for liquid fuel, including the need for motor fuel.

The development strategy of oil shale up to year 2015 is currently in the legislative proceeding of the Estonian Parliament. This document contains political agreement on the estimated mining volumes of oil shale and trends of oil shale use. This will first of all set guidelines for the whole Estonian oil shale sector how the Estonian state and industry should reduce in cooperation the environmental effects of oil shale sector and effect on human environment. Further appraisal of oil shale products is also a priority specified in the development plan that would still provide a bigger surplus value with a smaller volume of resource use. Technological innovations are considered that are necessary to be introduced both in oil shale mining and manufacture of oil shale products. Estonia is probably the only country in the world where the Parliament is devoting such great attention to oil shale as mineral resources and its use. However, this is understandable because oil shale has a unique role in Estonian economy.

Estonian oil shale manufacturers are also active in other countries besides Estonia where there is a wish to develop oil shale industry. Government owned power Company Eesti Energia AS is currently developing an oil shale mine in Jordan. Privately owned Viru Keemia Grupp AS is present in the Ukraine in the Boltyshk oil shale deposit. Besides Estonia there are big oil shale resources along the Baltic Sea in Russia in the Leningrad oblast where shale oil production capacities existed up to 2004. Russia plans to revive the oil shale treatment in the Leningrad oblast and Viru Keemia Grupp AS hopes to contribute to it with its skills. In addition to the above mentioned, oil shale resources are being introduced in several countries around the globe, including USA, Australia, Canada and Brazil.

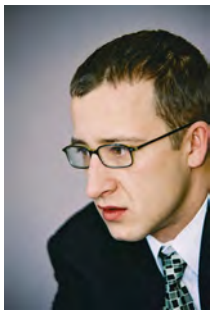
Maintaining the know-how of oil shale production and the existence of corresponding scientists and engineers creates an excellent possibility for Estonia to witness the rebirth of one industrial sector. At the same time the establishment of one heavy industry sector demands considerably more than the scientists and engineers of just one country could offer. With great probability the cooperation that is already taking place between the engineers and scientists of Estonia and other Baltic Sea countries will still reach to a completely new level. Leading mining engineers, chemists and power engineers of the whole world can exchange knowledge and experience so that everyone would benefit from it. At the same time the countries that develop the oil shale industry will ensure their energy security and attract huge investments in their economies.

Janek Parkman

Chairman of the Board

Viru Keemia Grupp AS

Estonia



Energizing opportunities

By Christian Lund

StatoilHydro was the first oil company to offer coffee and hotdogs when it entered the Baltic market in 1992. Today the Norwegian company operates around 400 service stations in the Baltic region and Poland.

-Our expectations have been exceeded, and we are very excited to see that StatoilHydro's growth in the Baltic countries and Poland continues, says Vice-President for Retail Jørn Madsen.

As the first foreign oil company, StatoilHydro opened a service station in Tallinn in 1992. Today StatoilHydro operates 190 Statoil stations in the Baltic countries, with a market share of 20 to 30 percent. In Poland StatoilHydro has 260 outlets.

-Early experiences from the Baltic region proved that our concept was very successful with local customers, so expanding in this market has been a natural growth strategy for StatoilHydro, says Madsen. He is now planning for expansion in the Russian market.

-We have already established a presence in Murmansk, with eight service stations, and working towards opening our first station in St. Petersburg by late 2009, says Madsen.

Food to go

-We regard the Baltic countries and Poland as very interesting markets, characterized by strong economic growth, increased purchasing power among consumers and geographical proximity to our home market in Scandinavia.

StatoilHydro has invested a lot in its station network, and has focused on building an organisation with a consistent profile. The stations are primarily company owned, and are mostly full service stations.

-When the company started its Baltic operations in the early 1990s, Statoil was the first chain to introduce hotdogs and coffee, and has been a leading player in convenience ever since, says Madsen.

-The Polish market is even bigger than Scandinavia and the Baltics combined, and we are working to expand our presence. There have been significant developments in these markets since we opened our first stations. The Polish market is very competitive, with many local and international companies. The past few years we have seen a shift in demand from grocery to convenience goods, and we have developed our offer accordingly, says Madsen.

Serving the business market

In addition to servicing retail customers at the pump, StatoilHydro has a considerable energy business in the region, marketing commodities such as fuel oil, aviation fuel, and lubricants for industrial machines.

- In Poland we are the largest foreign supplier of lubricants, with a market share of seven percent, says vice president for Energy, Hans-Olav Høidahl.

While StatoilHydro's home market in Scandinavia is relatively mature, the Baltic region, Poland and Russia are all markets with strong growth. In 2009 StatoilHydro will double the number of employees in the Russian lubricant business.

-We are experiencing increased economic activity, and many of our Scandinavian customers are now moving into new markets in the Baltic region and Russia. They are investing in new capacity, and want the highest quality lubricants for their processes.

New plant in Poland

In Poland, StatoilHydro is serving several large industrial customers, trough a program called "Total Fluid Management".

-This is a concept where we enter into partnerships with our customers, to serve all of their fluid management needs. We dedicate several full time employees to a factory, ensuring that the customer is always getting the right product and service quality. This has proven to be a very successful concept, says Høidahl.

StatoilHydro is also building capacity in Poland.

-We recently opened a new lube plant in Ostrowiec, with a production capacity of 15 000 cubic meters extension possibility up to 30 000 cubic meters. This plant is an important part of our strategy, and will also be able to export to the Russian market, where we expect the strongest growth in the years ahead.

Fuelling Riga Airport

StatoilHydro is currently supplying aviation fuel to Riga International Airport and will enter in to the finish market from year end.

-The Polish market for aviation fuel is monopolized, but liberalisation and increased competition are priorities of the European Commission, so we pay close attention to the developments in this market, says Mr. Høidahl.

StatoilHydro has been in the Baltic region and Poland for more than ten years.

-The EU enlargement has been positive for our business. Last year we had six percent growth in our lubricant business, and we aim to keep this rate in the years ahead, says Høidahl.

-It's always a challenge to enter new markets as a foreign player. But we have succeeded in building a good sales organization. I would say that our success is a result of working closely with our customers, and supplying high quality products.

Christian Lund

Public Affairs Manager,
Energy & Retail Europe

StatoilHydro ASA

Norway

Facts about StatoilHydro's operations:

Poland 261 gas stations. 1 lubes plant (Ostrowiec).
4 300 employees.

Estonia
52 gas stations. 700 employees.

Latvia
68 gas stations. Aviation fuel. 850 employees.

Lithuania
71 gas stations. 750 employees.

Russia
8 gas stations. 130 employees.

The Russian Arctic is turning into an important energy supply route to Europe alongside the Baltic Sea

By Erkki Kotiranta

The current situation in the Caucasus has increased the importance of the Baltic Sea as Russia's import and export route. It is clear that ensuring trouble-free and on-time oil transportation is crucial to the Russian economy.

Oil industry accounts for about 30 percent of Russia's GDP, more than 75 percent of export earnings and about 60 percent of the national budget. These figures indicate the importance of oil for the economy and prosperity of Russia.

Regardless of whether we talk about natural gas, oil, coal, or electricity Europe is the most important market for Russia both at present and in the future. But the Baltic ports will not be able to handle the future flood of Russian oil to Europe. At the moment 60 percent of Russian oil shipments are loaded at ports in the north-east region of the country. The port of Primorsk alone accounts for more than 70 percent of Russian crude oil exports.

The Importance of the Arctic is rising

According to Russian authorities the development of Russian economy depends on further increasing the production of oil and natural gas. They estimate that the production of natural gas is growing at an annual rate of 1 percent. The natural gas pipeline to Europe which is currently on the drawing board supports this view.

Now that the price level of crude oil has stabilized at above USD 140 per barrel, investments in the Arctic area have become profitable. On the other hand, if the current price level remains unchanged, growth prospects are going to diminish which will have inevitable consequences for the Russian economy.

Lukoil's Varanday terminal will be opened by the end of 2008. Shipments will be carried by Sovcomflot with an estimated annual capacity of 3 million tonnes but there are plans to increase throughput up to 12 million tonnes annually.

87 percent of Russian natural gas and oil reserves are located in the Arctic area, compared to only 1 percent located in Southern Russia. The appeal of the Arctic is reflected, for instance, in ship orders. Five arctic tankers with a capacity of over 75,000 dwt have been built recently. Moreover, Sovcomflot has ordered two vessels of over 114,000 dwt with an option for four additional ships. Gasprom is planning to order dozens of new drilling rigs for the Arctic region by the year 2030. There are also plans for large natural gas carriers.

It is obvious that the increasing demand for oil carriers requires new ice-breaking capacity to ensure the safety of shipments. Russians are planning to order four nuclear-powered icebreakers by the year 2018.

Political aspects

Russia has shown active interest in expanding its Arctic territory. One indication of this effort is the planting of the Russian flag at the North Pole. The expedition was successful, but the media turned the mission against Russia. In 2001 Russia tried to persuade the legal committee of IMO to annex certain Arctic territories to Russia, but IMO did not approve. The proposal will probably come up again in 2012.

We are going to see further activity all over the Arctic in Russian, American, and Canadian territories. Expeditions and seminars will be organised to study the North-East passage, North-West passage and other regions of the Arctic.

The Murmansk region will see significant growth and in the future it will become the main route of energy shipments to Europe and an important supply route to the United States, as well. This means new challenges to shipbuilders and to operations in this area where the nature is extremely sensitive.

Erkki Kotiranta

Neste Shipping Oy

Vice President

Finland

Safe and reliable global maritime transport of dangerous chemical cargo via the Baltic Sea

By Jyrki Vähätalo

We are dependent on maritime transport. Currently around 90% of all world trade is carried by sea. Sea transport includes chemicals that are frequently – but not always – classified as dangerous. Today, the transport via Finnish ports of classified dangerous chemical cargo, i.e. noxious liquid substances and gases carried in bulk, solid materials possessing chemical hazard and solid bulk materials hazardous only in bulk, harmful substances and dangerous goods in packaged form, amounted to about 20 million tonnes.

The regulations, rules and recommendations concerning global shipping of dangerous cargo are based on the work of the International Maritime Organization (IMO). The legal instruments are codes and conventions. An active specialized agency of the United Nations, the IMO today has 168 Members after the Cook Islands became a member state on 18 July 2008. IMO plays a key role in ensuring safety of life at sea and in protecting the marine environment from ship source pollution - as summed up in IMO's mission statement: “Safe, Secure and Efficient Shipping on Clean Oceans.”

Numerous vessels carrying also dangerous chemical cargo sail through the Baltic Sea, a unique, brackish inland sea with a sensitive ecosystem. The Baltic Sea can be considered an inland lake for the countries in the Baltic Sea region. In fact, it was only about 8,500 years ago that the Ancylus Lake was connected with the Atlantic through the Danish Straits and later formed what is now our Baltic Sea. Today, the Baltic Sea has the official status of a Particularly Sensitive Sea Area (PSSA) with the exception of the waters under sovereignty of the Russian Federation. A PSSA is an area which needs special protection through action by the IMO because of its significance for recognized ecological, socio-economic or scientific reasons and which may be vulnerable to damage by international maritime activities. When a PSSA has been approved, specific measures can be used to control the maritime activities in that area, such as equipment requirements for ships and installation of vessel traffic services (VTS). In the Baltic Sea safety measures involving shipping routes have been intensified including VTS systems, such as the Automatic Identification System (AIS) and the compulsory Gulf of Finland Reporting System (GOFREP) applied by Finland, Estonia and Russia.

The International Convention for the Safety of Life at Sea (SOLAS) covers various aspects of maritime safety including dangerous chemical cargo: the International Code for the Construction and Equipment of Ships Carrying Dangerous Chemicals in Bulk (IBC Code) provides an international standard for the safe seaborne carriage of noxious liquid chemicals in bulk. The corresponding codes for gases carried in bulk are the IGC Code and the BC Code for solids. To minimize the risks to ships, their crews and the environment, the IMO’s Codes prescribe the design and construction standards of ships and the equipment they should carry, with due regard to the nature of the products involved.

In 1992, the United Nations Conference on Environment and Development, familiarly known as the Rio Summit, established the Globally Harmonised System of Classification and Labelling of Chemicals (GHS). The GHS provides a basis for harmonization of regulations on chemicals at national, regional and worldwide level, also an important factor for trade facilitation. GHS coincided with the review of Annex II of the International Convention for the Prevention of Pollution from Ships (MARPOL). The revised MARPOL Annex II Regulations for the control of pollution by noxious liquid substances in bulk entered into force on 1 January 2007. It includes a novel four-category classification system for noxious liquid substances designed to be in harmony with the GHS. Improvements in ship technology, such as efficient stripping techniques, have made possible significantly lower permitted discharge levels of noxious liquid substances. Noxious liquid substances from tankers may accidentally enter the marine environment through operational discharge, spillage, or loss overboard. Nevertheless, accidents of noxious liquid substances are rare due to the high-level safety standards; for instance, most tankers are of double hulled construction to prevent outflow of cargo even in the event of a collision or grounding.

Cargo transport units (CTUs) have revolutionised the worldwide transport including dangerous chemical cargo. The ancient Egyptians used amphorae to ship liquid cargo and only recently, in the 1930’s, American entrepreneur Malcolm McLean (1913-2001), conceived of the container. Containers, commonly referred to as CTUs, replaced the traditional bulk method of handling goods. In sea transport the CTU is typically a freight container or a trailer. Notably, the volume of shipping of dangerous goods packaged into CTUs continues to grow significantly both worldwide and through the Baltic Sea.

The international rules for the carriage of packaged harmful substances and dangerous goods in packaged form are set in the International Maritime Dangerous Goods (IMDG) Code. The IMDG Code has been harmonised with the United Nations Recommendations on the Transport of Dangerous Goods and with other modal regulations (air, road and rail). In accordance with the principles set out in the UN Recommendations, the IMDG Code divides dangerous goods into 9 classes. The new GHS criteria for harmful substances, i.e. substances which are identified as marine pollutants only, will take effect from 2010.

The IMDG Code does not distinguish between ocean crossing and transport in smooth sea areas, also described as the concept of low wave heights. In the Baltic Sea today, most of the transport of packaged dangerous goods is carried out by trailers in ro-ro ships on relatively short voyages and within low wave areas. By derogation from the provisions of the IMDG Code, the Memorandum of Understanding on the Transport of Dangerous Goods in ro-ro Ships in the Baltic may be applied on all ro-ro ships operating in the Baltic Sea. The Memorandum is a multimodal agreement on the transport of packaged dangerous goods between Denmark, Estonia, Finland, Germany, Latvia, Lithuania, Sweden and Poland. The Memorandum has existed for more than 25 years with the purpose of facilitating multimodal transports of dangerous goods from land mode to sea mode and *vice versa*. The Memorandum is allowed under the existing provisions of the IMDG Code. We are proud of the fact that the safety records are excellent.

Today, we live in a society which is supported by a global economy. Maritime transport of dangerous chemical cargo via oceans and smaller seas such as our fragile Baltic Sea is an integral part of global economy. Fortunately the countries in the Baltic Sea region, including Finland which became a member of the IMO in 1959, actively struggle for safe, secure, environmentally friendly and efficient shipping of dangerous chemical cargo to the world via the Baltic Sea.

Jyrki Vähätalo

Senior Maritime Inspector

Finnish Maritime Administration

Finland

Al Qaeda's threat to oil and gas assets in the Baltic Region[1]

By Peter F. Johnston

Contemporary energy security is threatened by terrorist attack, particularly since al Qaeda has encouraged strikes on oil and gas infrastructure. The Baltic Sea region is not immune to this threat and could find itself the target of an al Qaeda assault at any time. The impact of such an event would be extreme in terms of the ecological damage, clean-up and also the affect on global oil prices.

The Global Threat

The leadership of al Qaeda intends to overthrow what it considers to be corrupt regimes in Muslim countries and replace them with a single Islamic Caliphate. Osama bin Laden's 1996 fatwa entitled, "Declaration of War against Americans Occupying the Land of the Two Holy Places," identified the expulsion of US and Western countries deemed to be supporting these regimes as a first step. In this fatwa bin Laden railed against what he argued to be artificially low oil prices controlled by the US. He insisted that the governments ruling the oil producing Muslim countries were robbing, in conjunction with the US, their own people. He also indicated that killing foreigners and causing economic hardship for the US through economic boycotts would convince them to leave. However, he argued against targeting oil and gas infrastructure in the Middle East in order to avoid hurting local economies.

In a 1998 fatwa, bin Laden reiterated the need to attack Americans, their economic interests, and the Muslim regimes supported by the US. He also widened the list of appropriate targets and locations to include US allies, declaring that it was the duty of all Muslims to attack these targets in any country possible.

In 2004, bin Laden advocated attacks aimed at oil and gas infrastructure in the Middle East used to supply the West. A January 2007 internet publication released by al Qaeda, Sawt al-Jihad, extended the threat to oil and gas infrastructure that provided resources to the US and its allies throughout the world and noted that oil is the lifeblood of the G-8 and the industrialized world.

Al Qaeda and other militant Islamist groups have responded by attacking energy infrastructure in the Middle East. Noteworthy incidents include the bombing of the French oil tanker, MV Limburg on October 6, 2002 off of the coast of Yemen; attacks on pipelines in Yemen in 2006 and 2007; and 2 separate attacks on foreign oil industry executives in Saudi Arabia in May 2004, killing 22. The oil and gas industry has also been targeted in Iraq. According to the Institute for the Analysis of Global Security Iraq Pipeline Watch, there were 469 attacks on pipelines, refineries, energy workers, and storage facilities in Iraq from June 12, 2003, to March 27, 2008.

More alarming was al Qaeda's thwarted February 24, 2006 attack on Saudi Arabia's Abqaiq refinery. In April 2007 an al Qaeda cell was arrested allegedly preparing to strike Abqaiq again. This hub processes roughly two-thirds of Saudi oil thus is key to the Saudi Arabian and global petroleum industry. These attempts indicate al Qaeda's intention to inflict significant global economic damage.

The Baltic Threat

Oil and gas infrastructure in the Baltic region has not been specifically mentioned in al Qaeda fatwas or documents advocating attacks. However, this should not lead one to conclude that attacks will not occur. This is because, with the exception of Russia, the Baltic states are all members of the West and thus are all targets of al Qaeda. More specifically, all of these states, again except Russia, contribute troops to the International Security Assistance Force in Afghanistan (ISAF) while Denmark, Estonia, Finland, Latvia, Lithuania, and Poland have, or had, forces deployed with the Multi-National Force in Iraq (MNF-I), making them targets of al Qaeda and sympathetic militant Islamist groups. Russia is likely a target since it exports approximately 400,000 barrels per day (b/d) of crude oil and refined products to the US. Moreover, its military actions against Islamists in Chechnya are still fresh in the minds of many extremists.

Denmark has also gained al Qaeda's attention due to the publication, in a Danish paper, of cartoons depicting the prophet Muhammed that offended some Muslims. The Danish embassy in Pakistan was attacked in June, 2008, and an al Qaeda spokesman released a statement in September promising that Denmark would endure more attacks in order to "…wipe you [all non-Muslim Danes] from the face of the earth."

The oil and gas infrastructure of the Baltic region offers many targets for terrorists. Russia exports much of its tanker-borne crude through the Baltic Sea via the port of Primorsk. Throughput in 2007 was roughly 1.5 million b/d and construction of the Baltic Pipeline II will increase this amount. Smaller volumes of Russian oil are shipped from Baltic ports located in Estonia, Kaliningrad, Latvia, Lithuania, and Poland. These facilities, along with the Mazeikiai refinery in Lithuania, receive their oil either by pipeline or train from Russia. Russian gas also transits to other European markets via the network of pipelines in the Baltic region. As well, refineries in other Baltic states including Denmark, Finland, Germany, Poland, Sweden, and Russia are potential targets. Also, Russian oil major Lukoil's Kravtsovskoye offshore oil platforms are located in the Baltic Sea. Finally, the Nord Stream Pipeline, once built, could be vulnerable to attack.

The MV Limburg attack demonstrated that al Qaeda has the ability and intent to strike oil tankers. Tankers in the Baltic Sea are constrained by extremely busy and narrow shipping lanes. They can exit the Sea via the 3 Danish straits, which narrow to 4 km between Sweden and Denmark. They may also use the Kiel Canal to transit to the North Sea, although few tankers are small enough to do so. Regardless of their routes, oil tankers using the Baltic Sea are vulnerable to attack — more so at these choke-points.

A successful attack on a tanker in the Baltic Sea would have tremendous regional and international repercussion. Regionally, given the 30 year period required for a complete water exchange in the Baltic Sea, the ecological impact and the clean-up costs would be immense. Globally, it could cause economic problems by driving up the cost of oil.

Conclusion

The threat of an attack on oil or gas infrastructure in the Baltic region is real. Al Qaeda has specifically identified Denmark as a target and all other states in the region are implicitly targeted due to their association with the West and also, except for Russia, because of their participation in the MNF-I or ISAF. Russia's oil exports to the US make it an al Qaeda target. There are numerous vulnerabilities in the region, with oil tankers perhaps being the most lucrative. Granted, it is easier for al Qaeda and like-minded militant Islamist groups to strike targets in the Middle East. However, these terrorist organizations have demonstrated a desire and capacity to operate further afield suggesting that a major attack in the Baltic Sea region is possible.

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[1]This paper, its interpretation, and any opinions expressed herein, remain those of the author and do not necessarily represent, or otherwise reflect, any official opinion or position of DND or the Government of Canada.

Russian shipbuilding - is a rapid turnaround possible?

By Arild Moe and Lars Rowe

According to Russian authorities, the country's shipbuilding industry is in a deep crisis: Labour intensity at Russian yards is 3 to 5 times higher than in other countries, and Russian yards take from 2 to 2.5 times longer to build similar ships. In 2007 the Russian Ministry for Industry and Energy (Minpromenergo) launched a strategy for the further development of the shipbuilding industry. In the strategy document two areas stand out: Russia's military capabilities, and the development of petroleum resources on the Arctic continental shelf.

The strategy has two main elements: development of a state investment programme for civilian shipbuilding and reorganization of the industry. All in all, the programme represents a very ambitious policy of modernizing Russia's shipbuilding industry. The goal is that the industry by 2016 is to be competitive and able to cover much of Russia's shipbuilding needs, and even conquer a 'significant share' of the world market.

The total cost of the federal target programme 'Development of civilian marine engineering for the period 2009–2016' is estimated to be 136.4 bill roubles (approx USD 5.5 bill.). Even if the sums are big, when spread out over the years and between the various sub-programmes, their contribution will not necessarily be strongly felt. But the main concern is with the approach. It is an attempt to force through modernization and innovation by decree, which is reminiscent of the centrally planned economy. It is a top–down approach, where little is said about incentives for innovation from below. In defence of the programme, one can argue that, given the problem description in official documents, the situation in the sector is so serious that only a concentrated infusion of capital and concrete tasks from above can bring it back on its feet. But if this is true, the goals sound overly ambitious.

The other main element of the shipbuilding strategy is a comprehensive reform of state management of the naval industry. This reform entails establishing a state holding company, the Unified Shipbuilding Corporation (*Obedinennaya sudostroitelnaya korporatsiya – OSK*). This will be the umbrella organization over three regional state-owned holding companies and one non-regional one, with special areas of competence within naval production. The aim of the reform is to establish an integrated structure that gives the state full control over key decisions, but it is also clear that an important goal is to secure cooperation between yards.

It is still too early to tell exactly how the reorganization will be carried out. But the reform is very much in line with the strong centralization trend seen in Russia in recent years and a belief that central administrative agencies will be the most likely providers of a new and efficient structure in the shipbuilding complex through active intervention. Moreover, the shipbuilding industry in Russia is clearly regarded as a sector of national significance, both militarily and within the civilian sector, justifying strong state involvement. This point is further augmented by the large military presence in Russian shipbuilding: military orders currently make up 77 per cent of the order books at Russian yards. Very few yards have an exclusively civilian profile.

It must be noted though, that not all Russian yards are integrated in OSK. Three of the most important yards – Vyborg, Severnaya verf and Baltiyskij zavod in St. Petersburg – are still privately held. It is speculated whether the owners of these enterprises will be asked to sell their assets wholly or partly to the state. The apparently most successful yards are in private hands and the government may want to include them in the state corporation to help develop the whole sector.

The Ministry's strategy makes little reference to the need for international collaborative programmes, which could allow for Russian insight into the technological capacities of other countries. The role of foreign companies in the development of Russian offshore industry is mentioned only once in the strategy, and then without much specification. The strategy as a whole is strongly geared towards promoting a Russian naval industry able to meet the demands of national customers, and to a certain degree be able to compete effectively on the world market, on its own. In light of the backwardness of Russian naval industry today, this palpable lack of reference to international collaboration needed for future development points up what one may term a strong rhetorical discourse of national self-preservation in Russia today. Foreign (Western) interests are perceived mainly as ideological and economic competition – not as potential partners. But even if the potential and role of foreign interests is not highlighted in policy documents, and even if the use of Russian yards remains a strong overall concern, there is still considerable scope for foreign involvement in various ways, as experience has shown. Of the offshore platform under construction for Gazprom at Vyborg, only the hull is built in Russia. Everything above deck comes from various foreign suppliers. The same is the case with the ill-fated production platform for the Prirazlomnoye field under construction in Severodvinsk.

The mammoth industrial complex of the Russian naval industry is not easily turned around, and will still be held back by systemic problems in the foreseeable future. This is a reality that has been acknowledged at the central level in Russia. In May 2008, Prime Minister Vladimir Putin was clear in his statement during a visit to the Admiraliteyskie yard in St. Petersburg: "…foreign ships are built faster, are of a higher quality, and importantly – are still cheaper."

In policy statements coming from the new Russian president Dmitriy Medvedev it is possible to discern a critique of the strong tendency of central control and transfer of industrial assets to state companies, so dominant in Putin's second term. '.. any additional strengthening of the role of the state, increasing its presence in the economy is not foreseen. On the contrary, we will take action to reduce the presence of the state in the economy.' It is uncertain, though, if a real policy change is underway. And even if that should be the case, it will probably first affect or rather prevent new centralization and state take-over initiatives. Rolling back or radically changing the recently approved strategy for the shipbuilding industry would be far more complicated. That is unlikely to come about until weaknesses in the strategy are commonly recognized, and several years may be needed to come to this point.

The goal of rapid development of the Arctic continental shelf relying primarily on the domestic shipbuilding industry does not look attainable. Russia will either have to accept more foreign involvement, or scale down its offshore ambitions. We believe a combination of the two alternatives is likely.

Arild Moe and Lars Rowe

Fridtjof Nansen Institute

Norway

Institute's turning points and highlights

By Urpo Kivikari

In a divided Europe, Finland was the giant of East-West trade. Only at the end of the 1960s did the Federal Republic of Germany usurp Finland as the Soviet Union's most important western trade partner. Until the break-up of the Soviet Union, Finland occupied a significant position in the foreign trade of its eastern neighbour. Business with the Soviet Union for Finland was, naturally, even more important. In addition to the great value and significance of this trade itself, what was special about Finland's commerce with the Soviet Union was its maintenance as bilateral trade to the very end.

In Finland's export to the Soviet Union, Turku was the most significant locality, due to the shipyards and industry situated within the city. Indeed, it was natural that during the midpoint of the 1980s, a project was launched in Turku to establish a university-level unit concentrated on research and education in the Soviet Union's economy and foreign trade. With the financial support of the City of Turku and several business enterprises, the Institute for East-West Trade was established in 1987 at Turku School of Economics. Faithful to its founders, the Institute – on the foundation of its scientific mandate as well as alongside it – selected, as its goal, to also be of use in resolving practical problems both in Finland and in international forums.

The target area in research and education comprised, first and foremost, the socialist nations of Europe and their external economic relations and, subsequently, the economic conditions and integration of those countries that had transformed into market economies. The development of the Baltic Sea area into a European meso-region which has reflected, in a versatile manner, the development that has occurred in Europe as a whole has also been a central theme from the very beginning, and this still continues.

During the entire time, the most pivotal target for research has been the Soviet Union/Russia. As examples of this activity, I would like to mention a theme that I regard as particularly close to me personally from each of the three decades.

At the end of the 1980s, I was a member of academician Shatalin's international group, whose headquarters were at IIASA in Laxenburg, Austria. Working with top Russian and Western specialists provided a unique possibility to gain familiarity with the requirements and conditions on the basis of which the Soviet Union proceeded to establish a market economy. The international group did not even discuss the time required by a transition into the market economy. This period was subsequently brought to the fore in academician Shatalin's reform programme, published in the Soviet Union.

In the 1990s, long-standing projects funded by the Academy of Finland and the European Union, in which Russia's development possibilities for external economic relationships were analysed, were implemented at the Institute. Via many publications and conferences, the results spread to the scientific community and were also put into use by the Russian government. During the first years of the new millennium, I acted as a Senior Expert for the EU in a project in Moscow that examined Russia's path to World Trade Organization membership in addition to the development of the partnership between Russia and the EU. Now, five years later, those expectations on the accomplishment of those aims have appeared to be overly optimistic.

Ever since the beginning, Estonia has been a central target of the Institute's research and education as well as its partner. The political tension between Russia and Estonia, from the perspective of the Institute, has not made them exclusive alternatives to each other even if the poor relations between these neighbours have sometimes overshadowed our projects. The cool relationship between Russia and Estonia has, however, prevented the realization of the "Gulf of Finland Growth Triangle" project, an undertaking that has received wide international recognition.

If, of the various countries that have been targets for the Institute, one is still given special mention, that would be Hungary. Luckily, I already familiarized myself with the Hungarian economy at the outset of the 1970s. This was fortunate for the reason that Hungary was a pioneer with respect to both the market economy and economics in Eastern and Central Europe during the last decades of the 1900s. Due to the firm contacts with Hungary, I was privileged to be involved with the "Hid" (Bridge) and "Blue Ribbon" programmes implemented during the transitional phase of system change.

The arrival of Estonia and Hungary as members of the EU in 2004 meant that the three Fenno-Ugric language group states of Europe came into closer mutual contact than ever before in their history, which is a remarkable result of European integration from the viewpoint of the Institute as well.

The staff and students of the Institute have actively participated as writers and visiting participants in the operations of the international scientific community. However, the image of a scientific unit also includes the arrangement of both large and small scientific events. The first large event organized by the Institute for East-West Trade was in 1993 in Turku, when the Institute hosted the Second World Business Congress of the International Management Development Association (IMDA).

Aside from research, university education has been a pivotal activity for the Institute from the very start. Our students, who have graduated as masters and doctors in great numbers, have taken on responsible positions in Finland and abroad. The current director of the Institute, Professor Kari Liuhto, is also part of this group.

In two decades, Europe has experienced epoch-making transitions which have not only renewed the task performed at the Institute but its structure as well. During the 1990s, substantial changes occurred in the mutual integration between the states of Western Europe, which also impacted Finland. For the purpose of investigating these matters, the Institute for European Studies was founded at Turku School of Economics. After the line of division between Europe's East and West had disappeared and pan-European integration was launched, it was illogical to maintain a split between two institutes within the university. With the arrival of the new millennium, the two units were welded into one under the name *the Pan-European Institute.*

Urpo Kivikari

Former Director and Professor Emeritus

Pan-European Institute

Finland

The global financial turbulence and Russia

By Simon-Erik Ollus

Russia is not an isolated country. The global financial turbulence has proved this fact in the recent months. When the American financial crisis started in summer 2007, Russia still appeared as a quite safe investment country with a high rate of return and a low risk. Russian firms did in 2008 still IPOs for a record of 18 billion dollars, and the cash flow to the country in dollars continued to grow, as the oil price climbed. The economy boomed and the market value of Russian firms grew rapidly in recent years. In the spring 2008, there were 13 Russian firms among the world 500 largest firms by market value, while still a year earlier there were only eight. Russian business seemed to enjoy a period of renaissance and rapid growth

In early 2008 we started to see some changes, and some Russian firms started to cancel their planned IPOs as the international demand fell. In 2008 Russian firms have done so far IPOs for only 1 billion dollars, all during the spring. Some Russian corporations complained already in spring that international interest rates stared to climb and lending was harder, but any financial crisis in Russia was still far from expected. In May 2008, we started to see the first real signs of some disturbance. International oil prices started to decline and the problems with Fannie Mae and Freddie Mac showed us that the American crisis is worse than we first expected. American institutional investors started to withdraw capital from abroad and Russia, which was seen in modest decline of the two main Russia stock indexes: RTS and MICEX.

In the summer 2008, the Mechel and TNK-BP cases occurred, where the Russian *administrative resource* was used brutally against healthy businesses and which reminded us of the *political risk* related to the Russian market. The political risk was refreshed, when the conflict in the Caucasus started in early August, but still we did not see any panic on the financial market in Russia. The Russian political leadership also seemed to be sure that the domestically driven economy was not disturbed by the war. However, the shock for the economy came when the American crisis revealed much worse than expected in late August, when the problems around Lehman Brothers and AIG came up. The stock exchanges around the world plumed, also the Russian exchanges. The Russian stock exchanges have fallen with nearly 60 % from May to early October, whipping 700 billion dollars out of the country.

Russian indebted firms and banks are in trouble

Russia has so far enjoyed strong capital inflows in recent years, as oil prices have climbed and investors have increased their investments to the country. However, in August we for the first time saw capital flight from the country. According to the central bank, 21 billion flew out from Russia in August and the central bank had to intervene using its currency reserve to keep the value of the ruble in the currency board. In September, some capital flight was also observed. But exact figures are still hard to get, as the central bank will first to publish the balance of payments figures of the third quarter in mid October.

The market turbulence has severely hit those Russian corporations and banks, which have expanded by foreign borrowed capital. The Russian large firms have borrowed liquidity abroad, using their owed shares as collateral for the loans. Now, as share prices have plumed, the values of the collaterals have declined and many foreign banks now demand better collaterals or even call their loans back. Some Russian firms have managed to renegotiate their loans with higher interest rates. Other Russian corporations turn towards the Russian banks and try to transfer their obligations there. And for some firms the doors for borrowing are closed and market rumors spread in Russia about troubled firms. Consequently, the period of cheap liquidity for Russian firms are definitely over.

The financial turbulence also strongly hit the Russian banking sector, whose growth is mainly driven by relending short maturity foreign borrowed liquidity. The domestic financial markets are still small and deposit funded borrowing is rear. The banking sector is quite static. Although, there are nearly 1 200 banks, only the 28 largest ones have access to central bank lending. Since August, the central bank and the ministry of finance have several times injected excess liquidity to the largest banks, but smaller banks still face serious problems, as the interbank market functions poorly and foreign borrowing is getting more expensive. In September, two mid-size banks were bought by larger banks and further similar actions are probably expected. Consolidation is good, but the bad part of the story, is that the sector is dominated by state controlled banks and consolidation means an increase of their market share.

Bad for the real economy, but still far from worse

The good news is that the effects so far are limited in the real economy. The Russian economy is largely concentrated on natural resource production and the financial sector is relatively small. In early July 2008, Russian firms and banks had external debts for 493 billion dollars, of which a fifth was short term. This corresponds only to about a third of the GDP, which in international comparison is very low. However, the private foreign borrowing has grown rapidly in recent years, by about 40% y-o-y, and some of the large players are heavily indebted.

The main driver of the Russian economy is the natural resource sectors and the economic growth is driven by increasing raw material prices. On an annual term, the oil price is still on a record level and GDP growth was 8 % y-o-y in January-July. Central forecasters expect the GDP growth to decline by a few percentage points until the end of the year, but we still talk about a relatively rapid growth.

The bad news is that the financial crisis will probably affect those sectors, which drive the modernization of the Russian economy; manufacturing, retail sale and construction. We have already seen a decline in construction growth during summer, especially housing construction. Also retail sale has been partly debt driven, and increased cost of borrowing will affect consumption, although August statistics still show a record level of sale. The August figure can be partly explained by the record high inflation that encourages consumption. Value added manufacturing will also suffer, if the cost of capital increases and the demand decreases.

How bad the situation will become depends much on the outcome of the American financial crisis. If the American crisis gets worse, the cost of international capital will increase and oil price continue to decline. This would also hit the Russian economy much more severely than what we have seen so far. But if the American crisis is nearly over, the effects on the Russian economy will be limited. Then, the crisis would function mainly as a welcomed reminder for Russian political leaders and businessmen that Russia is a part of the global economy.

Simon-Erik Ollus

Adviser and Economist

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Finland

From Russia, with gas

By Rainer Nõlvak

Brussels is mouthing about joint energy policy for Europe: together we stand better against risks in energy supply. Who's to decide what is in the best interest of Europe? Oddly enough, with its ages-old divide-and-conquer tactics, Russia's Gazprom seems to be the force in charge of Europe's energy future.

Imminent Russian-German gas pipe, Nord Stream, is necessity for both parties. Designed to meet about a quarter of gas needs of Europe it also fills Russia's state budget with much needed euros. "North European Pipeline", as the project is called in Brussels, is one with "utmost importance" to EU, according to recent memo.

Wealthy Europeans helping Russians to rebuild their economy, while we euries are cleaning up our energy act by switching from dirty coal to much cleaner gas. Can't get any better - or can it?

Nord Stream has been planned grande, in good old Russian style. Current plans call for no less than world's longest underwater pipeline, double stringed. With total length of 1200km, nonstop from Russia to Germany, the cost of offshore pipeline grew form initial 4.7bn euros to more than 6bn during first year's paperwork. The Russian-controlled company has seen cost estimate for pipeline ballooning with disheartening pace since then. Sources close to Gazprom already talk about cost of 9bn while recent Estonian "no" would allegedly add another billion plus to the extraorbitant pricetag. Mind you, entering Estonian waters would have been departure from initial plans to start with.

However, for mere mortals, there are alternatives for gas transport from Siberia to Europe.

First, there's an existing pipeline already. Rolling through countryside of Ukraine and Belarus, it has suffered from excessive political valve-shuffling and is therefore deemed unreliable for Europeans to depend upon exclusively. Whether underwater gas pipe with pricetag of 14bn euros would be reasonable expense or could deliveries be assured via political means has not been brought up for a serious discussion yet. Physically, the existing pipe has plenty of capacity to cater European needs.

Provided that the alternative gas route to Europe is necessary brings us to the question of its location. Is the current underwater pipeline the safest and possibly the least expensive choice? It is known that underwater pipeline is two to six times more expensive to build than pipeline on dry land. Allegedly lesser maintenance requirement underwater is not nearly enough to cover that difference, not speaking of hidden "cost" of increased military presence which Russia is gladly offering for patrolling the entire route. Albeit second to energy security in prevailing view, impact on the fragile Baltic Sea ecology will be huge. Gazprom's current plans call for essentially bulldozing all the uneven areas and thoroughly rework the rest of 1200km stripe of sea bottom, while blasting rocks where needed. One needs to recall that the whole Baltic Sea is essentially a military dumpster since World War II: the underwater gas pipe will have to cross no less than eight large minefields between Estonia and Finland alone, not speaking of dodging chemical weapon's dumpsites which no one dares to touch. Recently, while extending deepwater harbour in Muuga, Estonia, the digging into sea bottom brought up at least one mine daily from already cleaned area. Granted, Nord Stream plans to clean 2km wide corridor through minefields, creating incredible mess on the sea bottom. However, who's to guarantee that all the bombs will be caught? Cost of fishing out all the deep-settled metal debris is unthinkable. How will aging explosives behave in the vicinity of the gas pipe remains to be seen. In regard of the above, land is much safer place to put pipes on than the bottom of the Baltic Sea.

It turns out there's another route worth considering: Latvia. The Baltic country boasts huge aquifers where gas can be stored in mind-blowing quantities. One of the smallest aquifers in Latvia, with capacity of 2bn cubic meters, is already being used as gas storage in Inčukalns. Gas is being pumped to Inčukalns from Russia in summer, while supplying all Baltic States and feeding back to St. Petersburg in winter. Potential storage capacity in just one of the available sites, Dobele, would be ten times larger, surpassing many times the largest gas storage in Europe and being able to store quarter of Germany's yearly gas requirement.

It gets better than that. The pipe network to Dobele and further to coast already exists; all it takes is to widen it. Routing Nord Stream through Latvia would shorten underwater leg of the project more than twice, saving billions while providing extra security via added storage en route.

Why isn't Latvian-German pipeline being built already? Gazprom does not want it.

Lower cost for pipeline with huge storage bonus might be good for European consumers, but not necessarily for Russian leaders. It gives Russia much more control to put separate pipes to Turkey, Germany and soon to Italy rather than dealing with Europe jointly. Just the same, extra gas storage capacity might give Europe extra security, which might not be in the interest of Gazprom.

Whether enough gas will be available for Europeans is another issue. It's known that Gazprom struggles to keep up with future demand. What if the pipe runs empty in bitter cold of the winter? Even more realistic threat, whether any Russian gas will be available for Europe when pipeline to China will start pumping 40bn m3 of gas yearly to opposite direction, remains to be seen.

There's also a delicate question of private interests. Anyone who has done business in Russia knows the "creativity" of clerks, or apparatchiks as they're called in Moscow. Builder's ballooned bids are frequently kick-backed to apparatchiks, so bigger deal means essentially bigger "bonuses". Whether all the billions will be spent purposefully while digging up most of the Baltic Sea remains to be seen. Think Iraq and Halliburton, if you will. On top of that Nord Stream, being Swiss company, is outside European jurisdiction so there's not much we can do about it anyway. Except paying the gas bills, of course.

Don't get me wrong; I'm not blaming Russians. To collarise Europe would serve greatly to Russia's newly found global aspirations and it is smart thing for Putin to do. Question remains, whether it's of mutual benefit. Perhaps it's time for Brussels to act.

Rainer Nõlvak

Chairman of the Board

Estonian Nature Fund

Estonia

EU's growing energy import dependency a major risk

By Kari Liuhto

Russia plays a strategic role in the EU's energy supply. Russia accounts for 24% of the Union's gas consumption and 29% of its oil consumption. At the moment, the EU's own gas production covers 43% of our gas consumption and 14% of our oil consumption. The energy self-sufficiency of the EU decreases dramatically in the coming decades.

In 2030, the Union will only be able to cover 16% of its gas needs and 5% of its oil supply. Obviously, Russia's role as the Union's oil supplier does not increase as much as the share of Russian gas in the EU's gas consumption. When predicting future developments, we should keep in mind that Russia's oil reserves are not as significant – some 6-9% of the globe's oil – as their natural gas reserves, which represent 25-30% of the world total.

Russia is the world's second largest producer of oil after Saudi-Arabia, and already some 70% of Russian oil is exported – to a large extent to the European Union. Russian oil production has not increased in past few years. One reason for stagnation is the increasing role of the state in the oil business. Some five years ago, the state covered only 20% of oil production, whereas today it is already nearly 50%.

Russia is the largest gas producer in the world. The state-controlled Gazprom is a dominant actor, representing some 85% of the country's natural gas production. An important factor related to gas production is the fact that Gazprom's major gas fields are depleting, and it is anything but certain, whether enough new major fields can be opened during the next 10-15 years to replace the depleting ones. Secondly, even if private natural gas producers are rapidly increasing their production, they are not necessarily able to fill the gap caused by Gazprom's declining production.

When one analyses the capability of Russia to export more natural gas, one should remember that Russia's growing economy requires more energy. It has been estimated that Russia's own gas consumption increases by around 2% annually. Another factor to remember is that more than half of Russia's primary energy production is covered by natural gas.

Therefore, Russia should build new sources of energy, such as nuclear energy, in order to be able to export significantly more natural gas. Russia's plan to erect 26 new nuclear units by 2020 is not realistic, as it would require the building of two new nuclear power stations per year for the next 12 years. All in all, Russia should invest some $ 1000 billion in energy production and infrastructure, to be able to meet the future needs of the country's energy appetite.

A much more realistic option than building new energy capacity is investing in energy saving. The World Bank estimates in its fresh report that by investing $ 320 billion in energy saving, Russia would be able to reduce its primary energy consumption by 45%. The payback time of these energy savings investments is just 2-4 years.

If Russia is able to produce enough gas to meet the growing needs of the EU, then one should find the optimal way to distribute the gas from remote locations to consumers. As no major break-through in Russia's LNG production is likely and Russia's gas tanker fleet is insufficient to ship the gas, it seems that pipelines will remain the main channel for gas transportation. In order to increase the flow of natural gas to the EU, old pipelines should be repaired and new pipes should be constructed.

When the final decisions are taken concerning the routing of new pipelines, one should first prioritise the routes which are the most environment-friendly. Secondly, one should prioritise those routes which truly integrate Russia, the EU member states, and the countries-in-between. The Nord Stream and the South Stream have received a lot of criticism since they neglect the interests of many countries, such as Ukraine and Poland. The gas supply can truly integrate Europe, only if gas transit forces countries to talk with each other. Otherwise, gas becomes a major disintegrating force within the EU and Europe as a whole.

It is evident that Russia is a strategic partner for the EU, but is the interdependency between the EU and Russia sustainable. Those who believe in the sustainability of the interdependency seem to neglect the fact that Russia does not aim to stay a natural resource base for the EU, but that Russia wants to develop its own industry and army, and become a super power once again. In this context, one wonders if the super power with a guided democracy would become a competitor rather than remaining a credible partner for the EU in the long-term.

The interdependency between the EU and Russia is not developing favourably from the European point of view, since we are becoming more dependent on Russian energy, whereas Russia may become less dependent on European machines and cars. Moreover, in a crisis situation, Russia could move on without European machines and cars, but the EU would have considerable difficulties in replacing Russian energy in case of non-delivery. I dare to argue so, even if it is a well known fact that oil and gas account for half of Russia's budget income, and the EU is the largest external buyer of Russia's energy.

In addition, one should not forget that the EU's attempts to diversify its energy sources can be even less successful than Russia's attempts to diversify its energy exports. Therefore, the EU should seriously consider how to increase its own energy self-sufficiency instead of increasing its energy import dependency on Russia.

Should the EU be unable to design a common energy policy for itself, the Kremlin will create energy policy for Europe.

Kari Liuhto

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EU-Russia customs cooperation - solving border congestion

By László Kovács

The deepening interdependence between the economies of Russia and the European Union is directly reflected in the growing volumes of our bilateral commercial exchanges. Over the last five years, the EU's trade with Russia has been increasing at an average annual pace of over 24 %. In 2007, its total turnover exceeded € 230 billion. The EU is also Russia's first trading partner, with over 50 % of the value of Russia's total foreign trade.

Our success in developing our bilateral trade relations, however, has come at a price. The ever growing volumes of goods exported or in transit from the EU to Russia have led to an increasing strain on our common border. Finland, Estonia and Latvia have witnessed increasingly long queues of lorries awaiting clearance, sometimes for days on end, with serious consequences not only of a commercial nature and not only limited to the costs imposed on economic operators. Lorry congestion also has an important environmental and social impact on communities near the border.

The EU and Russia are both well aware of this problem, which has been discussed at each of the last four EU-Russia Summits.

At the end of 2006, the Commission took the initiative, in agreement with EU Member States, to propose to Russia a number of structured short-, medium and long-term actions to bring about a sustainable solution, in line with our mutual interests, to congestion at our common border.

The result is that we have agreed with our Russian counterparts a strategy resting on concrete objectives that is in our power to achieve, and which is already becoming a reality. The strategy is based on three interconnected priorities for action:

- Implementation by Russia of legislative, administrative and procedural measures to improve the situation at the border, notably by reducing the number of agencies operating controls at the border;
- Implementation of a pilot project on exchanges of advance information. Consignments for which advance information is sent will benefit from facilitated customs procedures leading to shortened clearance time;
- Implementing and developing border-crossing and customs infrastructure on both sides of the border.

In order to follow up the implementation of these actions, we have set up a working group with the participation of EU Member States on a voluntary basis, the Commission and Russian Customs.

In the framework of this strategy the Community offers to provide advance customs information to Russia on a pilot basis. This gives the Russian authorities an excellent opportunity to streamline and increase the efficiency of procedures at the border. At the same time, the Russian Federation commits itself to using this information so that in return it can offer economic operators real facilitation at the border.

Already 13 EU Member States[3] have subscribed to this project and to sharing this commitment in engaging in exchanges of information. The necessary technical work is being carried out so that the pilot project can become fully operational, as scheduled, in January 2009.

The success of the information exchanges and of the ensuing facilitation from which consignments of goods will benefit depend to a large extent on the results of the ongoing reform of border activities in Russia. If trade continues to expand, the efficiency and processing capacity of customs on both sides of the border will need to increase even faster: should one of the actors in the chain of customs procedures be less efficient than the others, bottlenecks will ensue. This is the reason why we are particularly looking forward to the implementation of Russia's reforms which come under the first priority for action of the strategy we have agreed. The result must be a streamlined, transparent and efficient system of border controls which functions in a predictable manner and eliminates the scope for any arbitrary application of procedures.

The Community has supported Russia's efforts in customs reforms and will continue to do so through commonly agreed and well-targeted technical cooperation projects. Indeed, the development of bilateral technical cooperation between Russia and the Community is of particular importance in order to achieve the compatibility of our respective customs systems as set out in the current Partnership and Cooperation Agreement.

A € 3 million project on the modernisation of Russia's transit system is already being successfully implemented. The Commission has also proposed another project, funded with € 5 million, which has the twin objectives of reducing the time necessary for the passage of persons and goods through the EU-Russian border, and of improving cooperation among Russian services as well as between them and their counterparts on the other side of the border.

In the longer term, we will also need to ensure that border-crossing and related infrastructure is of sufficient capacity to cope with ever increasing trade volumes. Russia nd the EU have already discussed this issue at length, leading to useful exchanges of information on the two sides' infrastructure priorities as well as current and planned projects, including financing possibilities. We need to keep up this discussion so that the development of infrastructure on both sides can take place in a coordinated manner.

In the last meeting of the EU-Russia Sub-Committee on Customs and Cross-Border Cooperation[4], held in Moscow on 19 June 2008, the EU confirmed its commitment and willingness to proceed along the lines agreed with Russia. The pilot project on exchanges of information will be up and running from the beginning of next year. It is my sincere hope that the reforms of Russian border procedures currently being finalised will also be fully implemented as of that time.

The work that we have achieved so far and that we will accomplish from now on will make an important contribution to the preparation of the new Agreement between Russia and the EU, on which negotiations have just begun and which will eventually replace the current Partnership and Cooperation Agreement. This work will further strengthen our cooperation and help us in harmonizing and simplifying our customs procedures, with the ultimate aim of ensuring the smooth flow of goods in our bilateral trade.

Both Russia and the EU firmly believe that the strategy we have agreed is the right way ahead to solve once and for all the problem of lorry queues at our common border. The EU has shown its commitment to the implementation of this strategy. We expect that Russia will implement the very same commitment and devote all of its efforts to the necessary reforms. Through the parallel and simultaneous implementation of all three priorities of our joint strategy, we will produce a lasting solution to border congestion.

László Kovács

EU Commissioner for Taxation and Customs Union

[3] Austria, Belgium, Czech Republic, Estonia, Finland, Hungary, Italy, Latvia, Lithuania, Poland, Slovakia, Slovenia and Sweden.

[4] This Sub-Committee is the main regular, high-level forum for the discussion of bilateral customs issues between the EU and Russia. Its meetings are chaired by the Commission's Director-General of Taxation and Customs Union and by the Head of Russia's Federal Customs Service. Member States may also participate.

Economy of Latvia - on the path to stabilization

By Kaspars Gerhards

Reforms and integration in the EU has made positive impact on economic development of Latvia. In the period of 2004-2007 GDP increased by 10.5% on average annually, which unambiguously reduced Latvia's backwardness in terms of the GDP per capita level compared to the EU-27 average level. High growth was ensured mainly by strong domestic demand, which was fostered by the growth of wages, household crediting and positive expectations of the future, as well as investments and exports.

Economic development in Latvia in the recent years had positive impact on the situation in the labour market. Latvia exceeded the average EU level in terms of employment already in 2006, when employment level in Latvia was 66.3%, but in 2007 it increased to 68.3%. Unemployment level has gradually reduced from 10.4% in 2004 to 6.0% in 2007, which is lower than the EU average. The number of unemployed reduced not only due to the increase of economic activity of the population. Since Latvia's accession to the EU in 2004, labour outflow to the old EU member states, which fully opened their labour markets for the citizens of the new EU member states, has been observed, causing labour shortage in some sectors of the economy.

Alongside with a high growth, economic disproportions developed and deepened since 2004, namely, inflation has increased and the current account deficit has deteriorated.

The imbalances of the Latvian economy are determined mainly by the following factors:

- High GDP growth, which outpaced potential,
- Growth was based mainly on rapid increase of domestic demand, which was fostered by credit expansion,
- Substantial wage growth caused by tight labour market conditions and emigration, and
- Loose fiscal policy in 2004-2006. Only in 2007 budget was balanced.

In order to reduce the overheating threats of Latvian economy, the government adopted *Inflation Reduction Plan* in March 2007. As a result of its implementation as well as cautious crediting policy of banks, domestic demand has slowed down. If during 2006 and the beginning of 2007 the quarterly growth rate of private consumption was about 20%, then in the second half of 2007 we can see that the growth of private consumption slowed down and in the first quarter of 2008 it was only 2.3%.

The decrease of private consumption and external situation, first of all, the instability of the global financial market, affected also GDP growth. Since the second half of 2007 growth rates declined. In the first quarter of 2008 GDP increased only by 3.3% compared to the respective period of the previous year. It means that economic growth started to decline substantially.

The main aim of the government at the current situation is to ensure soft landing of the economy and to create preconditions for increasing productivity and long term competitiveness.

In order to ensure those aims, Latvian government on April 15, 2008 has adopted *Macroeconomic Stabilization Plan for 2008 – 2009*. If Inflation Reduction Plan of 2007 was aimed to decrease domestic demand and crediting, then Macroeconomic Stabilization Plan pays particular attention to stimulating supply side of the economy.

Two key directions of Macroeconomic Stabilization Plan are as follows:

- To continue fiscal consolidation by developing budget with a surplus in 2008 and 2009, as well as increase effectiveness of budget expenditures and
- To implement structural reforms aimed at increasing productivity and long term competitiveness.

It is also foreseen to implement changes in the taxation policy, such as:

- To reduce tax burden on investment, by providing amendments in the Law on Corporate Income Tax and
- To amend the Real Estate Tax.

To increase productivity and long term competitiveness the Macroeconomic Stabilization Plan includes measures and concrete targets for:

- Reduction of administrative burden;
- Strengthening competition;
- Providing availability of finances for SMEs;
- Promotion of flexibility in the labour market;
- Development of knowledge based economy;
- Improvement of energy efficiency.

As regards the reduction of administrative burden, the key measures are aimed to:

- Improve the procedures of enterprise registration and licensing;
- Reduce costs related to employment;
- Optimize regulatory and control institutions in the construction sector.

One of the main tools for improvement of the business conditions is the Action Plan for Improvement of the Business Environment, which is being developed annually. In 2008 – 32 actions are identified in different fields.

Moreover, to ensure better regulation in 2007 the Ministry of Economics started 5 pilot projects to assess administrative burden in such fields, as tax legislation, labour legislation, construction issues and operations with real estate, as well as fuel market to increase bio fuel consumption.

To strengthen competition and anti-trust policy, amendments to the Competition Law are made, which will allow turning against substantial competition infringements more effectively.

In order to provide support for small and medium-sized enterprises of Latvia, the Cabinet of Ministers on May 13, 2008 has approved the *Supporting Programme for Improvement of the Competitiveness of Enterprises*. This programme will be implemented by the Mortgage and Land Bank of Latvia and its goal is to ensure availability of finances for improvement of the competitiveness of SMEs. The total amount of financing is 284.6 million EUR.

On April 8, 2008 the Cabinet of Ministers has adopted decision to establish holding fund with the aim to support export credit insurance/guarantees, risk financing (loans, venture capital), micro credit, portfolio guarantees and holding fund in the amount of more than 214 million EUR.

As it was mentioned before, the Macroeconomic Stabilization Plan includes also measures, which cover labour market, development of knowledge based economy and improvement of energy efficiency.

As concerns the labour market, measures include:

- Support of training and retraining of employees and
- Measures of the State Employment Agency in the area of fostering inclusive labour market.

Development of knowledge based economy foresees measures aimed to:

- Support the development and implementation of new products and technologies;
- Competence centres program;
- Technology transfer program, which is under way since 2007;
- Support to attract highly educated workforce.

Another issue, which is of crucial importance for Latvia is energy policy. I would like to point that there is a well established energy policy framework in Latvia and during the last years particular attention has been paid to the wider use of renewable energy and increase of energy efficiency.

Latvia supports limitations of the greenhouse gas emissions to facilitate achievement of set targets in Kyoto protocol. However, Latvia emphasizes that tightening up of the National Allocation Plan in order to achieve better climate protection should be well balanced with country's development needs. Setting emission allowances too low could detract investment and stem country's industrial development towards meeting the targets. I must say, that under the current emission allocation plan Latvia cannot ensure sustainable development.

Improvement of energy efficiency includes measures aimed to:

- Reduction of the losses in heating networks;
- Fostering introduction of new cogeneration power plants, based on renewable energy resources;
- Reduction of consumption of thermal energy in apartment houses.

In conclusion, it should be stressed that Latvia must work hard in order to develop knowledge economy, increase of competitiveness and improve the welfare of the population. The abovementioned facts witness that we go in the right direction. A lot depends from how efficient Latvia implements structural policy reforms and integrates in the EU.

Kaspars Gerhards

Minister of Economics

Latvia

Lithuanian transport sector - perspectives for development

By Algirdas Butkevičius

Lithuanian transport sector grew strongly in the year 2007, and an overview of the first half of this year also demonstrates a continuing character of this growth, revealing the optimistic patterns of further development.

The turnover of cargo in Klaipėda State Seaport has reached 15,9 million tons in the first half of 2008, showing an increase by 21 % comparing to the same period of 2007. What is more important, Klaipėda seaport continues its leadership among other ports of Baltic states, nearly doubling the handling of TEUs during last three years. In the first six months of this year, almost 182 thousands of TEUs were transported in Klaipėda. State enterprise "Lithuanian Railways" carried 28,6 million tons of cargo, which is by 10% more than during the first half of 2007, and the passenger traffic at the international Lithuanian airports went up by 23,7 %, recording a flow of 1,2 million of passengers.

These figures are important in the light of the whole Lithuanian economy. About 10 per cent of Lithuania's GDP is produced by transport sector. Transport operators are well established in the international markets and transport services account for almost 60 % of export of all services of Lithuania. This shows that a viable transport sector serves as one of the motors of economy and increases Lithuania's competitiveness. Moreover, for the period of 2007-2013, Lithuanian Government will invest 3,5 billion EUR to keep up with the growing demand of transport infrastructure.

Promoting intermodal transport

Intermodality has already become an imperative for a competitive transport system. Lithuanian intermodal approach deals mainly with the promotion of combined transport at Klaipėda and developing adequate logistics skills.

Growing demand for combined transport indicates the need to expand the cargo handling capacity of the port. In the short term, we are aiming at developing better interoperability between different transport modes in Klaipėda by reconstructing and building new rail and road infrastructure until 2010. This plan is an example of successful cooperation of various stakeholders: national and city authorities as well as business. The works will be funded from the national budget and EU funds. State enterprise "Lithuanian Railways" alone will invest more than 17 million EUR into better connections between maritime and inland transport.

A long term project is the construction of a deepwater port (-17 m deep) by reclaiming the land in open sea next to the nowadays port's entrance channel. According to the preliminary calculations in 2004, the costs of the project were 633 million EUR, but they may have doubled due to the inflation. Therefore, various investment strategies are considered, with clear prospects to private capital participation.

Comparing to the Western Europe, Lithuania has stronger experience in freight carriage by rail, which constitutes half of total freight carriage in our country. In order to use this experience and to make it advantageous, Ministry of Transport foresees the development of a network of public logistics centers, which form another part of intermodal approach to transport. As for today, Lithuania plans to build three such centers, near Vilnius, Kaunas and Klaipėda, at the preliminary total cost of nearly 104 million EUR.

Linking East and West

An unprecedented growth of trade and mobility of persons between Europe and Asia creates a great need for adequate transport connections. This determines Lithuanian ambitions to take part in the formation of global and regional transit policy.

Under Lithuanian proposal during the Eight Asia-Europe Meeting (ASEM) Foreign ministers Summit on 28-29 May 2007 in Hamburg, the Ministers of Transport of Asia and Europe will meet for the first time under the framework of ASEM in Vilnius in 19-20 October 2009. Our initiative was welcomed by the ASEM member states as well as by the European Commission. Our major partner in Asia is China, and such countries as Singapore, Sweden, Vietnam and Germany have already expressed their political support and will to participate in the event.

ASEM Vilnius Ministerial will be a great opportunity to discuss the issues of Asia-Europe trade facilitation, creation of adequate transport systems and climate change. Moreover, the meeting will attract global attention to the Baltic Sea as well, providing the possibility to present transit capabilities of our region in the global transport flows.

Intensive cooperation with our closest neighbours is a necessity for the creation of the effective transport links between Europe and Asia. We have already witnessed the success of the combined transport train Viking, running from Klaipėda to Minsk, Kiev, and then to Odessa/Illyichevsk, and thus connecting the Black and the Baltic seas. Under the agreement of Ukraine, Belarus and Lithuania, which was signed on 12 May 2008, this transport corridor will be developed further, by means of flexible tariff policy and facilitation of cross-border procedures.

With the implementation of the East-West Transport Corridor (EWTC), we are extending Viking and other transport corridors from the CIS countries to the Western Europe. Lithuania and Sweden recently expressed their support for further EU financial assistance to this project. Bearing in mind the fragile ecosystem of the Baltic Sea, we believe that being a "green corridor", the EWTC will be a good example of successful sustainable development.

Connecting North and South

Due to the specific historic legacy, the inland transport infrastructure links of three Baltic states with the rest of Europe are insufficient even today. In order enable the mobility of goods and passengers throughout Europe, we have to build adequate infrastructure. One of such projects is the Via Baltica road route, which is being nearly finished on the Lithuanian territory.

Main priority for us as well as for the EU is the Rail Baltica project. The beginning of this year was very successful, as we have seen on 29 February, when the first meeting of the International Coordination Group for the implementation of the Rail Baltica project took place in Vilnius. Parties have agreed on the strategic importance of the project and stressed the need to start construction activities in a few years.

Need for stronger regional cooperation

In large part, many of the initiatives mentioned here concerns the whole region. The success of their implementation depends heavily on the level of cooperation among different countries and other stakeholders of the Baltic Sea Region. Thus, I do believe that common efforts will increase the competitiveness of Baltic Sea Region in the international transport markets.

Algirdas Butkevičius

Minister of Transport and Communications

Lithuania

Globalisation and the Baltic Sea Region

By Halldór Ásgrímsson

The Top of Europe has become more globalised and interconnected than ever before. But how do we develop welfare and growth further in the age of fast-moving globalisation? This is perhaps one of the most pressing challenges, not only for the Nordic countries but also for the entire Baltic Sea Region.

First of all the new globalisation challenges cannot be solved by a single country. Instead the nature of these challenges requires all countries and regions to take synchronised and coordinated action. Strengthening the region's global competitiveness is not only ambitious and highly demanding in terms of compliance with the Lisbon Agenda; it also requires stronger links between neighbours. One way of achieving welfare and growth is to pool our resources and utilise our expertise and know-how in a more strategic way around the Baltic Sea.

The Baltic Sea Region – the Top of Europe

The Baltic Sea Region has a great potential to become the worlds leading region concerning welfare and growth. Almost every Baltic Sea country is growing faster than the EU average. We are a dynamic region that many other regions try to learn from. We must however further develop our regional cooperation and focus on both our strengths and on our weaknesses. Our countries have a very good chance implementing joint policies and thereby coping with the challenges and together turn them into added value and economic progress. In other words seeing the challenges as opportunities instead of treats – acting instead of reacting. Acting together and in partnerships.

Cooperation with partners around the Baltic Sea is not new to the Nordic Council of Ministers (NCM). We have since the beginning of the 1990s had offices in the three Baltic capitals, in St. Petersburg since 1995 and in September 2005, an office in Kaliningrad opened. They are an important part of the Nordic regional cooperation of today and will continue to be so. The forms for cooperation are developing and presently the NCM is working on new guidelines for its cooperation with the three Baltic countries and North-western Russia for the years 2009-2013. The new guidelines are expected to be approved later this year. But, we have also much longer traditions of trade cooperation as historically the Baltic has been a sea of trade. A few hundred years ago many of the Baltic cities belonged to the Hanseatic League, dominating commerce in Northern Europe for centuries as the world's first free trade alliance. We can be proud of this tradition and let it be an inspiration for our modern "Top of Europe" and a reminder that economic protectionism helps no one in the long run.

The Nordic Globalisation Process

Economic development or conditions supporting the economic development of the Nordic region, including the entire Baltic Sea region, stands high on the NCM's political agenda. This is seen clearly when looking at the "globalisation process" kicked off by the Nordic Prime Ministers in the summer of 2007. The objective of this Nordic globalisation process is to enhance a more skilled, visible and thriving Nordic region developing welfare and growth. Some key areas in this process are energy, environment, climate, research and innovation. Presently the NCM is working on a number of concrete projects supporting the Prime Ministers' overall globalisation policy objectives. Innovation offices in Asia, a joint Nordic energy expo, Nordic input into climate negotiations, joint promotions during the World Exhibition in Shanghai in 2010, promotion of higher education in the Nordic Region, greater mobility and freedom of movement, and joint investments in Nordic top-level research are just some of the important "Globalisation Projects".

One of the projects, a Nordic Globalisation Forum has already taken place in Swedish Riksgränsen in April 2008 and the next forum will be held in Iceland in spring 2009. At the forum in Riksgränsen the Nordic Prime Ministers confirmed in a joint declaration the globalisation process set out in Punkaharju. A Nordic Globalisation Barometer focusing on how the Nordic region is doing in the world was also presented at the forum. The so called "Riksgränsen Declaration" and the Nordic Globalisation Barometer 2008 can be seen on www.norden.org. Another interesting report soon to be ready is the Baltic Development Forum's (BDF) "2008 State of the Region Report". The report, sponsored by the NCM and the Nordic Investment Bank, will give an overview and analysis of the economic situation in the Baltic Sea Region and will be presented this autumn at the BDF Summit in Copenhagen.

EU strategy for the Baltic Sea Region

An EU strategy for the Baltic Sea Region is also an important way of strengthening competitiveness and accelerating economic integration in the region. This strategy serves as one way in which even closer ties can be established between the Nordic and the other Baltic Sea countries, and will create a joint platform from which we can act together in an EU context. It is also important that we with our neighbours continue to work together within the framework of the Northern Dimension not least because Russia is and will continue to be an important partner for the whole region.

Regional cooperation is a necessity if we want our societies to be prosperous and to have economic growth in a sustainable manner in this age of globalisation. The expansion of the EU to 27 member countries has brought new opportunities within the EU, but it also has raised the level of competition and we will perhaps, in the light of the resent EU developments, experience a revival of smaller regional cooperation. We must work closely and efficiently together, both in a broad European framework and in smaller regional frameworks if we want to succeed in the competition for jobs, investment and knowledge.

Halldór Ásgrímsson

Secretary General of the Nordic Council of Ministers

The Nordic Council of Ministers

The Nordic Council of Ministers (NCM) is the forum for cooperation among the five Nordic countries and the three autonomous areas Greenland, the Faroe Islands and the Åland Islands. The NCM focuses first and foremost on making added value for the member through cooperation. A lot of this work is about acting jointly in different areas and learning from experiences of different policy approaches between comparable countries. The NCM has traditionally focused its activities on education, research, culture, social health affairs, the labour market, matters to do with economic, environment, foodstuff, forestry, resources of the sea, industrial and energy policy – in other words a continuation of typical domestic affairs within a Nordic framework.

Today the NCM is refining its sphere of activity and priorities within the new international and regional context. The above mentioned policy areas are still on the NCM's agenda, but the perspective is broadening and the actions are more focused. It is fair to say that Nordic cooperation today has four major perspectives; The Nordic region in its own traditional identity, the Nordic region as a part of the Baltic Sea region, the Nordic region as a participant in a larger European cooperation, primarily within the European Union and the Nordic region in a global context.

Baltic Sea as an energy route

By Pekka Haavisto

Baltic Sea has many users. It is a unique Northern biodiversity area, and many species are dependent on its biological condition. Industrialization, urbanization and chemicalization of the agriculture have all increased the pollution of the Baltic Sea. Too many rivers are still used as sewage channels towards the sea.

During the World War II – as well as many earlier wars – the Baltic Sea has also been a war zone. And after the war arms and chemical weapons have been dumped to the bottom of the sea. The military importance of the Baltic Sea has been remaining – despite the fact that the sea is often called the "Sea of Peace".

For Finland the Baltic Sea is the main route for foreign trade – around 80 percent of our trade goes via the sea route. Even if not according to the maps, economically Finland is an island, dependent on the sea routes. Also the passenger traffic on the Baltic Sea is increasing. Maybe the rising prices of aviation fuel and concern for the changes in the atmosphere will in the future encourage even more people to use ships instead of planes?

In addition to all this, the Baltic Sea is also becoming a more important route for energy transport. I was last summer driving from St. Petersburg to Helsinki via Primorsk, prior to World War II known with its Finnish name Koivisto. It was Sunday, and there was a big outdoor party around an old Finnish church in the town center. When discussing with people, most of them were working in the harbor, which constitutes the new large Russian oil harbor at the geographical bottom of the Gulf of Finland. The capacity of this oil harbor is even increasing in the years to come.

This means more and more oil tankers in the Gulf of Finland and in the Baltic Sea. Everyone can understand what a bigger oil accident in this ecologically vulnerable area could mean. The building of the new harbor in Primorsk was anyhow dominated by economical and political factors, not by environmental ones.

When after the Soviet stagnation new investments in Russia emerged, many countries around introduced themselves as "gates" to Russia. This definition has never impressed Russians. They always remind you that the gate can be either open or closed. The idea of someone controlling their foreign trade or energy export is not very pleasant to Russians.

It goes without saying that guaranteeing the energy routes is nowadays part of the big politics. We all remember the Russia-Ukraine schism over the nature gas supply, and the recent conflict between Russia and Georgia, to take another example.

The Nord Stream nature gas pipeline between Russia and Germany will be a new dimension of using the Baltic Sea as an energy route. Actually the energy cooperation between the Western Europe and Russia is all the time deepening, and EU is becoming more and more dependent on Russian oil and nature gas. When selling the fossil fuels abroad, Russia is at the same time investing in new nuclear power plants. In the future it could increase its role also as an exporter of electricity.

When the Nord Steam pipeline was agreed between Russia and Germany, many EU-enthusiasts in Brussels were a little bit surprised. EU wants to increase its role in energy policy and in energy security, but the Nord Stream case shows clearly that the member states are making their own energy decisions still very independently. When the security policy in EU is deepening, there are also voices saying that EU should create an energy security network, or something like "energy NATO", for cases when individual member states are in crisis and need support for their energy supply. While EU is now increasing other collaboration in security and military affairs, it has still a long way ahead when it comes to a common energy security policy.

Countries around the Baltic Sea had different reactions to the Nord Stream project. Estonia took a hard line: it did not accept even any investigation of a southern route through its economic waters. Estonians were not delighted when Russian President Vladimir Putin announced that securing of the nature gas pipeline will be one of the new tasks for the Russian's Northern Fleet. Estonia looked at the project from the point of view of its own national security, and objected.

The discussion in Sweden was also around the security arguments: The pipeline route is close to Gotland, and according to some voices in Sweden, new espionage technology could be inbuilt to the pipeline. In Russia this kind of thinking was labeled as science fiction, but Sweden has had some negative experiences with the Russians earlier.

When Estonia refused the southern route for the pipeline, in Finland we knew what is left: the northern route via Finnish economic waters. In Finland the pipeline debate has not been around security, but around environmental aspects. It seems that the most risky part is the construction phase, when the sea bottom needs to be made suitable for the pipeline, and also to eliminate mines and dumped chemical weapons on the bottom of the sea.

While the Finnish politicians have concentrated on the environmental impacts of the pipeline, in internet debate there has been also some security concerns expressed by the ordinary citizens. Many Finns remember the beginning of Winter War in 1939: Soviet Union set up an attack in its own territory in Mainila village, and used that then as an excuse to attack Finland. What if a terrorist attack against the pipeline is used as a new Mainila, concerned citizens are asking.

In my mind this kind of speculation is not relevant today, when peace remains all over around the Baltic Sea. But pipelines are long term projects, and for that reason it is good to assess also long term consequences. I think it is clear that also Finland has to invest more to the ecological and security control of the Gulf of Finland, due to the pipeline project. It is always better to be prepared, than to be taken by surprise.

Despite the increased economic use of the Baltic Sea, for many individuals the biggest value of the sea is aesthetic. I am not an exception. One of my favorite places to walk and sit on the coastline are the big cliffs on the Cape Porkkala, close to Helsinki.

What do you think when you stare to the sea? My colleague in the Finnish Parliament, Mr. Jacob Söderman had a good aphorism: "When I watch the sunset in Turku archipelago, I am sure that this is not created by the local social democratic municipal organization."

Pekka Haavisto

Member of the Finnish Parliament and former Minister of Environment

Finland

Russian politics

By Kimmo Kiljunen

The shift from a monolithic Communist-driven single-party system to a pluralist political system has been painful in Russia. The party political domain is developing. There is still a tendency for power to concentrate in the hands of a single party. Opposition is viewed as criticism of the entire system and, ultimately, criticism of the chief executive — and as such tantamount to treason. In Russia there is no concept of dissent in party politics or, as they put it in Britain, of 'Her Majesty's Loyal Opposition'.

Emerging democracy is characterized by abrupt shifts of opinion and an emphasis on extremities. Parties are highly combative, and politics tends to be fruitlessly confrontational rather than aiming at consensus or compromise.

In a society approaching democracy and pluralism by degrees, politics inevitably initially revolves around strong personalities. Indeed, the Russian party political system is a kaleidoscopic, constantly shifting field where parties rise and fade in tune with individual charismatic leaders. The names of parties, their composition and their alliances change dextrously as the needs of day-to-day politics dictate, and most political movements are better known by the names of their leaders than by their official rubrics.

Since Russian parties do not represent social movements or interest groups, politics is mostly about power rather than about ideologies. This makes it difficult to analyse the party system. Russian parties scarcely have exact counterparts in the European system, and it is extremely difficult to draw parallels.

One party has risen above all others, and the party political field is otherwise fragmented. Former president **Vladimir Putin** has openly declared that the objective is to create a European party structure in Russia, with a strong centre-right party and a centre-left party forming the core of political power.

Leading parties

There is one party that clearly outguns the rest. *United Russia*, Vladimir Putin's party, controls the Duma elected in 2007. It commands the majority required to amend the Constitution. *United Russia* is often described as the 'party of power' (*partija vlasti*), which illustrates the nature of the party well.

It is a centre-right coalition that supports the initiatives of the President/Prime Minister and his administration. True to its name as 'party of power', *United Russia* represents the current political elite and bureaucracy of the country. 'Staying in power' is the only ideology it needs.

The leading opposition party is the *Russian Communist Party*. It is the best organized of all parties.

The Communists are on a nostalgia trip and long to restore the Soviet Union. They have been mercilessly critical of the present powers that be, albeit without being able to offer any alternative responses to Russia's everyday problems. The party is unable to mobilize its widespread support as political capital, a situation which is not helped by its ageing membership and the geriatric party leader **Gennadi Zyuganov.**

The third party in The Duma is the right-wing populist *Liberal Democratic Party* led by the vlamboyant **Vladimir Zhirinovsky** has not challenged the ruling elite. Quite the opposite: the vitriolic demagogy of the party obscures the fact that for the most part the Liberal Democrats have supported the policies of the President's administration in The Duma. However, their rabid nationalist populism has always guaranteed them success at the polls.

The reformist, West-oriented right-wing parties have not fared so well. Both the *Union of Right Forces* and *Yabloko* have failed to gain seats in the Duma as negotiations on an electoral alliance between them having failed.

The *Union of Right Forces* has been propounding a neo-liberal economic policy, supporting closer ties to the West and calling for reforms. Its supporters are for the most part young, entrepreneurial new-money types.

Yabloko is a Moscow-centred party of the intelligentsia and human-rights activists. It has a social-liberal platform. Yabloko has been a member of the Liberal International.

The fourth party in The Duma is a new party called J*ust Russia (Spradetlivaja Russia).* It was established in 2006 just before The Duma elections. It is the most serious effort by the president administration to advance the Russian "managed" or "sovereign" democracy towards bi-party system where both centre-right and centre-left are credibly represented.

The new party comprises three elements: the *Party of Life* led by **Sergei Mironov**, Speaker of the upper house, who is also the leader of the new party; the *Rodina l*eft-wing populist party; and the *Party of Pensioners*. The last one increased its popularity, in particular, after the government's social-benefits reforms in 2005 which caused major protests by pensioners throughout the country.

Would the *Just Russia* become a real and genuine centre-left force in Russian politics is to be seen. What is clear, the new party is created from the top and it takes time to consolidate its position as a strong and credible political force. The Party became an Observer Party in the Socialist International in 2008.

The matrix of Russian politics

The traditional European division into left-wing and right-wing parties seems ill suited to Russia's present political field. The extreme left — the Communists — are the conservatives. The ultra-liberals on the extreme right are the most radical reformists. They are also the most willing to engage in international interaction.

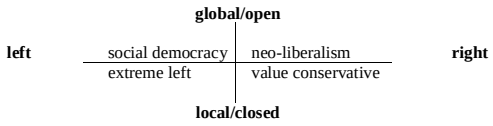
The quintessentially conservative values of 'home, faith, fatherland' are bread and butter for the extreme left, but they are also the rallying cry of the fundamentalist nationalist pan-Slavists and those portions of the right wing that appeal to traditional Russian nationalism. The community of the Russian people and Russia's superpower history is what they are nostalgic for. Or are they?

How can one analyse the political actors in Russia? Is it still all about a struggle between the market economy and the planned economy, or is it a question of political democracy versus single-party power? It is not that simple. There is no gateway to the past; a return to the old Soviet system is out of the question. Society is inevitably more pluralist and more open.

Today, Russia is steering a course between open international cooperation and isolationist traditional nationalism. At the same time, choices must be made between social responsibility and callous selfishness. The same political trends exist elsewhere in Europe too, but in Russia, the lines of division in the party political field are clearer and the confrontations sharper, due to the immature state of democracy in the country.

Globalization is shaping the domain of politics everywhere. The traditional left-right division is no longer adequate for describing political actors and parties. There is a new dimension at play, that of global versus local, or open versus closed.

Instead of the traditional linear view, we must now view politics as a matrix. At its simplest, this works out as a four-field matrix. Its horizontal axis is the familiar right-left division, the tension between collective responsibility and individual freedom. The vertical axis is the tension between openness and internationalization on one hand and closed parochialism on the other.



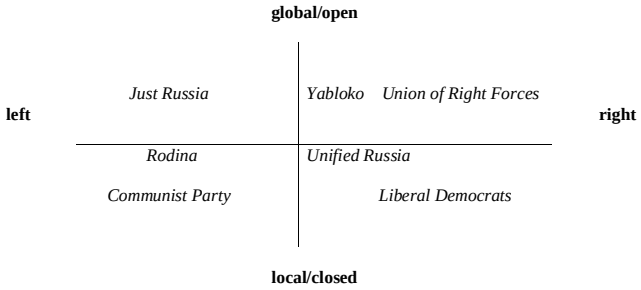
This four-field matrix is the only tool that can explain the curious unholy alliances that are political realities in Europe today, for instance in voting on the EU Constitution. The division between global and local permeates the entire political arena just as thoroughly as the traditional division between left and right. Attitudes to supranational integration constitute only one of its manifestations. The same division is apparent in the opposition of tolerance and rabid xenophobia. An open society is pluralist and democratic; a closed society is narrow-minded and authoritarian.

What about Russia, then? After the centrally led planned economy unravelled, its diametrical opposite emerged, the 'Wild East'. In the days of the Soviet Union, the Communists warned against the treachery of capitalism — and this devious system is exactly what was subsequently born in Russia, thanks in part to the Communists themselves.

Neo-liberal right-wing market-driven policies established themselves with a vengeance as soon as the Soviet Union had collapsed. In Russia, those who have sought to make society more open and more modern have also always sought to dismantle social controls and safety nets. This is most conspicuous in the platform of the *Union of Right Forces,* but the leading party has in practice pursued a similar policy.

As could be expected, there has been a reaction to this. The Communists on the left and the rabid populist Vladimir Zhirinovsky on the right have widespread popular support for their policies of Russian isolationism, for their hankering back to the Empire that was, to Slavic cultural unity and the Orthodox faith. External influences and foreigners are anathema to both the extreme right and the extreme left. There is a breeding ground for pan-Russian nationalism. Conservative, authoritarian nationalism has a wide audience in Russia. Even the sacramental internationalization of the Communists, 'proletarian internationalism', was by its nature repressive, as open international interaction was forbidden under the Soviet regime.

Agents of tolerance and social responsibility in internationalization are struggling in Russia. One of the main reasons for this is that European-style social democracy is still conspicuous by its absence in the left wing of the political field. Perhaps **Mikhail Gorbachev** has been a modern-day Menshevik, but he is a voice in the wilderness.



There is a stiff challenge. How to create a strong and credible centre-left political power in Russia and to link that force to the international Social Democratic movement? European social democracy today emphasizes not only equality and social responsibility but also tolerance and international cooperation. Solidarity knows no national borders. Democracy and pluralism go hand in hand.

It is surely desirable both in Russia and abroad that an credible centre-left political force emerges in the country. Now there is a new political party, *Just Russia*, to fill this gap. Will this succeed is to be seen.

Kimmo Kiljunen

Doctor,
Member of Parliament

Finland

OP-Pohjola Group - appraising expansion opportunities in the Baltic countries

By Reijo Karhinen

OP-Pohjola Group is the leading financial services group in Finland with over 12,500 employees, total assets of EUR 71.5 billion and over 4,100,000 customers at 30 June 2008. The Group has a strong market position in Finland in all its main business areas − 33% of deposits, 32% of loans, 21% of mutual fund savings, 20% of life and pension insurance savings, and 27% of non-life insurance. A key strategic objective is to continue strengthening the Group's market position in Finland by utilising the cross-selling opportunities offered by the vast customer base and unrivalled service offering.

In the Baltic countries, OP-Pohjola Group currently has some 200,000 non-life insurance customers through the Pohjola-owned Seesam companies. Seesam is the 3rd largest non-life insurance company in Estonia with a 15% market share; Latvia's share is 5% and Lithuania's 3 %. The Group's banking operations in the Baltic markets are minor, consisting of the operations obtained through the purchase of K-Finance in January 2008 and a representative office in Tallinn.

Baltic insurance market offers tremendous growth potential

The non-life insurance market in the Baltic States is still relatively underdeveloped. Insurance penetration rates are quite low (premiums 1.3-2.0% of GDP in 2007) compared to the European average (3.0%), insurance for private clients centres largely around motor vehicle policies, and insurance for businesses is only beginning to expand beyond compulsory insurance. General awareness of the need for insurance services and professional risk management practices is still at a modest level, and the risk evaluation and pricing methods of many insurance companies are also still inadequate.

That being said, however, it is equally evident that the Baltic insurance market offers abundant growth opportunities and we can expect to see very active product development, rapidly increasing penetration rates, and also substantial structural changes and industry consolidation in the relatively fragmented market during the coming decades. OP-Pohjola Group intends to take active part in these developments and we foresee that a substantial part of the overall growth of our non-life insurance business will emanate from the Baltic region in coming years.

Challenging short-term prospects for the Baltic economies and banking sector

The Baltic economies, particularly Estonia and Latvia, are currently experiencing a severe downturn and it is possible that it will take even 3-4 years or longer for these economies to return to growth rates anywhere near the impressive levels witnessed in 2005-07. Although forecasts vary greatly between experts and depending on the specific assumptions employed, one can safely speak of an economic crisis of considerable magnitude, which will have profound long-term effects on the economies in question. It should also be understood that although the economic difficulties of the region have been accelerated and magnified by the ongoing global financial crisis, the main causes of these difficulties lie elsewhere. Primarily, what the Baltic economies are now experiencing is an abrupt correction of fundamental internal and external imbalances that have accumulated over a number of years.

The substantial fall in property prices and other asset values, and the difficulties facing the construction sector will hit the Baltic banking sector hard. We can expect to see a marked increase in delinquency rates and credit losses, and significantly lower profitability over the next 2-4 years. Banks will also have to review their risk management practices and have already begun to tighten lending, which will slow down economic growth even further. The credit crunch will be lessened by the fact that all major players in the Baltic banking sector are foreign, mostly Nordic banks, which are quite well-capitalised and look set to ride out the financial crisis relatively unscathed. It remains to be seen, however, how the smaller local players will be able to navigate through the treacherous waters of a simultaneous global financial and domestic macroeconomic crisis.

Long-term development of banking sector linked to developments in the Nordic region

The high levels of concentration and foreign ownership in the Baltic banking sector have been viewed at different times as both beneficial and detrimental factors from the point of view of the long-term development of financial services in the region. In the early days following independence, the entry of foreign banks was both a necessary and inevitable development, as it offered the only realistic solution to setting up an efficient, modern banking system quickly and safely. And overall, looking back across the past decade and a half, the development of the banking sector in Estonia, Latvia and Lithuania can and must be viewed as a great success story.

Looking ahead, the story becomes more complicated. Owing to the dominating presence of five major Nordic banks in the region, the future development of the banking sector in the Baltic countries is inextricably linked to wider developments in Nordic banking. Consolidation in the Nordic banking sector could lead to even higher rates of market concentration in the Baltic states, or it could also pave the way for new entrants and thereby an intensification of competition. In any case, the Baltic banking market will continue to experience large changes, but they will mostly follow as a by-product of external developments.

Expansion opportunities in the Baltic region under review

In June 2007, the policy guidelines concerning OP-Pohjola Group's international business operations were revised, allowing for the expansion of operations in neighbouring regions – more specifically, the Baltic countries and Russia. The decision reflects above all the rapid increase in cross-border economic activities and interdependence between Finland, the Baltic countries and Russia, and the consequent rise in customer needs and expectations regarding services across this region.

OP-Pohjola Group's approach to international expansion and service development can be summarised by saying that we want to evolve alongside our customers, supporting their development in ways that are in line with our own long-term objectives. As the demand among our current Finnish private and corporate customers for banking and insurance services in the Baltics and Russia is clearly growing, we have to respond to this challenge with a credible, financially sound and sustainable concept that satisfies those needs as much as possible. We are currently in the process of reviewing different options for expanding our presence in these markets and are therefore closely monitoring developments particularly in the Baltic economies and financial services sector.

The Baltic countries offer an attractive operating environment for a financial services group in many respects – dynamic, innovative, optimistic, liberal, and open to new ideas. We strongly believe that Estonia, Latvia and Lithuania will emerge out of the current economic malaise energised and rejuvenated and have an exciting, prosperous future ahead of them, and we want to play our own part in their continuing success story.

Reijo Karhinen

Executive Chairman

OP-Pohjola Group

Finland

Challenges facing the higher education in the Baltic countries

By Anders Paalzow

Economic growth, the knowledge society and the role of human capital and higher education are issues high up on the EU agenda as well as on the agendas of the individual member states – the Baltic countries, Estonia, Latvia and Lithuania being no exceptions. On the contrary, their demographic situation further accentuates the need for a higher educational system that provides good graduates whose full potential is unleashed. In the coming years the cohorts of secondary school graduates will be smaller and smaller. In Latvia for example, roughly 42,000 people were born in 1988, ten years later, in 1998, a mere 18,000 people were born.

In this context, the debate on the role of the educational system has in the Baltic countries to a large extent focussed on the secondary schools' ability/inability to provide graduates who are well-prepared for university studies. Nevertheless, in the following I will disregard this issue. The main reason for this is that despite what various rankings tell, I do not believe that the problem lies here. Based on my experience, working with Swedish elite students as well as elite students from the three Baltic countries, the Baltic students without any doubt outperform the Swedish ones. Comparing the students we have at the Stockholm School of Economics in Riga (SSE Riga) with their counterparts at the Stockholm School of Economics (in Stockholm), I would say that we can work at least 1.5 times harder with the Baltic students in comparison with their Swedish counterparts. Although both schools attract top students with high intellectual capacity, the Baltic ones are however better prepared for higher education (in particular they have stronger mathematical and analytical skills) and they are much more motivated than their Swedish ones.

Since there are many more highly talented students in the Baltic countries than the 120 admitted to SSE Riga annually, the question to be considered is how does the higher education system take care of these elite students – students that, if properly nurtured, could play an important role in transforming the Baltic economies into knowledge-based economies. My answer to this question would be "in general not at all". In other words many of the current problems emanates from the higher education system as such and its unwillingness to address issues related to the challenges that come with the knowledge society. In the following I will therefore discuss some of the issues that, to my mind, need to be addressed in order to unleash the potential of the Baltic students and hence of the Baltic economies:

- Full time studies. It is almost 'common practice' to work full time or close to full time while studying full time. This could hardly be optimal and, needless to say, there cannot be full time studies if students mange to work to that extent at the same time. In addition the wide spread acceptance of cheating contributes to making this possible.
- Quantity versus quality. The current funding of higher education puts a premium on quantity rather than quality. Since tuition fees are an important source of income, it is in many cases better for a higher education institution to admit as many students as possible rather than providing a quality education. This leads to a large spread in terms of intellectual ability and motivation within a given class of students, which in turn hampers the learning process. Overall the current system results in maximization of the revenues of the higher education institutions rather than of the social returns to education.
- Central planning. The current system suffers from central planning. There is a belief that the government by allocation tuition free places, so called "budget places", could influence the demand, e.g. have more students studying engineering. In reality this means that many students in let's say an engineering class are not there because they want to study engineering, but because they could study there free of charge whereas they would have preferred to study law for example. In addition to a misallocation of human capital, the presence of non-motivated students does not contribute positively to the overall learning outcome.
- 'Diploma sickness'. The three Baltic countries still suffer from the Soviet heritage of 'diploma sickness', i.e. what is important is the diploma and the degree as such – not what is behind the diploma in terms of knowledge and skills. This has opened up for many 'academic' programmes that are of poor (or even worse) quality, many of them being offered by private institutions of higher education. This results in a situation where students waste their time and money on programmes of little, if any, value.
- Life-long learning. The current system does not recognize the need for life-long learning and the need to open up to new groups of students. Further contributing to the demand for life-long learning is the fact that a large fraction of the current labour force have a Soviet education that in many cases is obsolete in today's environment.

Failure to address these issues might not only make the route to the knowledge society more difficult, it might also discourage students to study at the higher education institutions in the region. Instead the most talented might leave the region and once they have done that it will be very difficult to lure them back.

A policy addressing these issues has to start with an overall improvement of the higher education programmes increasing the workload of students etc., making the Baltic countries' higher education institutions attractive from a learning point of view. This should be combined with the establishment of elite programmes and/or honours classes where the most talented students can release their full potential. In the light of this, it has to be emphasized that the governments have to recognize that quality costs and should thus be willing to support quality rather than quantity.

The scope of the higher education policy has to be broadened. It has to be part of an overall policy aiming at life-long learning. In this context it is important to keep in mind that a university education should provide the individual with the solid skills that are needed to develop his/her human capital and to adopt in an ever-changing environment, rather than being dictated by the short term needs of the labour market.

The scholarship system should be merit-based and not "subject-based", i.e. good students should get scholarships tied to the individual (giving him/her the freedom of choice) and not to the field of study. Issues such as lack of for example engineers or medical doctors should not be addressed by forcing students to study these fields. They should be addressed by taking a look at the lifetime earnings of graduates in these fields and the overall prestige of these professions. Central planning has never been a good idea, and this applies to education as well.

The current and coming generations of students are too precious assets to be wasted by a higher education system that does not allow them to realise their full potential.

Anders Paalzow

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The EU strategy for the Baltic Sea Region and its links to the Northern Dimension

By Hanna Lehtinen

The idea of the Baltic Sea Region Strategy (BSRS) first came from the European Parliament and was fostered i.a. by the MEP Alexander Stubb, the current Minister for Foreign Affairs of Finland. Following the adoption of the EP report the Swedish Government took on board the initiative and declared the Baltic Sea Region Strategy to be one of the top priorities of the incoming Swedish EU Presidency. In December 2007 the European Council invited the Commission to present an EU Strategy for the Baltic Sea Region at the latest by June 2009.

The preparatory work in the Commission is led by the DG Regional Policy. During the spring, several member states from the region, including Finland, have presented their views and ideas to be included in the future Strategy in the form of various non-papers. On the basis of these contributions, the Commission has outlined four main priorities for the BSRS. These priorities consist of making the region 1) environmentally sustainable, 2) prosperous, 3) accessible and attractive, and 4) safe and secure. The contents of these four pillars will be shaped over the next year, during which the Commission is planning to organise various stakeholder events and thematic round tables around them.

The awareness and priority given to the Baltic Sea Region is also reflected in the Finnish Government's programme of 19 April 2007, which underlines the need to enhance EU-related cooperation in the Baltic Sea Region, to increase the political weight and visibility of our region in the EU, and to streamline regional cooperation networks. Clean Baltic Sea, as defined in the HELCOM Baltic Sea Action Plan, encompassing aspects relating to maritime security is a the key priority of the Finnish Government along with the creation and maintenance of a Dynamic economic region.

The BSRS should be mainly an EU internal strategy drawing on EU acquis and the resources and instruments of the Cohesion Policy. However, to reach concrete results, the EU needs to cooperate in many issues with other countries of the region sharing common interests. The December 2007 European Council Conclusions singles out the Northern Dimension framework for providing the basis for the external aspects of cooperation on the Baltic Sea Region.

How can the Northern Dimension framework be used in the Baltic Sea Strategy context?

The Northern Dimension (ND) has been part of the EU's external and cross-border policies since 1999. It covers North-West Russia, the Baltic Sea and the arctic and subarctic areas, including the Barents region. During the Finnish EU Presidency in 2006, the Northern Dimension was reformed and it is now described as being a common policy of four equal partners, the EU, Iceland, Norway and the Russian Federation. The jointly negotiated Northern Dimension Policy Framework Document and the Political Declaration which define the ND as a regional expression of the so called EU-Russia "Four Common Spaces" guide the Northern Dimension work[1].

On a practical level, one of the main innovations of the Northern Dimension has been the concept of ND partnerships. The two existing ND partnerships, the Environmental Partnership (NDEP) and the Partnership in Public Health and Social Well-being (NDPHS), have produced tangible and concrete results, including the ND flagship project St Petersburg Southwest Wastewater Treatment Plant. In addition to these, a new partnership on transport and logistics is under preparation with an aim of being approved by the next ND Ministerial Meeting in autumn 2008. Culture is another potential area of future cooperation.

How could the ND framework then be taken advantage of when designing the EU Strategy for the Baltic Sea Region?

Firstly, the various ND structures, particularly the ND Steering Group where the EU is represented by the Presidency and the Commission, can serve as a useful forum for exchange of information among the ND Partners EU, Russia, Norway and Iceland.

Secondly, building on their various achievements, the eventual potential of the ND partnerships for bringing together the internal and external aspects of the cooperation in the Baltic Sea Region should be further explored.

Thirdly, within the ND framework there are several different cooperation organisations in the Baltic Sea Region, and due attention should be paid on how to make better use of these organisations and how to avoid any overlap of work between them.

The four northern regional councils, the Council of the Baltic Sea States (CBSS), the Barents Euro-Arctic Council (BEAC), the Nordic Council of Ministers (NCM) and the Arctic Council (AC), are so called participants to the ND. The CBSS continues to be the forum for political discussions on the Baltic Sea Region, also on the highest level. The decisions of the Riga Baltic Sea Summit in June 2008 on the reform of the CBSS pave the way for the follow-up work aiming at narrowing down and defining the concrete cooperation areas where the CBSS work will offer real added value to the Baltic Sea co-operation. The NCM can also have an important role in supporting the implementation of the BSRS. As to the other northern regional councils, also their work and roles need to be assessed where relevant.

In addition to these "ND participants", there are number of other relevant regional organisations which can play a useful role. For example in the environmental sector, the key structure for the Baltic Sea is the HELCOM, and its Baltic Sea Action Plan adopted by the Ministerial in Warsaw 2007 constitutes a useful framework document for the coming years.

Finally, as to the financing of the EU Strategy for the Baltic Sea Region, the Northern Dimension model consisting of co-financing of several financial sources – the EU budget, national budgets, private sector, IFIs, such as IBRD, EIB, EBRD, NIB – should serve as a model. Setting out clear strategic priorities for the region as such should contribute to better use of the existing financing opportunities. The existing Baltic Sea Regional Programme and the relevant CBC programmes including the ENP CBC programmes at large already provide the countries of the region with a useful tool for regional co-operation and the Strategy should further enhance their implementation.

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[1] http://ec.europa.eu/external_relations/north_dim/

Prospects for EU-Russia relations

By Fraser Cameron and Aaron Matta

With the start of negotiations for a new agreement between the European Union and Russia in July the stage is set for a new chapter in this controversial relationship. But the conflict between Russia and Georgia in mid-August has given many EU member states pause for concern. At an emergency EU foreign ministers meeting on 13 August, which endorsed a French Presidency peace plan, some argued that the EU-Russia talks should be suspended until Russia removed all its troops from Georgia. Others argued that the blame was not entirely on the Russian side and the talks should continue. These divisions between member states have plagued the EU in trying to agree a common approach towards Russia.

The last 20 years have brought momentous changes in Russia which have had an impact on the EU-Russia relationship. When the old Soviet communist system collapsed in 1991, Russia emerged as a reduced nation state with its own system of market economy and democracy. Russia is still struggling to come to terms with the loss of its superpower status based on empire, ideology and missiles and trying to create a new one based on its energy muscle. During this period, the EU has also undergone major changes, some of which such as the 2004 enlargement (and the NATO enlargement) have had a significant effect on EU-Russia relations.

Despite the political souring of relations, economic relations are moving rapidly ahead. Most EU countries have significantly increased their trade with Russia over the past few years. Exports have tripled in some cases, while imports from Russia have doubled; a trend which is due mainly to increased costs for Russian energy supplies. Two way investment has also increased substantially although there are some fears about the Kremlin's interference in business disputes.

The EU-Russia relationship is governed by the 1997 Partnership and Cooperation Agreement (PCA) which reached the end of its initial ten year period in November 2007, but which was automatically prolonged as neither side wished to withdraw. The PCA spawned a considerably network of political and official ties between the EU and Russia which should not be underestimated. While the PCA has worked reasonably well, within its limited parameters, there was a feeling on both sides that ten years on it should be replaced with a broader agreement reflecting the changed political environment. At the 2003 St Petersburg summit the EU and Russia decided to work towards establishing four "Common Spaces" (economic; freedom, security and justice; external security; and research and education) to provide a more detailed framework for mutual cooperation. The Common Spaces were an important move ahead in the relations but since they are not legally banding as the PCA they are incapable of holding the relationship together.

Despite the EU's previous failed attempts to include Russia into a policy addressed to a group of countries, such as the European Neighbourhood Policy (ENP), Russia has on several occasions expressed the desire to be treated as an equal. Therefore, if negotiated, a new PCA would have to be a sui generis type of agreement.

What are the options for the new treaty? The Commission view is that the more issues on the table the easier it will be to reach a comprehensive deal. What is clear, and major challenge, is that the EU has never attempted to negotiate such a comprehensive package with a third country. Some experts have suggested an Association Agreement as the basis for closer integration with the EU, other a reciprocal treatment such as with the US. But this will all mainly depend on the legal approximation approach taken by the sides in the next agreement – which is not favourable to Russia in its present form in the PCA. Therefore, an approach is needed in which Russia will feel respected and not pressured by the EU. Thus hopefully, Russia will eventually make the necessary logical moves towards approximation – possibly inspired by the need to create a Free Trade Area (FTA) with its proximate biggest economic partner or by the inevitability of having standardised legislation in the WTO framework in order to incorporate its economy into the rest of the world.

No one doubts that any new agreement will involve tough and onerous negotiations. The economic elements to be included in the new agreement, especially the prospect of a free trade area, will directly depend on Russia's accession to the WTO. Given EU dependence on Russian energy, this chapter will be a particularly contested area of the negotiations. It is unlikely that the Russian side will agree on including in the new agreement any reference to Russia's ratification of the Energy Charter Treaty (ETC) and its Transit Protocol, and even if it does, it is doubtful whether Russia will comply with it. However, mentioning of the 'energy dialogue' is important since it is one of the main areas of economic relations and should consequently, at least at a political level, be regulated.

Conditionality will be another difficult area. The EU intends that, the new agreement should, like the PCA, include the commitments to the UN and OSCE and the so-called 'conditionality clause' as an essential element of the agreement, whereby the PCA could be unilaterally suspended if there is any human rights violations. Additionally, the principles of the Council of Europe and the European Court of Human Rights (ECHR) as stressed in the Common Strategy should be included in the PCA. These elements would demonstrate that Russia and the EU have a common international legal basis for the protection of human rights.

A comprehensive new agreement would, besides linking all the aspects of cooperation, reinvigorate economic integration – envisaging practical steps to establish a FTA –, improve cooperation on energy, and add legal weight to the four common spaces. Any new agreement should also have as a very minimum the same standards referring to European values as the old PCA.

The EU has significant but limited leverage on Russia. Its powerful internal market and its consumption of Russian energy resources do give it important bargaining chips. But although its leverage is limited, the EU cannot give up on values as these are in the interests of both sides. An EU-Russia relationship that did not have values at its core would be a relationship not worth having.

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Creative dissent will enhance Baltic business

By Kalle Euro

At the Turku School of Economics' sixth European Day of the Entrepreneur, held in June of 2008, Åbo Akademi University and Royal Institute of Technology (Stockholm) professor Alf Rehn delivered a presentation that challenged positive associations with the current buzzword "creative". Rehn suggested that people coddle creativity like a pet bunny: it is generally regarded as something inherently good and sweet, and there is an emotional unanimity concerning the need to support creativity. However, this is precisely what suffocates it: creativity should incite, challenge, question and change things.

Rehn hit the mark in his critique: creating something new is all about changing things. The creation of the new requires unlearning, which is no easy thing to do. Resistance to change is the opposite of making new things, otherwise known as creativity. When creativity is reduced to little more than a common slogan, creativity itself is in danger of being forgotten for fear of causing irritation.

Creativity requires the identification and recognition of problems

Creativity is a prerequisite for not only art and culture, but also innovations, inventions and product development. Reshaping things demands the ability to come with ideas as to how things as they are right now can be improved as well as the identification and recognition of problems therein. Merely parroting common slogans does nothing to support this kind of thinking. On the contrary, it removes critical thinking from the equation entirely.

When creativity is discussed throughout the European Union and new meanings are assigned to it, these meanings should absolutely be questioned. What does creativity mean anyway? How does one act creatively in the workplace and what kinds of incentives or regulations are required to establish a creative operating approach? How does creativity really support European business or government? Is it because the Union and its member states initiate creativity programmes and open calls for proposals, in which funds are granted to events and citizen activities? I suspect that the benefit to business would be rather lacking in a large percentage of these calls for proposals. What about how civil society and the third sector can advantage creativity or promote the development of creative operating and thinking approaches in Europe?

There are many decisive issues to address in establishing a creative Europe.

Creativity needs conflicts and cross-thinking

Calling things into question forces one to seek new problem-solving models. Things that are considered good can also be improved upon, which is why questioning, rethinking, is beneficial, even if there are no actual problems. When creativity and creative economics are considered the goal, we must be able to dissect that goal in the manner described above: what exactly do we mean by creative economics and creativity as an operating approach?

On one hand, business development cannot be the only objective of creative thinking. The human mind is not only set loose during business hours. On the other hand, ideas generated exclusively at the workplace results in very one-sided, work-related thinking. Human thought evolves comprehensively. Ideas and experiences originating from an array of sources reinforce a person's ability to question and develop things related to their work. It is also for this reason that contacts formed between various fields have been shown to have a positive influence on development.

The merging of different fields forces one to approach things in a different way. Engineers and humanists usually look at things differently. When these two groups approach something together—with an open mind and no prejudice toward one another—a third perspective is formed. This perspective might prove ideal in terms of development of the matter as a whole. Likewise, there is also room for creative thinking between various fields. What do shipbuilding and architecture have in common and what are the differences? Although these fields certainly learn things from one another, could the new thinking and operating approaches they create be used in other fields. The co-operation of the ICT sector with other fields is an excellent example of how intersectoral co-operation generates creativity. The development of ICT applications for different fields has made the IT sector and other fields more efficient and user-friendly.

Is the Baltic region capable of critical thinking?

The Baltic region is undergoing a period of rapid development. The Baltic countries, Poland and Russia are enjoying fast growth. In the Nordic countries, which have remained stable for a long time, there is pressure to enhance efficiency, enterprise and the ability to advantage their strong expertise base in order to achieve success on the international playing field. Whereas the eastern coastal areas of the Baltic are willing and able to change, the western areas are more resistant to it. The need for change, however, is also recognised in the West.

The Nordic countries have a political tradition of being the pioneer, at least in their own view. The welfare state, the free schools that ensure a high level of education and social justice are trademarks, by means of which the Nordic countries have achieved excellent results in various international comparisons.

Nordic countries are widely known for their strong product development and technical leadership. Even though they are not generally considered very radical or fast-moving, even the largest Nordic companies are still seen as being flexible and competitive. The Nordic culture is extremely rational, which also informs its ability for critical thinking. The Baltic region's pace and change also requires a critical view of the old to make room for the new.

The Baltic region thus has the mutual ability for critical thought, a key factor in creative thinking.

The Baltic's role as an engine for Europe

The deepening of co-operation in the European Union has slowed along with its expansion. The European economy seems relatively stronger than before compared to other regions, which is largely due to problems in the United States. Despite this, Europe's growth figures are rather low and the goals specified in the Treaty of Lisbon will not be achieved. Europe still suffers from corporate domination, poor economic and social adaptability and a relatively low degree of innovativeness. In other words, high costs cannot be remedied with ideas and work efficiency.

In establishing co-operation between the countries and areas of the Baltic region it is vital that solutions for improving work productivity and innovativeness be sought, with an extremely critical eye and an open mind. This requires not only finding and sharing the best practices, but also unlearning many old operating approaches that compromise competitiveness. As regions go, the Baltic environs is compact and its populations are very highly educated. Regional development has remained stable for 15 years and

the Baltic Rim boasts some of the world's most prosperous, competitive and fastest-growing countries.

An ambitious basis for setting goals for Baltic co-operation should be the establishment of creative and adaptable economies, government and regional co-operation. If these characteristics were to be realised, it would not only make Baltic countries very competitive, it would also create common, effective operating models, which can be reproduced for use elsewhere in Europe.

If Baltic governments make rational, efficient and creative decisions, the Baltic region as a whole, with its over 80 million inhabitants, will become a new engine for the European Union's economy. The current combination of growth and wealth makes the region one of the Union's most interesting areas, and common Baltic policies make it possible for the region to further enhance its importance.

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Disparities and potentials in the BSR

By Ole Damsgaard

The Baltic Sea Region has experienced a tremendous surge of social and economic development since the beginning of the 1990s. This development has on the one hand been followed by an ongoing integration process between the countries in the Baltic Sea Region while on the other hand overseeing a polarization at the intra-national level between metropolitan regions and the more peripheral and less densely populated parts of these countries.

Another striking characteristic of the BSR-region is that the region continues to suffer from considerable East-West disparities in relation to e.g. wealth and demographic development. With this in mind and now that there are signs of a global economic slowdown on the horizon which may impact both the speed and the character of the future integration process it may be worthwhile to have a closer look at some of the most important potentials of and challenges facing the BSR-region.

Despite the fact that economic growth rates have for many years been consistently strong in the eastern part of the region considerable differences remain between East and West in terms of GDP per capita at the national level, see map 1. In addition, differences at the intra-national level between the capital regions and other regions, especially the more peripheral ones are increasing. The lowest (regional) values can be found in Belarus and Kaliningrad (below 25% of the EU27 level) while very high regional values can be found in the Nordic capital regions, in Hamburg and in Warsaw (more than 150% above the EU27 level).

Another important issue concerns demographic development where the Baltic Sea Region, in total, has experienced a slight overall population decline. The decline is driven by substantial natural losses (higher death rate than birth rate) which for most regions outweigh migration gains – especially in the Eastern part of the BSR. Generally speaking we can see that, over the last ten years, the East- West divide has undoubtedly widened in response to uneven population growth.

Another reality for BSR countries is that steady overall urban growth goes hand in hand with rural population decline. More particularly we can observe a spatial polarisation of the population towards the capitals and larger agglomerations in most parts of the BSR, which is followed by accelerating suburbanisation in and around several BSR metropolitan regions.

As a consequence of this, most of the other cities and regions in the BSR will increasingly suffer from a shrinking workforce as well as a 'greying' population. Such a development is not however unique in Europe. In the BSR however the shrinking labour force and the question of how far this might be compensated by in-migration from other countries and/or by productivity increases in the private and public sectors remains a burning issue.

The above-mentioned polarization tendencies between the metropolitan regions and other regions can to some extent however be explained by the fact that metropolitan regions now play an increasingly critical role in the global network economy.

In this regard Nordregio has recently carried out a study of 23 selected metropolitan regions in the Baltic Sea area, including Kaliningrad, St. Petersburg and Minsk[1], see map 2. Some of the important developments highlighted in this study will be discussed in what follows.

In respect of the metropolitan regions a significant difference can immediately be observed between the Eastern and Western parts of the BSR. Obviously the transformation of the Eastern half of the region and ultimately its integration into the global and European market will be a long-term process, which continues to be hampered by the various pre-conditions for development set in each half of the BSR. One such example concerns international financial services which have not thus far established a sufficiently strong network to enable the interconnection of the Eastern metropolitan regions with the rest Europe or with the international economy more generally. A functioning infrastructure enabling the inflow of international financial services is a precondition for significant investment by foreign companies. An exception to the general observation here is Warsaw, which has caught up in many respects with its Western BSR counterparts.

Given the potential market size of the Eastern part of the BSR and the market growth experienced there, such institutional barriers to growth and development need to be minimised. This includes additional services for international companies in order to ease their penetration into the BSR in general and into the Eastern part of the region in particular. Here the metropolitan regions play a crucial role, because only they have the 'critical mass' and the capacities to build up those services in order to reduce the institutional barriers faced. This will however, only deepen the differences between the metropolitan and non-metropolitan regions in the Eastern part of the Baltic Sea Region.

The East-West divide is somewhat lower when talking about metropolitan regions as centres for innovation, research and development. Here we discovered numerous competences, the existence of huge potential and comparably high levels of 'critical mass' in relation to the existence of talented and creative employees and strong research profiles across the BSR. This reality could then open the way for specific pan-Baltic co-operation initiatives.

On the issue of transport, which will enable the BSR's metropolitan regions to function as 'gateways' to the global economy we continue to see tremendous contrasts, specifically with regard to air transport. Flight connections between East-West in the Baltic Sea Region remain at a much lower level as compared to the available connections between e.g. the Nordic metropolitan regions.

Current patterns concerning sea transport are however more balanced while a number of strategic missing links concerning road and rail connections still exist in the Eastern part of the Baltic Sea Region.

In conclusion, the metropolitan regions continue to play an important role in the integration of the BSR into the global network economy. Nevertheless, a lack of specialised services in the Eastern part of the region, particularly in respect of international financial services, remain. On the other hand however huge potential exists in respect of R&D and innovation, - a potential which can only be fully exploited through further cooperation and integration across the Baltic Sea Region.

The ongoing polarization between metropolitan regions and other regions dominated by small and medium-sized towns undoubtedly remains an obstacle to future development particularly when viewed in relation to the economic and demographic trends alluded to above. The risk here is that the metropolitan regions of the BSR will, in the long run, be the only sufficiently integrated BSR-regions in the global economy, while the rest of the Eastern and considerable parts of the Western BSR will be left irretrievably behind.

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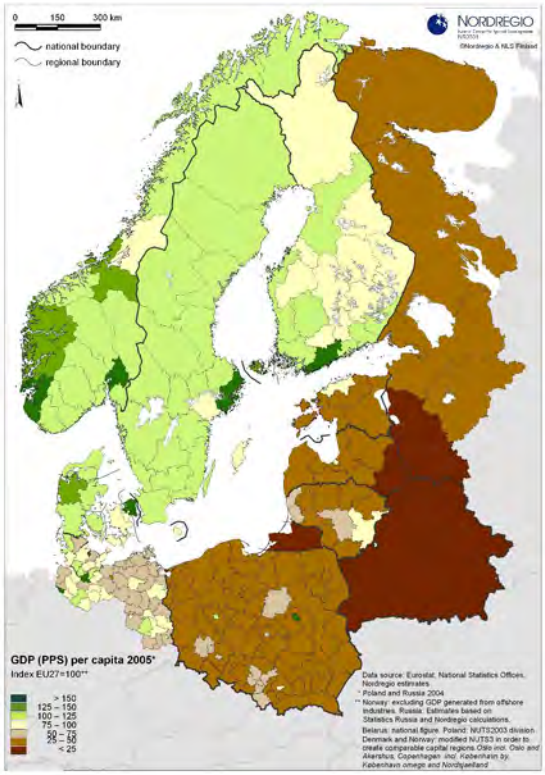
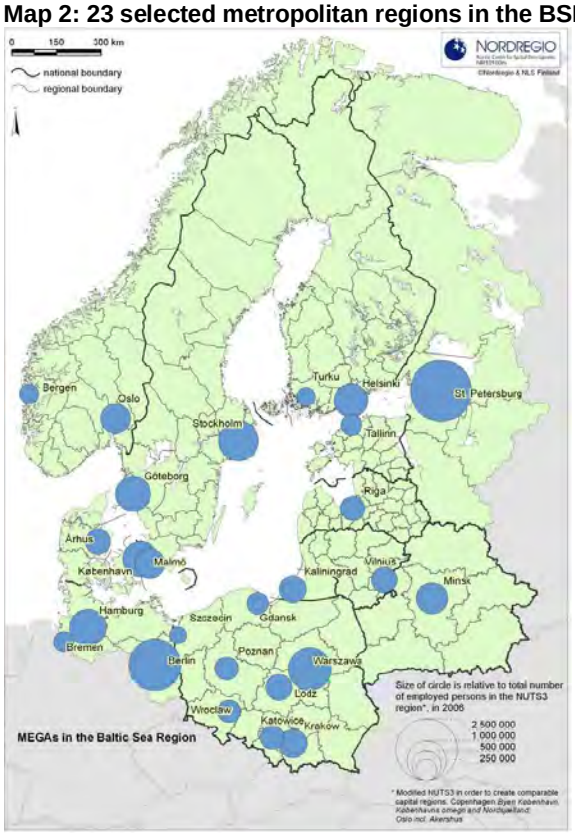
[1] This study will be published by Nordregio in October 2008

Map 1: GDP per capita 2005. Index EU27 = 100 (yellow)



Map 2: 23 selected metropolitan regions in the BSR



Cluster approach as a tool of industrial policy in the Baltic Sea Region

By Jarkko Heinonen

The benefits of clusters

Clusters are important for the competitiveness of a region. The network structure of a cluster opens up an excellent operation environment for small and medium size enterprises considering both growth and internalisation possibilities. A well functioning cluster structure with a subcontractor network also plays an important role for developing cost-efficient production of large industrial companies.

Cluster structures and well-functioning co-operation related thereto can be used to achieve benefits of large-scale production without one company being responsible for all production or organising it. Even small companies in the co-operation network could focus on developing their special expertise and production. Being able to focus on the core competence enhances the creation of both product and production innovations, which in turn has a direct positive effect on the cost-efficiency and competitiveness of the whole cluster.

The benefits from Baltic Sea Region wide clusters and cluster policy

The Baltic Sea Region forms a potential common market area in many ways, which is also visible in customer relationships. We may claim that Baltic clusters offer a more natural base for co-operation than more distant companies. That provides a good basis for developing a common cluster policy.

The countries of the Baltic Sea Region are mainly rather small national economies, which leads to the fact that the domestic markets for production factors are very limited. This means that, for example, the subcontractor network maintained by the leading company must extend to a geographically large area around the Baltic Sea. This makes it pertinent to take actions covering the entire Baltic Sea Region to ensure the international competitiveness of the clusters operating in the area.

Furthermore, the relatively small domestic markets in the Baltic Sea Region often lead to a situation, where new innovations developed in the area and enterprises established along with the innovations are struggling to grow big enough to achieve real potential in the international market. With the help of a cluster policy covering the entire Baltic Sea Region, a wider operational environment supporting business development should be established for the small innovation companies to ensure sufficient circumstances for growth.

We should also encourage a deeper integration of promising Russian clusters into the Baltic Sea networks. We may assume that this could be of added value to the process of trans-national cluster development.

Challenges

The critical mass important for the efficiency of operations, creation of cluster structures and international attractiveness of the industry is often not achieved at a regional level. Hence we should co-operate in the Baltic Sea Region in order to build larger and more attractive clusters within which companies operating in different regions and different countries could seamlessly develop co-operation. The problem is, however, that nationalistic views prevent co-operation far too often.

Furthermore, the supportive activities of the public sector must not be geographically limited. Broad regional co-operation is a requirement for the operation of clusters, especially in the Baltic Sea Region. Nevertheless, national and local public organisations that support innovations are usually not allowed to use their funds outside the country or the region. This does not provide a good basis for the creation of geographically larger, and hence potentially more competitive, clusters.

One of the most important challenges in the Baltic Sea Region is that many key elements of the level of infrastructure do not match the transportation needs. Also the time required by border crossing needs to be reduced for both road and rail transports. The poor predictability of the time of arrival of transports quickly leads to serious problems in the operation of the subcontracting and co-operation network, and thus to the production efficiency of the cluster.

Enhancing the production environment of clusters

We can point out a few key areas of operation in which it would be possible to create better prerequisites for local clusters. These key areas include:

- Common vocational training
- Promoting the mobility of labour
- Harmonisation of working culture
- Funding research

The production of large industrial clusters in particular requires geographically extensive utilisation of labour and subcontracting resources. It is important for the organising of work and production efficiency that the standard knowledge and competence of different professional titles is the same regardless of the country of education.

It is very important for the operating conditions of the cluster that the cost-efficiency of production does not suffer even though labour resources from a large area might need to be utilised in the production process. On the basis of the companies' experiences, the free mobility of labour inside the EU is still not realised. Because working abroad usually lasts for a very brief period for a number of reasons, staff turnover is also great. This creates significant additional challenges to the effective organising of work.

The working culture in the Baltic Sea Region needs to be harmonised, so that introduction to working methods and regulation does not take up a disproportionate amount of working time. A consistent labour legislation as well as norms and practices need to be created for the Baltic Sea Region. This will clarify the labour markets and their common rules, promote safety at work and enhance the productivity of work.

One important part of many clusters, especially high-technology clusters, is the research conducted in universities and other institutions. The public sector could play an active role in promoting clusters by funding research and development. By pooling resources and allocating them to the most fruitful environment, rates of return on investment increase.

Jarkko Heinonen

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BCCA Office Representative

Finland

Problems of the Archipelago Sea are self-created

By Harri Ekebom

Current awareness and media attention about the bad ecological conditions of The Archipelago Sea are considerable. The Archipelago Sea in front of south-western coast of Finland with its algal rafts have become the symbol of the state of the Baltic Sea for the rising amount of Finnish and foreign tourists. Awareness of the state of The Archipelago Sea is high and the citizen's pressure on the real action grows.

Reasons of the problems in and therefore their solutions are different whether it is Baltic Sea in general or The Archipelago Sea in question, which makes the outline of the matter complicated. Role of the Finnish agriculture as a source of the nutrition burden in The Archipelago Sea is central, i.e. at least 60 percent, as in the scale of the whole Baltic Sea it is under 10 percent. For example the direct impact of the much spoken St. Petersburg area emissions for the state of The Archipelago Sea is much smaller than it is e.g. in the Gulf of Finland. Ongoing progress in the sewage treatment in St. Petersburg will hardly improve the situation in The Archipelago Sea. However, the acceptance of the homespun and self-created origins of the Archipelago Sea's problems seems not to be easy for everyone. It would be enormously easier to search the guilty parties from further away and call for the others to act.

There is for the time being a wide inconsistency between the general opinion and the ongoing measures. The citizens are waiting and with a strengthening voice demanding real action in water protection. In practice the measures in the water protection are based in the different actors' volunteering and the use of different kinds of incentives. For example agriculture branch has recognised and accepted its own central role to the state of the Archipelago Sea. Protection measures designed for every farm can have a researched and effective impact in attempt to limit the nutrition burden. Furthermore, the willingness to this kind of actions is rising. This is a slow process and its results can be seen only after several years. Climate change has its own impact to the process by in different ways adding burden to the Archipelago Sea and thus weakening the effects of currently ongoing tasks. It is still uncertain how long can the current voluntary-based state of affairs can continue.

There is still hope remaining for the Archipelago Sea. A very positive sign is an observation about the improving conditions of the sea when the nutrition burden drops. Nature reacts in a positive manner quite quickly, which has been one of the main reasons for the establishment of the Protection Fund for the Archipelago Sea. The meaning of the fund is to support effective and carefully directed water protection measures, which in a strong probability have a quick and positive effect. The emphasis is thus put on to the support and speed up taking in use the best practices, not in research of new methods. The work is based on multi-year programme, whose measures have been prioritised on the basis of influence. Most resources have been directed to the measures having the most effective and quickest influence. Examples about these are the measures aiming at the diminishing nutritional emissions of agriculture. There are also measures in the programme that aim at affecting actors being able to advance the aspects related to water protection with their decisions. These kinds of actors include among others cities, towns and municipalities. For further information about the fund and its operational programme, please visit www.saaristomerensuojelurahasto.org .

The Protection Fund for the Archipelago Sea is a new sign of business life's growing interest on the state of the Baltic Sea. Majority of the fund's activities is financed with the support of private actors, companies, communities and private persons. John Nurminen foundation has made a successful effort for a long time in this area, not to mention all the actors. Strong involvement of private actors is an example of influence caused by strengthening citizen pressure on the decisions made in the companies. Social responsibility has already been written down in many companies' values for a long time, but its channelling depends on the citizens' and market's expectations. The Protection Fund for the Archipelago Sea offers a concrete influence channel especially for those companies having their action and interest area in south-western Archipelago Sea.

Harri Ekebom

Representative

Protection Fund for the Archipelago Sea

Finland

Energy security and environment - energy challenges in the European Union

By Hanna Mäkinen

Energy issues are about to become one of the greatest challenges facing the European Union in the future, both from political, economic and environmental perspective. In a global scale highly topical energy issues include climate change, increasing energy consumption especially in developing countries of Asia and Africa, sufficiency of energy resources and energy supply, and increase in energy prices. For the EU the guaranteeing of the Union's energy security has become an essential, yet not easily achievable goal. The EU's increasing reliance on imported energy and the sufficiency and reliability of imported energy, mainly from Russia, are strongly affecting the energy security of the Union. Russia's restrictions on natural gas delivery and disputes with the transit countries, as well as the possible impacts of the political development of Russia on its energy deliveries have raised many concerns and discussion. Very important issues for the EU include also environmental issues, such as environmental effects of energy production and energy transports.

Internal and external policies of the EU will be strongly affected by energy issues, especially the need to guarantee the EU's energy security. Energy issues are in the focal point of EU-Russia relations as well. There is a strong tendency in the EU to develop a common energy strategy and a common energy policy, which would make the Union a stronger player in the negotiations with Russia. However, the differing opinions and interests of the EU-countries have hindered the efforts of the EU to speak with one voice in energy affairs.

Energy issues are highly topical, which guarantees that they will be widely discussed and debated both in a global and regional scale and throughout the EU as well. Therefore it's not surprising that the importance of energy-related issues has also been acknowledged among Finnish enterprises. According to a recent study by Peeter Vahtra and Valtteri Kaartemo (Pan-European Institute 2008) questions related to energy are high on priority for the 250 largest enterprises in Finland. The companies were asked to evaluate impacts of energy-related factors on their businesses. Almost 85 % of the respondents considered energy issues important and 40 % very important to their businesses.

The companies were first and foremost concerned about the increase in energy prices and guaranteeing stable energy delivery in the EU area. The increasing reliance of the EU on imported energy was regarded important to the companies' businesses. Especially the reliance of Finland on Russia as its main energy supplier was considered significant. The political development of Russia and its impacts on energy deliveries raised many concerns among the respondents. The development of common energy policy of the EU was also considered fairly significant, as well as increasing energy investments in the EU to meet the demand.

However, global energy challenges appeared to be considered more remote to the companies' businesses. Increasing demand for energy and competition for scarce energy resources in a global level were not considered as significant. Only global environmental effects of increasing energy consumption were considered fairly important among the respondents.

In general, environmental effects of energy trade were not as high in ranking in the companies' priorities as were the issues related to energy prices, stable delivery of energy and energy politics. Among the environmental issues included in the enquiry the development of sustainable and renewable energy sources was considered to have the greatest significance to their businesses. On the other hand, regional environmental issues related to energy were of a lower meaning. The companies found the environmental impacts of the North Stream pipe line to be quite insignificant on their businesses, as well as the oil transports in the Baltic Sea. This could be seen as quite surprising, considering the increasing risks of the energy transports in the Baltic Sea region.

According to the study, the Finnish companies are aware of the commercial meaning of energy issues, although not all issues were considered equally significant. Indeed Northern Europe has to face great energy challenges in the future. Due to its strategically important location as a transit area for Russian energy, Northern Europe plays an important role in the development of EU-Russia energy relations. On the other hand, the environmental risks of energy production and transports are severe for the ecologically very sensitive region. The rapidly increasing oil transports in the Baltic Sea produce the greatest environmental risk to the area. Currently probably the most discussed energy-related topic in the EU is also related to Northern Europe and the Baltic Sea – the North Stream natural gas pipe line which is supposed to be built in sea bottom. The debate has mainly been related to possible environmental impacts of the pipe line but the question has also been politicized in some EU-countries

The highly topical energy issues will also be discussed in the Pan-European Institute 20th anniversary conference "Energy Challenges in Northern Europe", which will be organized on 27–29 November 2008 in Turku, Finland. The conference will bring together leading professionals in the area of politics and economy to discuss the future energy challenges in Northern Europe. The aim of the conference is to bring new perspectives to the European Union's energy dialogue and to offer first-hand knowledge on the developments in the energy relationship between the EU and Russia. For further information on the conference, please visit www.tse.fi/pei.

Hanna Mäkinen

Project Planning Officer

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Finland

Energy challenges and opportunities in the Baltic Sea Region

By Anders Fogh Rasmussen

Combating climate change and improving our energy security are among the greatest challenges facing the Baltic Sea Region today.

During recent years we have witnessed dramatic effects of climate upheaval. The evidence from the UN Climate Change Panel is extremely convincing.

One thing is clear: If we are to tackle climate change we will have to cut green house gas emissions. We must reduce our dependency on fossil fuels. This will also increase our energy security. We must co-operate globally to find solutions that offer opportunities for everyone.

The preparations for the UN Climate Conference in Copenhagen in 2009 present a unique opportunity to embark on a common path towards low-carbon economies. And a chance for the Baltic Sea countries to engage actively in the necessary transition to low carbon economy – not only to contribute to combating climate change but also because of the business potential it offers.

We need a new industrial revolution based on climate-friendly technologies.

It will require heavy investments and incentives that promote energy efficiency and clean technologies if we are to reach our ambitions of reduced GHG emissions and security of supply. Co-operation between governments and the private sector is the key. Research is also crucial to lower cost of clean energy and to put industry at the forefront of the growing low carbon technology sector.

Many tend to focus on the economic costs in this transition. But there need not be a contradiction between economic growth and reduction of emissions. On the contrary more focus on energy efficiency measures and on renewable energy sources offers also plenty of opportunities for business, growth and prosperity.

In Denmark we have achieved increased energy security and diversified our energy supplies. Moreover, with increasing oil prices it also makes good sense to save energy and to increase the use of renewables. Our long lasting efforts to convert district heating to combined heat and power and to save energy in buildings now provide a buffer zone against the rising oil prices and the adverse effect on our economy. Due to these efforts the energy consumption has been nearly stable for 25 years even though Denmark's economy has grown by 75 %. Our CO2 emissions have in the same period been reduced by 14 per cent.

The Baltic Sea Region can make a significant contribution to combating climate change. Our countries have a wide range of renewable energy sources and we have already demonstrated our willingness and ability to develop those resources. Some of our countries are experienced in creating incentives and technologies for efficient use of energy.

In the EU we have agreed on the most ambitious climate and energy targets in the world. We will cut emissions by 30 % by 2020 as our contribution to a global deal. We have also set binding targets for the share of renewables in the energy mix and we have stressed the need for improving energy efficiency. In this way, we have shown that Europe is ready to take global leadership.

However, the EU countries cannot achieve its energy and climate change objectives on their own. We will also have to act and co-operate at regional levels as well as strengthen co-operation with neighbouring countries like Russia. Russia is also paying great attention to ways and measures to increase energy efficiency and the use of new technologies in their energy system. The energy co-operation in the Baltic Sea Region represents a unique tool in furthering the EU-Russia dialogue with its major producers of oil and gas.

It is essential to have as many suppliers as possible with regard to competition and security of supply. For instance some countries in the Baltic Sea Region more or less rely on one gas supplier. Diversification of supplies is important to ensure security of supply and to make use of the commercial opportunities that more than one supplier gives.

In this connection I would like to emphasize that creation of a fair, non-discriminatory and well functioning competitive market for energy round the Baltic Sea in itself will lead to diversification of supplies. One of the challenges for the Baltic Sea Region is integration of energy infrastructure as a precondition for a free and open flow of energy across the borders.

During the Danish presidency of the Council of the Baltic Sea States, the Minister for Climate and Energy will convene a conference on the key energy perspectives of climate change in September 2008. The objective is to agree on intensifying their co-operation leading to concrete measures for integration of regional markets, tackling climate issues and promoting renewables and energy efficient technologies with a specific focus on district heating and combined heat and power.

In the transformation to low carbon economy the Baltic Sea Region has the potential to take lead.

Anders Fogh Rasmussen

Prime Minister

Denmark

Recent European Court of Justice rulings highlight potential complications for labour mobility, but overall a mobile work force will contribute to a more dynamic EU economy

By Vladimír Špidla

In recent years, the European Union has done much to improve the relatively low labour mobility of Europe's work force. Put simply, making Europeans more mobile in the job market can help the EU meet labour shortages and contribute to a more dynamic economy.

But European labour laws have been put to the test in the past few months with two court rulings concerning the posting of workers to another Member State. Laval, a Latvian construction firm, angered Swedish unions when it posted workers from Latvia to work on building sites in Sweden. Trouble flared when Swedish workers began industrial action in the form of a blockade, to protest at what they saw as unfair competition from cheap labour from Latvia. A similar situation arose when Finnish ferry company Viking replaced the crew of one of its ships with Estonian workers. In both cases, the European Court of Justice ultimately ruled in favour of the two companies, while still recognising the right of workers to take collective action. The Court recognised that both the freedom to provide services and the right to take collective action are fundamental rights and should be reconciled.

Both cases highlight the potential complications that greater mobility and increasingly open EU national borders can bring. But in spite of this, labour mobility still holds considerable advantages and remains a key element in Europe's ongoing efforts to create a more flexible, competitive EU economy.

There are a number of benefits that increasing labour mobility can bring to the EU. For instance, there are still serious skills bottlenecks in Europe, despite high levels of unemployment. These bottlenecks can leave employers unable to find qualified staff for the jobs that need filling. Facilitating mobility means that unemployed, skilled workers from one Member State can, more easily, contribute to easing labour shortages in another Member State. In this way, it helps increase the efficiency of the European labour market.

Furthermore, mobility strengthens the economy; it aids the creation of more jobs and increases productivity by enabling workers and businesses to adapt to changes in the labour market more flexibly and effectively. EU workers themselves can also benefit directly from increased mobility. By moving to a different country or changing jobs, people acquire new skills and experience, something that may benefit them and increase their employment chances. This in turn is good for the economy, because a work force that is able to broaden its expertise and adapt to new demands will be better equipped to face the challenges related to globalisation, such as restructuring.

One of the main issues driving the need for greater EU labour mobility is demographic ageing – and perhaps nowhere is this more relevant than in Finland. As a result of low fertility rates and rapid improvements in life-expectancy, Finland now has one of the world's fastest-ageing populations. According to Statistics Finland, 16.5% of the population are over 65 years of age. The Baby Boomers are retiring and there are increasingly fewer people of working age. Consequently, labour shortages that Finland's own younger generation will be unable to fill loom large on the horizon. The shortage of labour can only be solved either by encouraging more people to enter and remain longer in the job market, or by attracting workers from outside the country. So, labour mobility is particularly important for Finland.

But mobility can only really work if people are able to adapt to a change of job or career. Consequently, training is becoming increasingly important. Globalisation and technological advances are leading to radical shifts in the relative importance of individual sectors or occupations – and skills today can quickly become obsolete. So, lifelong learning and education and training that respond to an increasingly knowledge-based economy are vital.

Lifelong learning is an integral part of the "flexicurity" model – a policy approach that could help strike the balance between the advantages and the challenges of mobility. Flexicurity promotes a combination of flexible labour markets and a high level of employment security. The approach is made up of four main elements: modern contractual arrangements that allow a sufficiently flexible organisation of work; active labour market policies which help people adjust to job changes; lifelong learning systems which keep abreast of the requirements of a constantly changing configuration of work organisation; and social security systems which combine the need to make labour market mobility easier with the provision of supplementary income.

The situation regarding European labour mobility today is somewhat paradoxical. On the one hand, globalisation, ageing and rapid technological progress mean that mobility is more important than ever. Furthermore, it has never been easier to move around the EU – markets are more open, labour is more mobile and there are a lot of job vacancies and a lot of jobseekers across 27 Member States. And yet, the current rates of worker mobility remain low. Despite some recent improvements, only around 2% of working-age people in the EU currently live and work in Member States other than their own. And, in nine EU countries, over 40% of workers have been in the same job for over 10 years.

There are signs of improvement, however. Europeans – particularly young people – are becoming more flexible and international in their outlook and consequently, more open to changing job or moving to a new country. A 2006 Eurobarometer survey revealed that a clear majority of young workers – over 70% – are now aware that their career will require some sort of mobility. And the EU is doing more and more to facilitate and support mobility, be it through our EURES platform and network for job mobility or tools like the European health insurance card, which facilitates access to emergency healthcare during short stays in another European country.

The Laval and Viking cases highlighted some of the potential complications that can result from greater labour mobility. But overall, geographical and occupational mobility can go a long way to helping boost labour markets and growth and making the EU economy more dynamic and competitive.

Vladimír Špidla

EU Commissioner for Employment, Social Affairs and Opportunities

Co-operation in the Baltic Sea Region

By Jan-Erik Enestam

Co-operation in the Baltic Sea Region is growing closer on all fronts: political, economic, cultural and social. People and companies are forging ever-closer bonds. The walls between countries and the remains of obsolete political systems have now almost completely crumbled. It is more and more natural for people to move back and forth across borders, whether for tourism, study or work. Of course, there is still a long way to go before we can describe the Baltic Sea Region as completely integrated in all respects, but the tendency is clear and the work continues apace. It is important that all countries in the region are able to participate in this work on an equal footing.

Today, a number of organisations in the Baltic Sea Region, for various reasons and in a range of different ways, address issues that are of importance to the region and its inhabitants. On the government side we have, for example, the Nordic Council of Ministers, the Council of the Baltic Sea States (CBSS) and the Helsinki Commission (HELCOM). On the parliamentary side, there are the Nordic Council, the Baltic Assembly and the Baltic Sea Parliamentary Conference (BSPC). Those active on a regional level include the Baltic Sea States Subregional Co-operation (BSSSC) and the Union of the Baltic Cities (UBC). Business is strongly represented in, for example, the Baltic Development Forum (BDF). In addition, there are also NGOs, such as the World Wildlife Fund (WWF) and Coalition Clean Baltic (CCB), to name but a few.

The good news is that this diversity bears witness to a broad-based commitment to the development of the region and to the investment of substantial resources. A disadvantage is that it can also lead to territorial disputes, and to the overlapping and inefficient utilisation of the overall resources. It would be beneficial if these existing organisations worked even more closely together, and if agreement could be reached on how best to share the work. This would benefit both the individual organisations' efforts and the overall ability of the Baltic Sea Region to deal with the challenges it faces. Initiatives in this direction have certainly already been taken, but greater efforts are welcome.

The Nordic Council – the co-operation body for the Nordic parliaments, founded in 1952 – has long had Baltic issues on its agenda. The Council served as a kind of role model when the three Baltic states' parliaments founded the Baltic Assembly in 1991. Co-operation between the two bodies is increasingly based on the drawing up of joint political strategies and specific campaigns on politically prioritised issues. Environmental issues are obviously central, but health and social welfare, trafficking and international crime, and cultural co-operation are also priorities. Similarly, the Nordic Council of Ministers has been a driving force in building up Baltic co-operation on the government side.

The Baltic Sea Parliamentary Conference (BSPC) was established in 1991 and brings together participants from all national and regional parliaments in the Baltic Sea Region and from the European Parliament. The Nordic Council occupies a strong position in the BSPC. Since Russia, Norway and Iceland all take part, the BSPC constitutes a political platform that enables parliamentarians from both EU and non-EU countries to engage in opinion-forming, exert political pressure, and carry out different types of joint political activity. 'Task forces' and rapporteurs have been utilised as tangible and fixed-term political tools, and are becoming more and more common. The political challenges and recommendations issued by the BSPC are directed at the governments in the region, the CBSS and the EU. More than 200 MPs, ministers, experts and NGO representatives met at the 16th BSPC conference in Berlin in August 2007. The 17th conference will be held in Visby in September this year, and will focus on energy issues and climate change, the eutrophication of the Baltic Sea and labour-market issues.

There are many good examples of words being translated into action. With the help of funding from, among others, the Nordic Investment Bank (NIB), the environmental partnership within the Northern Dimension runs a whole series of environmental projects that are of great importance for the health of the Baltic Sea. One outcome of this work is the southern sewage plant in St Petersburg, which was completed in 2005. Following a certain amount of labour pain, in November 2007 the governments in HELCOM adopted a groundbreaking action plan for the Baltic Sea (BSAP), which includes a number of far-reaching commitments and tangible strategies, e.g. for significantly reducing phosphorus and nitrogen emissions. It is also gratifying that the financial institutions active in the region, such as NIB and the Nordic Environment Finance Corporation (NEFCO), have clearly stated that they are prepared to direct financial resources into the implementation of HELCOM's action plan. At a HELCOM conference in St Petersburg in mid-March this year, it became obvious that the major task now is that the players and stakeholders in the Baltic Sea Region develop tangible and 'bankable' projects that realise the overall objectives of the action plan by linking them to the economic resources of the financial institutions. It is therefore vital that project-development skills be enhanced.

The EU Commission is in the process of drawing up its own Baltic Sea strategy. In order for it to be efficient, this strategy has to have a direct link to the Northern Dimension's policy. The Northern Dimension provides a joint overall framework for co-operation between the EU and Russia, Iceland and Norway. The EU's Baltic Sea strategy, linked to the Northern Dimension, will therefore become an important tool for mobilising resources for development in the region and for improving its position in a wider European and global context. The European Parliament is hosting a parliamentary conference on the Northern Dimension in autumn 2009, at which it is important that the representatives from the region make sure Baltic issues are given due prominence.

CBSS is in the middle of a reform process that is expected to culminate at its summit in Riga in June. The current expectation is that it will strive for greater efficiency and concentrate its work on achieving more obvious and faster results.

These are just some examples of specific initiatives that have major potential for the Baltic Sea Region's health and prosperity. The governments involved must therefore live up to their commitments to, for example, HELCOM's action plan. For their part, the region's parliamentarians have an important task ahead in terms of demanding political responsibility and following up and driving development, e.g. in their own national parliaments, in the Nordic Council, in the BSPC and in the EU Parliament. It is important to forge closer links and enhance co-operation between the players in the Baltic Sea Region so that they are able to harmonise their efforts and enable the region to speak with one voice.

Jan-Erik Enestam

Secretary General

The Nordic Council

Logistics unites markets

By Anu Vehviläinen

In the global economy the companies take advantage of the differences of various markets. Manufacturing and consumption that may lie on the opposite sides of the globe are united with efficient logistics services. The same logistics services that enable companies to sell their products all over the world bring global competition to their doorsteps. The importance and challenges of supply chain management and related logistics have become widely recognised among the chief executive officers and also politicians.

The logistics system consists of actors, operations and technology, including infrastructure. The efficiency of the system may be hampered by deficiencies in any of these elements. Logistics processes are very information intensive. Long international supply chains require more planning and are still more vulnerable than domestic chains.

In Finland we have interpreted the word “logistics” to mean co-operation and common sense. Nobody can do logistics alone. It is a challenge to get all actors to operate seamlessly towards the same target and to make them share the costs and benefits fairly. For example in the logistics of the local supermarket – selling daily consumer goods – everybody involved in the delivery process should perceive themselves as part of the shelf filling system.

Logistics includes goods transport. The mobility of goods and people are increasing as the economies are developing. Each transport mode serves both people and goods. Traditionally the passenger transport has been given priority on the transport networks. When the networks get congested it is the freight that has been accused. It seems to be easier to set restrictions to freight transport than to passenger transport. On the other hand in some cases excessive heavy goods vehicle traffic can really create unreasonable nuisance to local residents and to other road users.

The common concern today is the climate change. We need to seriously take actions towards more sustainable society as transport is one major producer of the CO2-emissions. In the global economy the environmental measures should be agreed globally in order to avoid distortion in competition. Of course, each country is reluctant to make national decisions that may harm the competitiveness of their trade and industry in relation to their neighbours and competitors. However, environmental measures, price of oil, and shortage of qualified labour will soon – if not already now – force companies to rethink and restructure their supply and demand networks.

The common transport policy of the EU has for the last decade emphasised the intermodal transport. The development of Short Sea Shipping has been favourable but the rail and combined road-rail-transport have not reached the targets. There are many reasons for the slow development of rail freight, e.g. the historic burden of the state rail monopolies and lack of competition. I see analogy with rail freight and public transport: most people have nothing against them but still they choose truck or passenger car if they can afford it because it is easier and offers better service level (from door to door –services). Public transport or rail freight become attractive just when the capacity of roads is used and their service level dropsor the total cost of using rail is significantly lower than using road.

The customer is always right, also the user of transport services. But the potential customer of rail freight services is often wrong. The service that he or she would like to have is not nor is going to be available. Manufacturing and trade usually don’t care how their goods are transported as long as the price and quality demands are met. The logistics service providers try to consolidate their customers’ shipments to enable efficient return goods flows. When the flows are strong enough, the use of rail can be an option. The customers want to have greener cargo as long as it is not more expensive. However, in many cases there is the egg and chicken phenomenon: there is no rail service because there are not enough customers and there are not enough rail customers because there isn’t any service.

The EU has laid down a number of regulations to develop the rail freight services. Also the environmental and labour market circumstances are changing so that the competitiveness of rail services should rise. Unfortunately the insufficient rail infrastructure seems to become a bottleneck to the promising outlook. Also, the intermodal transport by definition has interfaces which require infrastructure. The production of logistics and transport services should be commercially viable; transport is business.

Coming back to the analogy of rail freight and public transport, I would like to note that in many places the society has considered that it is wise to give subsidies to the public transport system. In Germany the state has supported the investments of intermodal terminals (GVZ). Is it time for the public sector to make strategic decisions on the development of the freight transport system? Or should we leave it to the markets as we have done in Finland? There are voices claiming that the markets are unable to solve the intermodal transport business. Whose business is it anyway?

The Baltic Sea is one of Europe’s Motorways of the Seas. The growing trade leads to increased vessel traffic. From the point of view of logistics as well as of the environment it is extremely important that the vessel traffic flows undisturbed. The Finnish Maritime Administration and the Gulf of Finland Mandatory Reporting System, GOFREP, have been given the Logistics Project of the Year 2008 award by the Finnish Logistics Forum for its efforts to develop sea safety in the Gulf of Finland. The international cooperation with Finland, Estonia and Russia has granted the success of the GOFREP system.

Studies (e.g. LogOnBaltic) show that the logistics costs depend on the size and branch of companies. Although transport is usually the largest cost component, it is still less than half of the total logistics costs. People from trade and industry often call for government actions to improve logistics. They are eager to demand better transport infrastructure which would reduce their logistics costs. I admit that there are areas where insufficient infrastructure really is a bottleneck but in general the marginal time savings gained by better roads are easily wasted in poor operations at the terminals.

Logistics is a subject of expertise. Yet, it is just co-operation and common sense.

Anu Vehviläinen

Transport Minister

The Ministry of Transport and Communications

Finland

The EU Strategy for the Baltic Sea Region as a tool for implementing the HELCOM Baltic Sea Action Plan

By Andreas Carlgren

During the summer months the shores of the Baltic Sea are the natural choice for holiday recreation for many people living in the Baltic Sea region, as well as for many visitors to the region. Today, more than ever, we have an attractive region in many ways open to the movement of people, goods, services and capital, as well as ideas. However, we are also facing a situation where many people have their precious summer holiday disturbed by algae blooms. With each passing summer we become more aware of the environmental challenges to the Baltic, and the threats to the attractiveness of our region. Under the surface, the dead bottoms of the Baltic Sea cover vast areas and are threatening to bring the state of the Baltic to a point of no return. Many of the ecosystem services that the Baltic provides for us are now close to ecological collapse.

What needs to be done to reverse this trend? First, it is necessary to have broad understanding at all levels, on the part of stakeholders and sectors, that the restoration of the Baltic Sea is crucial for long-term prosperity of this region. The Swedish Government has made the marine environment a priority. This includes additional budgetary resources for concrete restoration activities and initiatives for a sector-integrated maritime policy. One initiative taken by the Government is to prepare, together with Finland and others parties, a background document for a socioeconomic study to provide decision-makers with a solid foundation relating to the economic benefits of ecosystem services, the cost of measures required to protect these services and the estimated cost of inaction. The initiative follows on from the report "The Economics of Climate Change – The Stern Review" that strengthened the arguments of conservationists and scientists that something has to be done about climate change. The conclusion of that report was crystal clear: the costs of mitigation are only a fraction of the cost of climate change. The Swedish study will be ready at the end of this year and I am looking forward to its conclusions, putting forward the case for action for the Baltic Sea.

Second, I would like to highlight the geopolitical developments that, in combination with policy developments, are creating new political momentum for action. Today, after EU enlargement in 2004, eight out of the nine Baltic Sea littoral states are EU Member States. In practice, this mean that eight out of nine Baltic Sea states share legislation and policy with an impact on – and a potential to improve – the Baltic Sea environment. This includes the Marine Strategy Directive, the Integrated Maritime Policy, the Water Framework Directive, the Common Agricultural Policy, the Common Fisheries Policy and legislation on chemicals. So by jointly strengthening policy implementation and further improving policy instruments when needed we are now more able than ever to take coordinated action. With the aim of drawing on this momentum, the Swedish Government has taken on board a proposal from the European Parliament by making an EU strategy for the Baltic Sea region (the Strategy) one of the key objectives for the Swedish EU Presidency in the second half of 2009. The first step was the decision of the EU Summit in December 2007 to invite the Commission to present an EU Strategy for the Baltic Sea Region by June 2009. The Commission is now working actively on this issue, and is inviting stakeholders to participate in consultations.

We welcome the immense response regarding the development of an EU Strategy for the Baltic Sea region. From the Swedish perspective we hope that the Strategy – to be adopted in the autumn of 2009 – will be a concrete, action-oriented instrument with a clear follow-up mechanism that helps the EU and the EU Member States in the Baltic Sea region identify measures to address the specific challenges of our region. We foresee a Strategy tackling the environmental challenges related to the Baltic Sea while enhancing the growth and competitiveness of the region. The adoption of the Marine Strategy Directive and the Integrated Maritime Policy open the way for regional action enabling steps to be taken for coherent regional implementation. The Strategy should aim to make the Baltic Sea Region an EU marine and maritime best practice region. To achieve this vision, more efforts are needed to improve cross-sectoral policy and implementation of legislation, as is improved matching of the available resources to priorities. The Strategy should suggest action on a broad range of issues. We see that important steps can be taken to ensure that EU legislation and policy development, for example agricultural and chemicals policy, meet the concerns of the marine environment. The macro-regional implementation of the Marine Strategy Directive in the Baltic Sea Region should develop the pilot area concept, with stricter timetables and content. Taking further steps in the Baltic Sea region could serve as a useful example for other regional seas.

Importantly, the Strategy should contribute to the implementation by EU Member States of the HELCOM Baltic Sea Action Plan (BSAP). The BSAP, adopted by all the states around the Baltic Sea – EU States and the Russian Federation – and the European Commission last year, is unique in the sense that the reduction targets are set on the basis of the ecological need to restore the Baltic Sea, not as merely a political compromise. It is clear that the plan will only become a true "action plan" if action is taken to implement it. The Russian Federation is now taking over as chair of HELCOM. I believe that the EU Strategy for the Baltic Sea Region can be a tool for enhancing the implementation of the Baltic Sea Action Plan. This will improve regional cooperation and prosperity, thereby ensuring that our region will also be an attractive place to spend our summer holidays.

Andreas Carlgren

Minister for the Environment

Ministry of the Environment

Sweden

Photo: Pawel Flato

More maritime safety for the Baltic Sea - what are the options?

By Anita Mäkinen

The scenario of a severe oil accident in the Baltic Sea is omnipresent. Huge number of islands, routes that are difficult to navigate, slow water exchange and long annual periods of ice cover render this sea especially sensitive. And at the same time the Baltic Sea has some of the densest maritime traffic in the world. During the recent decades the traffic in the Baltic area has not only increased, but the nature of the traffic has also changed rapidly. One important change is the increase of oil transportation due to new oil terminals in Russia. In the Gulf of Finland only, the amount of transported oil has increased from 22 million tonnes in 1995 to more than 140 million tonnes in 2006. The forecast for the year 2015 is more than 250 million tonnes of oil. But not only the number of tankers has increased but also their size has grown.

Furthermore, the cruises between Helsinki and Tallinn have increased tremendously. This route is crossing the main routes of vessels transporting oil and other hazardous substances. In case of a serious oil tanker accident all coasts of the Baltic Sea would be threatened, economic activities possibly spoiled for years, and its precious nature even irreversibly damaged.

There are also other activities in the Baltic Sea area such as wind mill parks, oil and gas pipelines and oil platforms. This development puts even more pressure on the marine environment: besides the increasing risk of oil spills, more alien species such as the North American comb jelly get introduced into our sea through ballast water, marine habitats get destroyed due to building projects and the species and their populations associated to these habitats are threatened. In WWF our concern is how to safeguard our marine nature and heritage under these pressures.

More maritime safety through PSSA status

Accordingly, WWF and its Baltic partners had asked for the official status of a "Particularly Sensitive Sea Area" (PSSA) for the Baltic Sea for years in order to tackle the environmental effects and threats associated with increasing international maritime traffic, especially oil shipping. The whole Baltic Sea except for the Russian territorial waters, was designated, in principle, as a PSSA in the International Maritime Organization's (IMO) 51st MEPC meeting in April 2004. The final approval for the Baltic PSSA and associated protective measures (APM´s) was adopted in IMO Assembly in December 2005.

The PSSA status is meant to avoid accidents, intentional pollution and damage to habitats. Although, the PSSA status as such would increase the international recognition of the ecological significance of the area, it is not enough to decrease the risk of an oil accident. Hence, the IMO can also decide, upon request by the countries concerned, associated protective measures (APM´s) to strengthen the protection of marine environment.

There is a variety of shipping management tools which could be used as APM's in conjunction with PSSA´s. These include ships´ routeing systems (traffic separation schemes, areas to be avoided, no anchoring areas, inshore traffic zones, deep water routes, precautionary areas, recommended routes), ship reporting systems (Vessel Traffic Service Systems VTS, and Vessel Traffic Monitoring and Information System, VTMIS), discharge and emission restrictions.

Furthermore, there are possible measures for APM's in the territorial sea which have to be considered on a case-by-case basis, based on the particular circumstances of the area. A coastal state might consider: a) Special Passage Planning Requirements (e.g. closure of routes to certain types of vessels pr cargoes, seasonal closures to protect migrating marine mammals, speed restrictions b) special anchoring requirements, c) special activity restrictions (e.g. regulation of offshore bunkering), d) obligatory escort towing and obligatory pilotage, e) discharge restrictions, f) air pollution emission limitation.

Every day 2000 ships are in service in the Baltic Sea, and the traffic at sea is estimated to increase at least by 5 per cent annually. In order to ensure safe use of our sea, maritime surveillance is of high importance. Surveillance activities are carried out by the coastal countries but most of the activities and threats that they address are transboundary in nature. Thus, better collaboration among all the Baltic countries is needed. Furthermore, we should evaluate further associative protective measures in conjunction with PSSA, and submit proposals for associative protective measures to the IMO for approval.

Co-operation with Russia is critical

There is also a need for an analysis to discover the spatial and temporal variations in human's uses of the marine ecosystem resources in the Baltic Sea area with an integrated approach. This is not an easy task, but a very much needed exercise and worth of doing. Furthermore, there is a need for the sensitivity mapping of our sea to tell us what are the nature values and where are they located. The outcome of these two analyses could give us decision making tools in considering where to establish new harbours or shipping lanes and where we need more strict regulations for shipping.

In EU we have taken the first concrete steps in developing an integrated approach to maritime affairs as we have The Commission Communication on an integrated maritime policy for the European Union and the proposed Action Plan (Blue Paper). Therein, marine spatial planning is in central role and the future maritime policy should be developed as a tool to address the challenges facing Europe's sustainable development and competitiveness. The Marine Strategy Directive is the environmental pillar of the future European maritime policy and our mission in WWF is, that nature values will be seriously taken into account when establishing the new EU maritime policy.

Although, eight of nine Baltic countries are EU member countries, it is extremely important that European Union and Russia have good dialogue in the Baltic Sea area. European Commission is preparing an EU Strategy for the Baltic Sea Region. It should be presented in June 2009 at the latest, for example as a Communication. The new Northern Dimension policy has important role in the EU Strategy for the Baltic Sea. Russia values being an equal partner in the Northern Dimension and is now more firmly committed to constructive cooperation. For the EU and especially for the Baltic countries this should be a welcome opportunity for further cooperation in the Baltic Sea area.

The Baltic Sea is a unique and extremely sensitive ecosystem threatened by international shipping, which is also recognized by the International Maritime Organization. Furthermore, we have several options to improve maritime safety in the Baltic Sea area; we only need to agree upon the most effective ones - without any delay.

Anita Mäkinen

Head of Marine Programme, Dr.

WWF Finland

Economic and trade cooperation between China and Finland – mutually beneficial and win-win development

By Ma Keqing

Finland and China have been enjoying longstanding and traditional friendship. The two countries established diplomatic relations as early as in 1950. In 1953, the inter-governmental trade agreement was signed between the two sides, as the first of its kind in Europe. Over the years, the two nations have witnessed a continuously consolidated political relationship and an ever-developing trade and economic ties.

Finland has been China's largest trade partner in Nordic region for the last four consecutive years, and Finland has also served as an important source of FDI and technology in North Europe. Meanwhile, China has been Finland's largest trade partner in Asia.

According to Chinese statistics, bilateral trade in 2007 reached 10.36 billion US dollars, a 28.2% increase year on year. In the breakdown, China's export to Finland amounted to 6.56 billion USD, and import stood at 3.8 billion USD. China is Finland's most important export market in Asia and the biggest import origin outside Europe. With regard to product mix in bilateral trade, machinery and transport equipments accounted for nearly 70% of the total trade in 2007. And the majority of machinery and transport equipments are telecommunications and sound recording equipments, which took a share of 36% in the overall trade.

Apart from trade, investment has also seen continuous and new developments. EK statistics shows that more than 200 Finnish enterprises have invested in China with total capital input of 5 billion Euro and annual turnover 10 billion Euro. Finnish investments in China are concentrated in IT, telecommunication, forestry, paper and machinery industries, etc. Nokia, UPM, Metso, Stora Enso, KONE, Outokumpu, among others, are the key players. More and more SMEs are showing enthusiasm in exploring the Chinese market as well.

Chinese investment in Finland is still rather modest, yet Chinese companies are displaying stronger interest in Finland. COSCO established a joint venture with John Nurminen Group in Finland in 1996, and Air China has set up a representative office in Helsinki. The famous Chinese telecommunication equipments provider Huawei Technologies signed a cooperation agreement with Finnish telecom operator Teliasonera at the end of 2007, and is planning to establish a subsidiary in Finland. At the same time, the Chinese IT and electronic parts manufacturer BYD, one of the biggest subcontractors of Nokia worldwide, has opened its subsidiary in Finland.

Technology cooperation between two countries is also growing. In 2007, the contractual value of technology export from Finland to China totaled 633.5 million USD. The highlight is that in terms of average value per project, Finland ranks No. 1 among all the European countries. In August 2007, China-Finland CleanTech Conference was held in Lahti, which attracted more than 400 participants and boosted bilateral cooperation. ICT and Nano-tech cooperation has also been enhanced.

The sustained, steady and sound economic and trade relations between China and Finland have promoted the development of both economies, and brought benefits to the two peoples as well. Finnish investment has brought to China advanced technology and managerial expertise as well as capital and job opportunities. Meanwhile they have yielded huge return on their efforts and realized fast development and improvement in their business. China is now the largest market for Nokia, an important player in the Finnish economy. In the meantime, Chinese exports which are of good value for money brought real benefits to the Finnish people by reducing living cost of Finnish households.

Early this year, Finland's Foreign Trade and Development Minister Paavo Väyrynen led a delegation composed of representatives from 50 Finnish companies to China. In this July, the two countries will hold the 18th meeting of the Joint Economic and Trade Committee, which will further promote bilateral cooperation. Given the traditionally sound political relations, complementarities between the two economies, inter-dependence for future development and great passion of the two business communities for cooperation, the bilateral economic and trade cooperation is promising and enjoys enormous potential. For her part, China will adhere to the policy of reform and opening-up, follow the scientific approach of development and bring forward the mutually beneficial and win-win cooperation with Finland. I believe, this will provide great opportunities for businesses of the two sides.

Ma Keqing

Chinese Ambassador to Finland

China

Estonia - the country we are building together

By Merle Pajula

2008 is an anniversary year for Estonia – on February 24 we celebrated the 90th anniversary of the declaration of our independence, both home and abroad. The celebration of our anniversary was in a sense a continuation of the jubilee of our neighbour, since on December 6, 2007, Finland had celebrated its 90th anniversary. The motto of Estonia's anniversary year is "The country we built together", while Finland held its jubilee under the banner "Us!". The fact that both countries once declared themselves independent within a space of three months and the similarity of the slogans used in celebrating our anniversaries reflect the fact that while the two have different histories, they share many goals, principles and values. As two EU Member States bordering the Baltic Sea, we now share a closer connection than ever before.

In May 2003, a year before Estonia became a member of the EU, a report entitled "Estonia and Finland in the European Union. A Report on Future Relations" was issued by the so-called Wise Men instituted by Siim Kallas and Paavo Lipponen, the heads of government of the two countries. Jaak Jõerüüt, the Estonian ambassador to Finland, and Esko Ollila, the vice president of the Bank of Finland, presented a joint list of fifty proposals on a wide scale of topics ranging from environmental issues to cultural, political and official cooperation. Today, many of these proposals have been carried out and most are taken into account in the day-to-day cooperation between the countries. A specific example would be commissioning in 2006 of the submarine Estlink cable running between Estonia and Finland – it is the first link in the energy bridge being created between the Baltic states and the Nordic countries. An Estlink 2 cable is currently being designed in order to further facilitate the sale and purchase of electricity between the regions.

In the years following its accession to the Union in 2004, Estonia has become an experienced Member State with a steadily high level of public support for EU membership. Estonia has regained its place in Europe's common structural framework and Estonians make active use of the fundamental freedoms they have earned. The opportunities for international integration have not been exhausted, however – in December 2007 Estonia became a member of the Schengen Agreement, thereby opening many new travel possibilities for its residents but also accepting more responsibilities in the fields of border surveillance and the maintenance of law and order. The next big challenge on the national scale will be Estonia's accession to the Euro zone. According to the assessment of the European Central Bank, Estonia meets all the criteria for adopting the Euro, except for the criterion on price stability. Estonia's economic policy foresees the adoption of the Euro at the first opportunity as one of our most important goals and according to the spring forecast issued by the Central Bank, Estonia's inflation should meet the price stability criterion by the end of 2010. There are also challenges to be met outside the EU, as Estonia has been invited to participate in accession talks with OECD. Ever since we restored our independence in August 1991, it has been our aim to contribute to the spread of security, rule of law, economic welfare and stability in the world. What goes around comes around – the Estonia we see today was created as a result of international cooperation.

Bilateral and regional relationships also play an important part in Estonia's wide-ranging cooperation efforts. In June 2008, prime ministers Andrus Ansip and Matti Vanhanen will present to the public volume 2 of the report on the future relations of the two countries, prepared by Gunnar Okk, vice president of the Nordic Investment Bank, on the Estonian end and ambassador Jaakko Blomberg on the Finnish end. The goal of the rapporteurs is to determine the scope of areas in which the cooperation between Finland and Estonia could be implemented in an innovative manner and to identify innovative trends, also prognosticating new trends related, for instance, to research and development. The wealth of mutual relations ranging from grassroots relationships to contacts between members of the governments will ensure that this issue demands a complex solution.

The authors of the aforementioned 2003 report on the cooperation between Estonia and Finland recognized that "the accession of Estonia, Latvia, Lithuania and Poland into the European Union will significantly increase the importance of the Baltic Sea region. The importance of the Baltic Sea in the context of the European Union will be similar to that of the Mediterranean. Estonia and Finland play a central role in demonstrating the importance of the Baltic Sea, as we have a considerable stake in the knowledge of Europe, the historical memory of the region." The necessity of developing an EU Baltic Sea reagion strategy was recognized by the members of the European Parliament, among others Toomas Hendrik Ilves, and was a report on this objective was submitted to the European Parliament in November 2006 by the former MEP and current Finnish Foreign Minister Alexander Stubb. The idea of creating a strategy for the Baltic Sea region has inspired EU Member States to think and act in order to achieve this goal.

In our opinion, the Baltic Sea region strategy should become one of the ambitious internal policies of the EU. In addition to environmental issues, the BSRS could strive towards overcoming the local differences in the region through improving the functioning of the internal market and developing infrastructures, especially energy networks. Free networking should apply in case of all fields of activity, especially in case of the "fifth freedom" of the EU – the free movement of knowledge.

There are several cooperation organizations, associations and inititatives that can be employed to implement the Baltic Sea region strategy, ranging from the Council of Baltic Sea States to HELCOM and Interreg, and it is in our interest to make the best use of these institutions and to avoid overlapping in their functions. The BSRS could be used to create an interlinked network based on existing programmes in order to determine the main problems interfering with the development of the region and to develop complex solutions to these problems. Taking into account the large differences that currently exist between the countries of the Baltic Sea region, the cooperation coordinated through the BSRS would contribute to closer integration between Member States, which in turn would increase the competitiveness of the EU as a whole. An important issue will be the funding of the strategy, which should include both regional and international financial institutions.

We believe that finishing the development of the BSRS by June 2009 in accordance with the European Council conclusions from 2007 is an achievable goal. The governments of many Member States, including Estonia, have already provided their opinions on the potential content of the strategy. Hopefully these visions will be complemented by joint positions put forth by several countries. The strategy will be discussed in many coming

international forums, including the two-day conference on the Baltic Sea Region Programme 2007–13 in Tallinn (November 26 – 27).

People living in the Baltic Sea region feel and acknowledge the necessity for day-to-day joint action. An article published in Helsinkin Sanomat on May 16, 2008 states that concern for the Baltic Sea has made people change their behaviour. The results of a poll conducted in Estonia, Finland and Sweden are also telling: 83% of Estonians, 91% of Finns and 94% of Swedes considers the contamination of the sea a problem that requires intervention. In Finland and Sweden approximately 40% of respondents believed the problem was extremely serious, while in Estonia about a third of the respondents were as concerned about the pollution of the sea. The people of the Baltic Sea region are gradually beginning to understand that the way to solve problems is through complex action programmes involving all aspects of life and that it is the governments' task to agree on the implementation of the programmes.

Merle Pajula

Ambassador of Estonia to Helsinki

Estonia

Customs administrations and economic crime

By Tapani Erling

Economic crime keeps expanding and seeking new forms, and it endangers the safety of citizens and national economies, and even the competitive positions of legally operating companies. Regarding consumers, economic crime appears in its most serious form when dangerous copies like those of crucial spare parts or medicinal preparations are put on the market instead of authentic products. Counterfeit goods naturally also weaken the position of those companies which manufacture original goods.

Customs fraud and tax fraud cause important losses of income to the State. They also distort the competitive conditions since fraudulent companies are able to enter the market at lower expenses. Illicit operation may either take upon itself the form of traditional smuggling or exploit the structures of legal trade by forging, say, the product values and/or the data on the consignment content, thus reducing the taxes and duties to be imposed.

Economic crime may also be considered to comprise illicit transport of and trade in totally prohibited or restricted products. These include e.g. narcotic drugs, explosives, and weapons, which constitute a risk to the safety of both citizens and states. Such "transactions" also involve enormous amounts of money, which are being moved by the hard core of organized crime. They resort to illicit funds with a view to expanding into the sphere of traditional economic crime, where the risk of getting caught may be smaller or at least the consequences are more lenient.

Economic crime in its various shapes is the focus of international customs policy, both within the EU and the World Customs Organization WCO. As regards commercial and industrial life, the goal is that all customs administrations be increasingly operating like a network, thus ensuring equal and competitive conditions as efficient as possible for those companies which comply with the laws and provisions. Parallel with this, operators guilty of malpractices shall be excluded from the market and brought to justice.

It constitutes a special problem for Finnish companies that customs fraud and tax fraud cases still occur every day within the trade between the EU and Russia. In the course of the past few years, almost one half of the total value of Finnish exportation to Russia has vanished by the time of arrival in Russia. Part of this may be put down to reasons related to origin or statistical mechanics, but about one third is still unspecified or amounted, during the most recent years, to two billion euro per annum. This figure may be used to estimate the extent of customs fraud and tax fraud on which about one fourth ought to have been collected in taxes and duties.

Since malpractices of this type also appear in other fields of import, the problem is most serious both from the viewpoint of the State of Russia and for those legally operating companies which carry on trade with Russia. Also the EU Member States suffer from the consequences of double invoicing. In particular South European countries have brought up this matter, and the phenomenon is not unknown to Finnish import either. There have even been efforts to reimport in the internal market electronics that had previously been smuggled from the EU territory on forged documents.

Furthermore, it has become evident within a couple of past years that international crime is also striving to get established within the logistics business operating in Finland. In Finland, tens of new companies have been founded which are maintaining e.g. customs warehouses in East and South Finland. There is evidence that not all of these companies are familiar with the customs procedures or do not comply with those. More and more often, customs fraud and tax fraud incurring in the trade with Russia have been both prepared and committed on the Finnish soil. If goods which were declared on the documents to be destined for Russia actually stay in the Community territory, a case of tax fraud is involved.

The valid legislation does not enable an efficient interference in the crime which exploits the structures of foreign trade, because illicit action assumes differing forms and modes within the international chain of trade. The tools applied to combat economic crime are mostly national and intended for a set-up where the act is committed and the repercussions are felt within the same state. This approach, however, has definitely become inadequate since almost all the more serious economic crime is getting organized on an international basis.

Together with the other law enforcement authorities, the Finnish National Board of Customs has repeatedly called attention to this disadvantage and proposed that a law providing for a so-called customs clearance offence be enacted urgently. It would complement the selection of the tools for combating international economic crime and enable a more efficient prevention of illicitly operating companies having foreign backgrounds from getting established in Finland.

The actual problem is that in cases where the repercussions of falsely declared data are felt outside Finland but the forged documents were drafted in this country, Finnish Customs can handle the matter as a mere offence, which only leads to a fine even in the worst case. On top of it all, such a procedure is possible only when the false documents were presented to Finnish Customs. If forged documents issued in Finland were to be given to an authority of a foreign country only, not even a fine can be sentenced. Accordingly, the criminalization of the issuance and submission of false declarations has to be sharpened with a view to enabling the use of more efficient anti-fraud tools and the threshold to engaging in falsifications raised.

It is the responsibility of the authorities to protect Society against economic crime. In the case of malpractices embedded in foreign trade, the responsible authority is Customs. Yet Customs definitely needs to cooperate with the police authorities and often also with the system of prosecution. The contribution of respective foreign parties, too, has to be solicited. Regarding this, the work is only starting towards developing legislation and practical operating models.

It is of vital importance that these aspirations of the authorities be also supported by the commercial and industrial life and its organizations. Individual companies, too, have to recognize their responsibility. Accordingly, also those Finnish companies carrying on trade across the East border of Finland shall strive to ensure that every link of their logistics chains comply with the provisions. On the other hand, it has been claimed that such a demand would lead to losing sales to those competitors whose morals are more flexible.

That might well have happened in certain cases, but as a main rule, the safeguarding of the correctness of the logistics chain has not led to detrimental consequences. In future all efforts shall be targeted at promoting the swiftness and safety of the deliveries made by complying companies. At the same time, illicit trade will get stopped

on a wider scale than before. Both of the lines of action will thus be supporting each other.

As the controls at the Finnish-Russian border are becoming stricter than elsewhere, it has also been suggested that the competitiveness of the transport route via Finland would fail. The facts, however, do not sustain this claim either. The intensity of customs controls gets determined according to the risks, which means slower traffic on the routes involving the most irregularities. Supposing, of course, that the authorities themselves are not involved in the illicit action.

The cooperation between the Finnish and Russian customs administrations has been efficient regarding both anti-fraud action and the facilitation of trade. Despite this, traffic congestions have increased and crime is common. Efforts have been made on a wide front to remove those problems. It is important that each party shoulder its due responsibility. As promised, Russian government must urgently rearrange the operation of their various authorities at the border. The improvement of traffic routes is a joint project, which in fact is progressing satisfactorily. The electrification of customs clearances, which was started during the EU Presidency of Finland, is proceeding under a cooperation project between the Russian Customs and the EU Commission and is due to get completed towards the end of 2008.

The aggregate of all these subprojects will not be moving without a vigorous input by the political leadership of Finland and an active contribution by the authorities in the directions of both the EU and Russia. It is likely that within two or three years, the trade will be running smoother and the irregularities will be fewer than today. That will also enable the Finnish economy to benefit from its excellent geographic situation next door to the Russian market.

Tapani Erling

Director-General

The Finnish National Board of Customs

Finland

Need for a Baltic Sea Region strategy from the viewpoint of Southwest Finland

By Risto Ervelä - Hannu Elo

The European Parliament has adopted a Conclusion for a Baltic Sea Strategy

The European Parliament adopted in November 2006 a conclusion of an EU strategy for the Baltic Sea region. The Parliament stated as a starting point that cooperation strengthening economic growth in the Baltic Sea region could be promoted. The Parliament emphasized that the Baltic Sea region is an important gateway between East and West and since 2004 the Baltic Sea is almost an inner sea of the EU.

In the conclusion there is a wish to deepen integration in the Baltic Sea region, which is seen as a dynamic part of European economy and politics. The potentials of the economies of the Baltic Sea region are to be utilized to the full extent, because the region is one of the most competitive regions of the world. The European Parliament wants to prevent the deterioration of the Baltic Sea and its environment by diminishing emissions of harmful substances and risks of accidents.

Preparation of a Baltic Sea Strategy

In December 2007 the European Council invited the European Commission to prepare a Baltic Sea strategy for the European Union. This was defined as follows: "Without prejudice to the integrated maritime policy, the European Council invites the Commission to present an EU strategy for the Baltic Sea region at the latest by June 2009. This strategy should inter alia help to address the urgent environmental challenges related to the Baltic Sea. The Northern Dimension framework provides the basis for the external aspects of cooperation in the Baltic Sea region."

The preparation work has been started. The Baltic Sea strategy is considered to be part of EU's internal policy, i.e. it will be prepared only with member states while the policy of Northern dimension is part of EU's external policy and is focused on the relationship between the EU and Russia. A working group of the Commission is collecting ideas from the DG:s and member states are sending lists of their objectives. In Finland the preparation of the strategy has been divided between the foreign ministry and Prime Minister's Office. A paper of the Commission is expected in the beginning of June. There will be a stakeholders' meeting in Stockholm in September-October with the purpose to hear opinions from different quarters.

A strategy for the Baltic Sea region has been outlined lately by public officers who have divided it into four parts:

1. Prevention of environmental threats, e.g. maritime protection and maritime safety
2. The Baltic Sea region as an economic zone seeking for growth and competitiveness
3. Safety and security, especially the fight against organised crime
4. Enhancing the brand of the Baltic Sea region and accessibility, inter alia transport networks

The focus is now on environmental questions. The preparation process is lead by Sweden, who is looking for a clear focus and priorities. The programme of the Finnish government, which was made a little more than a year ago, contains also outlines for the Baltic Sea policy, like a study of cooperation structures, environmental safety, economic cooperation and a programme for maritime safety.

Comments on Proposals from the Viewpoint of Southwest Finland

In its conclusion the European Parliament told that the EU supports the working of the Council of the Baltic Sea States, CBSS, and proposed an annual Baltic Sea summit before the summer meeting of the European Council. On the other hand there is also criticism, according to which the CBSS has lost its role and the cooperation between the Nordic countries and the Baltic countries is now more important. The opinions of the Baltic Sea regions and cities should in any case be transmitted via their most important cooperation organisations, such as the Baltic Sea Commission of the CPMR, BSSSC and UBC, to the cooperation forum of the Baltic Sea states to be furthered to the European Commission.

The European Parliament stated in its conclusion that part of the actions of the Baltic Sea strategy requires cooperation with Russia. The general big solutions concerning transports, energy and protection of the Baltic Sea cannot be made without Russia being involved and committed to common solutions. A much better coordination than now is required to avoid an oil catastrophe and to prevent its influences. As an example we can mention double hull structures and couplers that make oil boom equipments fit together.

Concerning accessibility and transports it is, from the viewpoint of a region, important to maintain and further develop accumulated specialization and to avoid congestion caused by too centralized solutions. In the Baltic Sea region we ought to seek for a balanced, polycentric regional model, where the transports are divided and are running smoothly and there is free capacity, which can easily be utilized. For example, our region Southwest Finland is able to offer competitive alternatives in port and flight traffic and also in supply of land and services connected with them.

New financial opportunities are essential from the viewpoint of a region to get necessary resources for the implementation of the Baltic Sea strategy. For example, the proposed diminishing of the eutrophication of the Baltic Sea concerns the whole Baltic Sea area, and so does the network of valuable coastal and maritime zones. Financing from agricultural and structural funds of the EU is also needed for them. From the viewpoint of our region it is also important to utilize the present specialized research capacity like the Archipelago Research Institute and regional financiers like foundations and funds. Utilizing funds we can get development results that we shall be committed with.

In its conclusion the European Parliament states that the Baltic Sea joins the region together and tries to find smooth border-crossings "on the borderless Baltic Sea". Motorways of the seas are welcomed. On the other hand it is stated that because of growing sea traffic the maritime safety is an urgent concern. That is why the Vessel Traffic Management and Information System, VTMIS, should be widened to the whole Baltic Sea area. The TEN network connected with the Nordic Triangle should also be widened to the whole Baltic Sea area. From the viewpoint of our region these opinions and proposed actions are to be welcomed. The motorway of the sea ought to be implemented in the way that also the ports of Southwest Finland, the ports of Turku and Naantali being the biggest of them, would be involved.

As a conclusion we can state that the region Southwest Finland welcomes the Baltic Sea strategy of the EU as a new opening of EU policy. It is important to take the own objectives of the Baltic Sea region into consideration. The Baltic Sea region represents a dynamic economic region of 80 million people. At the same time it is utmost vulnerable. This fact must be taken into consideration, especially as the Russians are increasing their oil harbour activities and tonnage on the Baltic Sea. There is a need to get the shipping companies on the Baltic Sea to make inputs to safety operations and technical structural solutions by common development actions. The control over our common Baltic Sea should be brought under the International Maritime Organisation IMO. We may not just hope for the best and wait for the worst in this matter.

To make the Baltic Sea strategy feasible, it is essential that all operational levels, also the regions and cities of the Baltic Sea region, will be heard under the preparation process all the way. The Regional Council of Southwest Finland and the City of Turku will arrange on 14 October at the European Parliament a seminar of Baltic Sea strategy and invite representatives from the EU, Baltic Sea states, regions and cities. The foreign ministers of Finland and Sweden have been invited as keynote speakers.

Risto Ervelä

Chairman of the Assembly

The Regional Council of Southwest Finland

Finland

Hannu Elo

Head of the International Affairs

The Regional Council of Southwest Finland

Finland

Innorail - facilitating the renaissance of railways in Northern Europe

By Aimo Ahti

Innorail is an important cooperation and development forum for international players in the railway business and related services. The main focus of its activities is on Asia and Europe and on promoting the railway transport in trade between Russia and Europe. Kouvola is a rapidly developing research, education and services centre for international rail-way business operations. The Innorail Business Park is Finland's biggest railway services centre.

Baltic Sea Region – a Focal Point of Trade and Traffic

The Baltic Sea region is an important economic area in Northern Europe with distinct features. Since the Hanseatic era the Baltic Sea has always been a major transport channel for surrounding areas and an important link in building commercial, economic and cultural ties. The economies of the Baltic Sea region have been among the fastest growing in Europe, mainly driven by rapid development of Russia.

The railway station of Kouvola was established at the intersection of Helsinki - St. Petersburg and Savo-railways in 1875. Kouvola is located in South-East Finland, between the EU and Russia. The so called Kymenlaakso province has throughout the history been in close trading and economic relationship with North-West Russia and especially with cities of Vyborg and St. Petersburg.

The logistics competitiveness of the Baltic Sea region is promoted through harmonisation of administration and legislation as well as the new investments to traffic and cargo handling infrastructures. Logistics in the Baltic Sea region is clearly set to undergo a renaissance in order to support foreign trade and economic growth. The Finnish logistics sector has grown to become a versatile and significant service industry. However, local demand accounts for only half of the sector's overall volume, with an increasing share being accounted for by international trade.

The special position of Kouvola at the western end of the Trans-Siberian Railway is significant both nationally and internationally. Many kinds of goods, including raw materials, forest industry products and consumer goods, travel through Kouvola, from which they are trans-ported to different locations via specific distribution channels.

Railways – Linking East and West

From the beginning of 2009 Kouvola and the municipalities surrounding it will form an urban network of almost 90,000 inhabitants. Kouvola's position as a railway hub linking East and West creates an excellent foundation for developing the region as a centre for traffic and trade, entrepreneurship, living and recreation.

The basis for the programme is set by the growing trade between Asia and Europe and Russia and Europe and consequent potential for rail-way transports. Recent developments in Russia create new opportunities for developing Kouvola as a railway services centre. The main trends supporting this development are:

- Increasing consumption and manufacture of products in Russia, also outside Moscow and St Petersburg
- Development of regional storage and distribution centres throughout the whole country
- Increasing congestion in the Moscow and St Petersburg areas and a rapid rise in cost levels
- Increasing problems in road traffic between Europe and Russia with longer transport distances and more border crossings
- Improvement of unit freight traffic infrastructure and service structures in Russia

These trends create the conditions for developing container and trailer train transport between Kouvola and the Russian metropolises. With concern about climate change, the railways are also receiving increasing attention as a genuinely environment-friendly mode of transport.

The rail transport market is opening up stage by stage both in the EU Member States and in Russia. In the EU, freight transport has been open to competition from the beginning of 2007. In Europe there are al-ready numerous new railway operators both in passenger and in freight traffic operating either regionally or over the whole continent. The growing demand and for rail transport and is also reflected in the development of new international railway services between Russia and Europe.

Innorail – Unique Private-Public Development Cluster in Railway Sector

Due to its central location and railway expertise, Kouvola is now a substantial railway city with excellent connections and the largest railway yard in Finland, where millions of tons of cargo are handled every year.

According to the vision of Innorail programme the City of Kouvola is the leading railway business and know-how centre in the border area of EU and Russia. We wish to establish Kouvola Innorail the leading international railway business co-operation forum in Northern Europe, by

- Operating as co-operation forum for companies and developing co-operation networks,
- carrying out and resource private-public development projects,
- developing railway cluster and offering business services and
- providing new information with partnership companies and institutes for business purposes and enabling its adoption to business sector.

The companies operating in Innorail Business Park have established a successful railway cluster and a business network linking Asian, Russian and European markets. The business activities are supported with research and education. The Kasarminmäki campus area in Kouvola is an internationally-acknowledged innovation, research and education centre that brings together different cultures and research communities. Growth of the market share will require more efficient research on rail-ways and a sharper focus on the training of railway personnel. The in-crease in rail traffic, new operators entering the field and tighter technical and maintenance requirements will make it necessary to create and develop railway technology services.

The core of the Kouvola Railway Cluster's operations is formed by the international, multi-cultural Innorail Business Park. The freight terminals served by railway lines and suited for handling general unit freight are owned at present mainly by private investors and the service providers.

The combined area of the rail terminals is currently about 90,000 sq.m In addition there are more than 60,000

sq.m of terminals dedicated to serve road traffic. The newest of these is the recently inaugurated ultra-modern food and freight terminal, with an area of more than 10,000 sq. m. All in all, the area has more than 150,000 sq.m. of modern, Class-A storage and terminal space to offer. In addition Kouvola has a combined container yard area of about 20 hectares. There are over 100 hectares available land areas for new investments.

There are both local and international forwarding agencies operating in Kouvola, as well as warehouse and terminal operators. Together with their subcontractor network, these companies offer all services relating to rail and road, cargo handling and also services requiring sophisticated logistics. Labour force availability is extremely good, and the area also has an efficient system for vocational education that has been tested and proven in practice.

Under business park services there exist an implementation concept regarding new kind of trade and industry service company. The company will support and facilitate the networking of trade and industrial enterprises with Russia, and likewise the establishment of Russian enter-prises on the Finnish market via Innorail Business Park.

Aimo Ahti

Mayor

City of Kouvola

Finland

Saint-Petersburg State University performance in the Baltic Sea Region

By Nikolai M. Kropachev

From the very moment of foundation in 1724 the Saint Petersburg State University (SPSU) – by virtue of its geopolitics – was bound to vigorous activity throughout the Baltic Sea Region.

Over the early years the University had vast cooperation with academic and educational institutions in Baltic States. Foreign scholars and scientists came to Saint Petersburg, assisting by initialization of the Academy, the University and the Grammar School (the Gymnasia). In turn Russian punditry left abroad from the city to get hand in, uppermost to Dorpat (now Tartu) and to some universities located over present-day German territory.

This way stable tradition of academic and scientific cooperation between the SPSU and Baltic educational institutions had arisen.

The cooperation was of great concern in the nineties, when not only the SPSU but the whole country acclimatized to the new realities of life. That time during an administrative reform in the University we used, in particular, experience accumulated and kindly provided by our Swedish academic colleagues.

XXI century and its realities and challenges have brought certain corrections into academic life of the universities worldwide. Today Bologna Process and global trend to internationalization of higher education push us to new strategy making in the Baltic Sea Region. New goals and objectives are forming, and a comprehension is coming that the only right answer to all the challenges in fast-moving changing world is regional integration, especially in the area of higher education.

This statement has a great importance particularly for the Baltic Region with its pronounced geographic, social and cultural diversity, various political and economical cultures.

Today the SPSU realizes its role and special liability in a common cause of formation the Northern Dimension united academic and scientific area. And we possess a great deal of methods and means to achieve this vital goal.

First of all, for efforts consolidation together with abroad colleagues we look forward to use existing bodies in the region. Being active participant of two main profiled organizations in the region, the Baltic Sea Region University Network (BSRUN) and the Conference of Baltic University Rectors (CBUR), we rush to make heavy contribution to the organizations' main goal achievement. Namely, it is enhancing the integration of knowledge-based resources in Northern Dimension according to Bologna principles. As an illustration of its bottom line one could recall the seminar for front-office staff "Bologna Process: implementation, quality assurance and accreditation" carried out at the SPSU in 2006.

Another strategy-forming factor over the Baltic is realization by regional elites that it is nowadays extremely urgent to relay not only on political institutions and business, but on intellectual resources of regional academic community too by creating a new approach to regional problems and challenges tackling.

This thesis is high on CBUR Agenda, and recently the participants of this organization have shaped a course to efforts coordination towards guaranteeing real impact of academic institutions on regional processes.

We see this course in the light of "Sustainable Development" concept which was recently brought forward by the Europe Rectors Conference: while keeping researching and educational functions, universities must be not only "source of manpower" today, but appear on questions of principle as consultants to Government and Business. There are some key topics – e.g. cross-cultural communication, environmental management, ecology, business etc., which are being investigated and worked out most seriously and effectively by universities' academic community. And the outcome – the knowledge-based product, produced by universities – must be used to the benefit of region.

Nowadays we feel the need of active universities' engagement and connection to problem-solving process stronger than ever. And it's worth saying that the SPSU as a classical university has substational potential for successful realization of the task.

Certainly, we should first of all speak about forming-up educational process in accordance with contemporary needs and objectives. In this regard we consider two aspects as to being most essential – gaining innovative character and internationalizing University's educational programs.

Here we rest upon wealth of experience in bilateral and multilateral cooperation with Northern Dimension states and their educational establishments. Up to date the SPSU maintains and conducts partnership relations with leading universities and research institutions in Estonia, Finland, Germany, Denmark, Latvia, Lithuania, Poland, Sweden.

Cooperation within the frame of international agreements between the SPSU and universities of these states has an overwhelming character: from students/staff exchange to joint research activities, educational projects and beyond.

One may speak for a length of time on the SPSU regional academic cooperation, but it is most likely to highlight here two projects, that easily respond the criteria mentioned above.

The Baltic University Program (BUP) is a joint educational project of many universities throughout the Baltic Sea region. It is aimed at development, formation and realization of innovative courses of study and focuses on topics attached common problems in the Baltic Sea Region. In particular within the framework of this project some actual courses are developed: "Baltic Sea Environment", "Peoples of the Baltic", "Sustainable Baltic Region".

"The Baltic University" exists as a program at the Division of International Baltic and Arctic Projects (DIBAP) that was established in May 1994 on the basis of the Faculty of Geography and Geo-ecology of the SPSU. Noteworthy, "The Baltic University" was among the first to implement telecommunication and satellite-based technologies in academic activity, and thus became pioneer in distance learning.

Second project – the Finnish-Russian Cross-Border University (CBU) – is even more innovative and large-scaled. There are 9 universities (4 Russian, 5 Finnish) participating in this project jointly developing and implementing 6 different Master's Degree programmes. The SPSU collaborates with 4 of 6 courses: Business and Administration, Information and communication technologies, International Relations and Public Health. CBU embodies all imaginable educational innovations: Internet based learning, jointly supervised projects, instruction in foreign languages, summer/winter schools, and double degree – as main goal of the project to reach.

CBU has been changed from pilot program into active project in 2007 and continues to progress. Particularly, last project's panel session (Council's meeting) held in 2008

came to a decision to introduce joint Doctorate programs starting from 2009.

Besides, the SPSU collaborates with Baltic neighbors not only in the field of academic and scientific activity. Together with partner universities of Northern Dimension we take part in such European projects like TEMPUS, Erasmus Mundus ECW, Norlet and some others. The SPSU also participates in the Neighborhood program INTEREG III "Baltic Sea Region Program 2007-2013" financed under European Neighbourhood and Partnership Instrument, ENPI.

Moreover, we are already experienced in direct cooperation with governmental institutions of some Baltic Region states. Such cooperation exists, for instance, within the frames of bilateral agreements between the SPSU and Estonian Ministry of Education, the SPSU and Kouvola City Administration (Finland).

It is much and much more to say about the SPSU activity in the Baltic Sea Region – not for nothing the region has priority importance for us. But, marking off would like to conclude.

In November 2006 Russian President V. Putin and his colleagues from Helsinki, Oslo, Reykjavik and Brussels during the Lahti Summit in Finland signed a framework agreement, converting the Northern Dimension from EU policy into common policy for Russia, EU, Norway and Iceland. Thus, innovative character in all areas of international relations in the region was affirmed on a top-level. And the Baltic Sea Region's aim is now to become the most competitive one in the world.

Succeeding that goal in April 2007 the SPSU claimed a proposal to form a united and integrated educational area within the frames of The Baltic Sea Action Plan. This proposal has gained approval by the Helsinki Commission, and nowadays the SPSU is ready to become a ground for working coordination of scholars, scientists, businessmen and local authorities on the Baltic Region issues. We take a strong stand on pursuing this red line of integration in the Baltic Region and we are on firm ground herein.

Nikolai M. Kropachev

Acting Rector, Professor

Saint-Petersburg State University

Russia

Baltic region strategy for the technical consulting business?

By Olli Manner

Technical consulting business in Finland

Finnish consulting and engineering companies employ approximately 20.000 people in Finland and over 14.000 of them work in member companies of the Finish Association of Consulting Firms (SKOL). More than half of them are employed in the industrial sector. Most of the investments in Finland are designed by these professionals. Domestically owned companies have, in addition, nearly half of that amount of people employed in their foreign offices, mainly outside Europe, engaged in investments abroad.

During recent years, business in Finland has been characterized by good growth and healthy order books. Global economic problems and threats have, at least until today. not had a negative influence. Investments inside Finland have grown by 30% since 2003. This has provided new work opportunities but has also resulted in workforce shortages in some areas. The export part of the business has developed well; the turnover generated from exports has grown over 50% during the same period. In general, however, the Finnish consulting business depends heavily on the success of the Finnish export industry. Smaller consulting companies hardly have any export activities of their own and the larger ones have only a small part of their activities outside the Finnish borders. This part is, however, growing and direct exports currently account for 16% of the total invoicing of SKOL member companies.

Elomatic is a leading Scandinavian consulting and engineering company. More than 600 Elomatic engineering professionals work in four business units: Life Science, Marine, Paper & Mechanical, and design solutions Cadmatic. Elomatic has six offices in Finland, an office in Sweden, in Russia and in China as well as joint ventures Elomatic-Pharmalab in India and Cadmartech in Poland. Elomatic supplies a complete and comprehensive range of plant, ship and machine design, engineering and project management services, from R&D and feasibility studies to CAD/CAM and maintenance solutions. The turnover of Elomatic reached 44 M€ in 2007 and the estimate for 2008 is approximately 47 M€.

Finnish engineering is highly appreciated abroad

The Finnish technology industry has played a key role in creating our national well-being. Behind the impressive export figures lies a long tradition in providing excellent learning opportunities for everybody. The success of the Finnish export industry is very much based on the great innovations of Finnish engineers. This success story has, however, not led to increased employment in Finland for several years. This is due to increased productivity and the fact that investments for additional capacity are done abroad: closer to the clients and in countries with lower labour costs. An Indian and a Chinese engineer works for more than half a year with the same salary that a Finnish engineer earns in a month. This is not, however, the real cost difference. Productivity is higher in Finland and the overheads are lower. In addition, Indian and Chinese cost levels are increasing much faster than in Finland. Finnish designers can survive by keeping their knowledge up to date and their working moral at a high level.

Business Strategy – Case Elomatic

Elomatic has selected to be a diversified consulting and engineering company. Being active within several industries ensures more stable growth and fewer fluctuations in capacity needs and profitability. Services are offered on a full-service principle and with the objective of providing services for all lifecycle stages of plants, ships or products. In addition to engineering and consulting services, Elomatic also markets the results of internal design method and tool development. Emphasis is placed on the employees' high level of knowledge. This is ahcieved by hiring well educated personnel and through continuous internal and external training. More than 70% of Elomatic employees have a MSc. or BSc. level of education.

At Elomatic we have always believed that engineering services can be an export product. In the long run, professional services may actually be the only type of export product we have. Transferring goods is becoming more and more expensive and also environmentally unsustainable. ICT developments have made it extremely easy and fast to exercise design and engineering globally and in a distributed environment. Most information forms have no borders and can be transferred rapidly. _The world is open and full of opportunities for a knowledge-intensive company.

In reality, there are restrictions for conquering the world. These include restrictions such as financial resources, lack of strategy, competition, lack of special knowhow, etc. A part of the services must also be localised i.e. companies need offices close to their customers. There is a need to be familiar with the local circumstances, rules and regulations, cultural aspects, etc. Without a network of local offices it is difficult to succeed.

On average, one third of the turnover of Elomatic has been generated from direct export. The strategy for export was, and still partly is, to scan the market and act where there are suitable projects. Typical examples are biotechnology projects in Malaysia, a pharmaceutical project in Bangladesh, food processing technology in China, concept design of ships in Japan …

This strategy is, however, no longer enough even though it is still working. Another type of internationalisation is needed. Local presence must be developed. Some companies have selected the so-called Baltic Strategy for themselves. Many of these are companies which have end-users as their customers. As it should be, the desired customer actually defines the strategy. Elomatic must also look carefully at what our most important customers are doing. For a multi-branch consulting and engineering company, it is too challenging to choose for example between a Baltic and a Global strategy. Some of our customers have Baltic, some European and some very global strategies.

The steps that Elomatic has selected and taken are based mainly on the following key points:

- Medicon Valley in Copenhagen – Malmö region is a leading biotechnology area
- Russia is the closest really big market and has potential for Elomatic at least in the food, pharmaceutical and shipbuilding industries
- China is the main market for the pulp and paper industry, many of Elomatic's main customers focus their activities in China
- India is experiencing huge growth in the bio and pharmaceutical sector
- Poland has a good resource of professional ship designers and has one of the highest potentials for other Elomatic businesses

These steps have been realised through acquisitions or by setting up companies from scratch.

Conclusions

Elomatic was one of the first Finnish consulting companies to work actively abroad. Even tough we have had a tradition of direct export business for decades, we are still in the very early stages of our internationalization. To be part of the inevitable globalization of our clients, we must be present in the markets that they see as the most important.

Geography, in the traditional sense, has lost its importance, at least to knowledge-based organisations such as Elomatic. Strategic decisions are not based on what market is closer to our existing markets but, for example, on studies about the strategies of our clients, on the availability of resources and knowhow in specific market areas.

However promising any market looks, success will not follow automatically. We must develop our technology, increase our investments in developing the skills needed in the international consulting business, continue innovating new engineering methods and improve our capabilities of working efficiently in a truly networked environment. Elomatic is in solid financial shape and has the desire to continue its international growth. We have already completed projects and/or installed our software in over 70 United Nations member states. We will strengthen our position step by step in some of them in order to make Elomatic a reliable and preferred engineering partner in the Baltic region and elsewhere for our clients in the future too.

Olli Manner

President, CEO

Elomatic

Finland

Baltic Sea neighbors - time to engage with Belarus

By Torbjörn Becker

The Baltic Sea region, like any region or country, is affected by what is going on in its immediate neighborhood as well as globally. Right now, one of the neighbors, Belarus, is facing challenges that have important implications for the Baltic Sea region. This stems from Belarus' past reliance on cheap energy from Russia in the form of both gas and oil. The terms of this cheap energy has recently been re-negotiated and is putting pressure on Belarus' current account.

Although high energy prices in Belarus in itself may not be bad from a Baltic Sea perspective—since it may lead to more efficient use of energy and less pollution on our borders—it is associated with other issues that may be less appealing. For example, Russia's convoluted dealings with the transit countries for energy is one of the key reasons for the current exploration of the North Stream pipeline, which obviously has a very direct bearing on the Baltic Sea and the surrounding countries. Belarus may also develop alternatives to Russian energy, for example nuclear power, that is not necessarily attractive to all its neighbors, including the ones around the Baltic Sea. Finally, this will affect the lives of people in Belarus that we care about.

The macroeconomic impact of the oil and gas price shocks has been discussed in detail in a SITE report on Belarus that was issued in the fall of 2007. Although actual developments since then have made some of the numbers presented in the report outdated, the main thrust of the report and associated forecasts of likely versus desirable policy responses are still valid. Basically the increases in gas prices charged by Russia in combination with changed arrangement governing the trade of oil and refined product were projected to lead to a substantial current account deficit for Belarus in the order of 5 percent of GDP in 2007 and then increasing over time if imported quantities do not change.

The deterioration in the current account did not turn out to be quite as sharp as predicted since the gas prices were not increased as much as initially agreed and favorable external conditions for some key exports dampened the effect of the energy shock on the trade balance. Nevertheless, the current account widened by 2.5 percentage points of GDP compared to 2006 to 6.6 percent of GDP in 2007. Growth slowed somewhat from 9.9 percent in 2006 but still remained high at 8.2 percent in 2007. However, both CPI and PPI inflation doubled in 2007 to 12 and 17 percent respectively which puts in doubt how sustainable the recent growth is.

With a fixed exchange rate and very limited international reserves at the beginning of 2007 it was obvious that Belarus needed to find large amounts of foreign funding to deal with the gas and oil shock and associated impact on the current account. The prediction then was that this would predominantly come from borrowing from Russia and selling of some assets in not so transparent deals. This has certainly been a quite accurate prediction and external debt to GDP increased by an alarming 10 percentage points in one year, albeit from a low level. There are signs that Belarus would like to diversify its funding sources and this could provide an opportunity for the West to engage with a Belarus that is now clearly more eager to open up to foreign investors and potentially also to countries in the West.

Attracting foreign funding is clearly important when dealing with an external shock of this magnitude. However, this is only a way of smoothing out the impact of the shock and not a substitute for real reforms since this is a permanent shock; energy prices will continue to increase and stay high. The short-run policy of borrowing and selling off assets must be accompanied by policies that aim at raising production and efficiency, particularly energy efficiency, to sustain economic growth over the longer-term. The list of reform areas are long in a country that ranks very poorly in comparison with other transition countries in the EBRD's score card on reforms; in terms of the cost of doing business as detailed by the World Bank; and in terms of corruption and democracy as is the case in the indices produced by Transparency International and the Polity IV project.

The future success of the Belarus economy will be greater if the government creates a more business and investor friendly environment. This may sound trivial but will require serious reforms of the legal system, dealing with corruption, creating a more predictable tax system and reducing the influence of government in all aspects of business. Most likely this will also require that the political system moves in a more democratic direction sooner rather than later.

If these reforms are not undertaken while the country remains eager to attract foreign investment, it could easily end up attracting the "wrong" investors from the point of view of regular Belarusians. Basically, the less attractive the country is for investors, the more special deals, protected markets and non-transparency will be part of selling-out Belarusian assets. This will not be the best way to attract companies that will improve competition in the domestic market and modernize the economy to the mutual benefit of investors, consumers and future generations of Belarusians.

That said there is of course great potential for investors in a country that has seen very low levels of foreign direct investment in the past while enjoying high growth rates, has a relatively well educated labor force and is in need of modernizing the economy. With growing income level, Belarusian consumer will also demand more of the goods and services that are produced by international and multilateral companies which makes it a potentially interesting market to enter.

These opportunities have to be weighed against macroeconomic, legal and political risks. Although Belarus has managed to attract foreign loans and has enjoyed favorable market conditions for some of its key exports, the country will continue to face pressure on the current account if the gas and oil bill continues to increase as predicted. Inflation is also picking up (like in other parts of the world) and this will pose additional challenges as the government tries to keep up growth rates while containing prices. The issue of taxes, property rights and political risks associated with the most autocratic regime on the borders of the Baltic Sea region are also things to consider for investors. Furthermore, the limits on human rights and democracy require well-intended investors to take ethical issues very seriously. Any company or donor should consider to what extent their investment or business in the country influences the move towards a more democratic and open society.

The countries in the Baltic Sea region will greatly benefit from a stable and prosperous Belarus on its borders and should think long and hard about what can be done to help the people in Belarus to move their country in this direction. In a world going global, the Baltic region will need to define itself on the global stage. Being engaged in its immediate neighbors is a first step.

Torbjörn Becker

Director

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Sweden

Is the heyday of the transit traffic via Finnish ports to Russia over?

By Matti Aura

The transit traffic via Finnish ports to Russia is constantly under debate. There is always one Doubting Thomas who predicts that the transit traffic will soon end and that no investments against it should be made. However, the transit traffic has persistently grown with success.

The official political stand in Russia is that all the Russian sea transports should be handled through Russian ports. Russia is no different from the other countries in this respect. It is common to aspire to the development of ports located in one's own country and to wish that the traffic would run through those ports as much as possible.

Nevertheless, the flow of goods tends to find a route which has the best price-quality ratio. The big ports of Germany, e.g. Bremerhaven and Hamburg, would certainly prefer handling all the German sea transports but the Port of Rotterdam in Holland and the Port of Antwerp in Belgium have always been significant for the German traffic as well. The same applies also to Gothenburg; that port has been an important gateway to the traffic to Norway.

The economic growth in Russia is remarkably rapid and the high oil price quickly increases revenues in Russia. In year 2007 the Russian import grew by 30 %. Such a rapid increase in import means that goods are flowing into Russia through all potential routes. Also the Finnish ports benefit from this.

The asset of the Finnish ports is their proximity; the Ports of Kotka and Hamina are not located much further from St. Petersburg than the new Port of Ust-Luga. In addition, the reliability and proficiency of the route raise its value. The Finnish ports function accurately and the proficiency in logistics is of high level in Finland.

However, the problem with the Finnish route is the periodically extremely congested traffic at the Vaalimaa border crossing between Finland and Russia. At worst, the truck lines have reached lengths of even 50 kilometres. The lines have been heavily criticized by the local residents because the trucks waiting in lines hinder the travelling of the locals and reduce the level of road safety. The congestions at the border crossing have caused delayed transports for exporters. In spite of the periodic lines, one should bear in mind that the Finnish-Russian border is evidently the most functional border between Russia and the Western Europe.

The best way to solve the problems of border crossing would naturally be that Russia would appoint an adequate number of officials to its borders to facilitate flexible border crossing. The problems of border crossing have regularly been under discussion at meetings held between influential Finnish and Russian authorities at all levels, even up to the presidents of both countries. Any significant improvements to border crossing have not occurred.

Because of this Finland is going to build a parking area for the trucks close to the frontier crossing point in Vaalimaa this year. The vehicle park will accommodate 30 kilometres' worth of queueing trucks, which means that the truck lines can be removed from the roads to the parking areas. This will vitally improve road safety; and it will also be more pleasant for the truck drivers to wait for border crossing in these parking areas than on the side of the road. However, this does not solve the problems of slow border crossing; that is something only the Russians can unravel.

Matti Aura

Managing Director

Finnish Port Association

Finland

The 'Baltic Main Street' highway proposal

By Alfred Hecht

In 2006, I first raised the concept of a highway around the greater Baltic Sea which would be called the Baltic Main Street highway[7] and would be more then 4000 km long (Figure 1). The basic idea is that such a highway would, wherever possible, hug the Baltic Sea and pass though the different countries that border on it. Driving it would be a great challenge for adventurous tourists. Having an adventurous and challenging road to drive is not a new idea, as many famous roads, routes, path, and highways[8], and even famous trains[9] , exit in the world today. But such a highway would help to integrate the development strategy for the Baltic proposed by Ojārs Kalniņš[10]. Even though the greater Baltic region has a number of organizations that could foster and promote such a road designation, the Council of the Baltic Sea States (CBSS)[11] is probably one that already has the umbrella structure to do so. The support of the various tourist offices and departments of the different countries however, would be crucial for this challenge.

Figure 1: Baltic Main Street highway

The concept that the Baltic Sea can be a power to unite people and commerce goes back to the Hanseatic League which, dominated most of international trading in Northern Europe from the 13th to the mid-15th century[12]. At its maximum extent the Hanseatic League power was based on some 70 cities and 130 smaller places, mainly around the southern Baltic, but reaching as far north as Estonia and Visby in Sweden and as far into the interior as present day Novgorod and 'Frankfurt an der Oder'. It also extended its power to many ports on the North Sea. Water transport, especially on the Cog[13], was clearly the major mover of goods and people around the Baltic. Today however, road transport clearly dominates in keeping commerce going over most of world. Private cars are by far also the most important mover of people. Even international tourists use the road 40% of the time to get to their destination[14].

But, from where do tourists come to the Baltic states? Sixty percent of international tourists to Lithuania in 2006 for example, (Table 1) came from countries bordering on the greater Baltic Sea. In absolute terms, the bigger countries of Germany and Poland provided the greatest number. However, in terms of the percentage of the sending countries population, the smaller and closer countries of Latvia and Lithuania were more important. They are followed by Finland, Denmark, Sweden, Germany and last, by a substantial margin, by Russia. An international tourist origin summary of nights stayed in Sweden, for 2006, also showed that the first three countries by origin of tourists were the neighbouring countries of Norway, Germany, Denmark, and in 6th place Finland[15]. Hence, connecting all neighbouring Baltic bordering countries by a famous road should improve tourism substantially for all countries.

The Baltic Main Street highway map above proposes that the highway go through eight countries with a side road through Russia's Kaliningrad Oblast. All, except the later, are members of the EU and hence travel visas would not be required. Because Russia requires visas, this paper proposes that the main part of the Baltic Main Street highway bypass the Kaliningrad Oblast.

To make the Baltic Main Street highway a viable tourist road, it has to have a number of attributes. One is that it be clearly recognised with proper road shields and have a major web site with national portals. Each national portal should provide the following; accommodation information along the route, good maps with all the major cities and towns listed on it, information on historic sites along the route, information on restaurants, souvenir and trinket shops, automotive services, etc. Each country should offer certificates to travelers at entry and exit points that would read; " 'Joe Blow' travelled the Baltic Main Street highway in country X".

Of what benefit would such a road be to the countries and communities it would go through? The main benefit would be increased tourism. Many famous roads and highways have performed such a function all over the world: US Route 66, the Blue Ridge Parkway, the Pan-American Highway, and the Trans-Canada Highway to mention a few North American ones. A good road promotional highway model is the one for the Dempster Highway[16] in Canada that runs some 671 km north form

[7] Hecht, Alfred, "The Kaliningrad Oblast of the Russian Federation: Its Development Prospects on the Conceptual Baltic Main Street", GeoINova, Numero 12, 2006, pp 297-323.
[8] "Famous Roads - Highways", http://www.lonympics.co.uk/new/ywxx.htm, accessed April 28, 2008.
[9] Wikipedia, "Famous Trains", http://en.wikipedia.org/wiki/Famous_trains, accessed May 6, 2008.
[10] "A Baltic Sea Strategy –acting regionally, thinking globally", by Ojārs Kalniņš, Expert Article 134, Baltic Rim Economics, 31.10.2007. http://www.mfa.gov.lv/data/CBSS%202007-2008/expert_article134_52007.pdf, accessed April 28, 2008.
[11] "The Council of the Baltic Sea States (CBSS)", http://www.cbss.st/, accessed April 29, 2008.
[12] "Die Hanse historic", http://www.hanse.org/en/the_hansa/die_hanse_historic/, accessed April 28, 2008
[13] "Hanseatic cogs, Luebeck. circa 1350", http://gordonmiller.ca/01_early_voyages/Luebeck.htm, accessed April 28, 2008.
[14] "Tourism Highlight, 2007 Edition", http://unwto.org/facts/eng/pdf/highlights/ accessed April 29, 2008.
[15] NUTEK, "Turiståret 2006. Tourism in Sweden 2006", www.nutek.se/, accessed May 6, 2008.
[16] Dempster Highway; http://www.yukoninfo.com/dempster/

Dawson City (64º 04' N) in the Yukon Territory to the community of Inuvik in the Northwest Territories (68º 16'N) near the Artic Sea and north of the Arctic circle. Tornio, Finland, the furthest northern point of the Baltic Main Street Highway, is located a little further south at 65º 50'N, just south of the Arctic Circle.

Such northern highways produce a special challenge to drive in the summer and winter in order to experience both the long day and night phenomena. Other tourists could do it by stages in different years. It certainly would help to integrated the greater Baltic countries.

Table1: Lithuanian tourists from Baltic Sea bordering countries, 2006

Year	2006	%	Country Population (1)	Country Tourist - %
Total - Non residents	756857	100.00	NA	NA
Denmark	15817	2.09	5,475,791	0.289
Estonia	32212	4.26	1,340,602	2.403
Finland	34898	4.61	5,308,208	0.657
Germany	132540	17.51	82,210,000	0.161
Latvia	56299	7.44	2,270,700	2.479
Poland	102539	13.55	38,518,241	0.266
Russia	59743	7.89	142,008,838	0.042
Sweden	23410	3.09	9,182,927	0.255
Total	457458	60.44		

Source: Lithuania, State Department of Tourism, "Lithuanian Tourism Statistics, 2006", http://www.travel.lt/ntisFiles/uploadedAttachments/LT%20statistika2008311101424.pdf

(1) country population are taken from country Wikipedia websites

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accessed May 1, 2008.

Ports as gateways and hubs of Baltic Sea Region

By Elena G. Efimova

More than 950 million tons of cargoes will handle by seaports of Baltic Sea region countries in 2008[1]. This record level will achieve appreciably due to the accelerated growth in region of the Russian ports, first of all Hamburg, Primorsk and the Big port St.-Petersburg. For last years the ports have come out on top among all countries of the region on the basic parameter of transport work: the total amount of goods turnover. It became consequence of fast expansion of Russian foreign trade on Baltic direction and steady raising the transfer loading capacities of domestic seaports in the region.

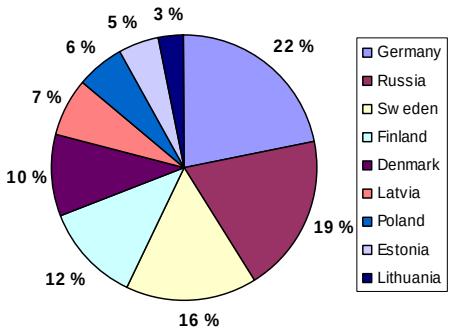
Now the Russian Federation uses Baltic Sea maritime routs to support trade and economic relations both with the Baltic region states, and other countries of the world. In the geographical aspect 8 countries of EU, main Russian trade partner, refer to Baltic basin. Over 19% of the total foreign trade volume of the Russian Federation, and 37 % with the European Union, is realized with these countries. The absolute index of Russian – Baltic Sea countries foreign trade has exceeded 105 billion dollars in 2007[2].

The largest freight traffics in/from the Russian ports pass through the Danish belts. Also Russian foreign trade traffics have brought the powerful contribution to the operations of Ost-Nordsee-canal. For last 10 years the turnover of goods of the canal was doubled and for has come nearer to 100 million tons (99.6 million tons in 2007 against 49 million tons in 1997). Since 2005 the Russian foreign trade cargoes have the highest position in canal turnover. Basically transportations have increased due to crude and refinery oil, coal and wood cargoes, metals, fertilizers, containers, i.e. those categories of cargoes due to the activities indexes St.-Petersburg and other Baltic ports of Russia were increased. Up to that the main suppliers of cargoes for Ost-Nordsee-canal were ports of Finland. Now about a quarter of all freight traffics in the direction from Baltic to Northern seas are cargos of the Russian ports origins. The most part of these cargoes follow in ports of Germany, the Netherlands, Belgium, the Great Britain, France.

Due to maritime routs with Russian port the largest European port Rotterdam attracts more than 40 million tons of cargoes a year. It puts ports of Russia on the second place among all counterparts[3]. It makes the tenth part of all annual goods turnover of the port. Hamburg port is interested in cooperation with Russia also. Since 2006 Russian ports are its main trading partner among all European ports in container transportations, conceding to ports of China and Singapore on the world container market only.

In 2007 the total commodities turnover of all seaports of Baltic Sea region was 926.4 million tones. The share of German ports was 208.9, Russian – 172.2 million tones, Swedish – 146.5, Finnish – 107.2, Danish – 97.2, Latvian – 62.4, Polish- 55.5, Estonian – 44.7, Lithuanian – 31.9. The shares of Baltic Sea countries in the total commodities turnover in 2007 are shown on the diagram 1.

Diagram 1. The shares of Baltic sea countries in the total commodities turnover in 2007



It is necessary to consider, that the volume of sea born trade of Russia in the Baltic region is not limited by cargo handling via domestic ports only. Large streams of the Russian foreign trade commodities continue to go as transit goods via ports of Latvia, Estonia, Lithuania, Finland, and also Poland (crude oil). In 2007 it has been passed 65.5 million tones Russian cargoes via ports of the Baltic States[4]. 6.3 million tones the Russian cargoes as transit goods have gone via ports of Finland[5]. Thus, all in ports of the Baltic region in 2007 it has been handled nearby 244 million tones the Russian foreign trade cargoes. It makes 31 % from all port goods turnover in the basin.

About 50 container ports with different development levels are in Baltic region. About 75% of total container turnover is concentrated in five largest ports (See Table 1). During last years this region shows the fastest growing rates of sea container transportations in Europe. Because of specificity of the Danish belts all the Baltic container ports have the feeding status and cannot accept container vessels with the capacity above 4 000 thousand TEU. Besides they slowly process cargoes. The unique port of the Baltic region accepting large vessels, port Hamburg, has the status of "gateway". Big port of St.-Petersburg, Goeteborg, Klaipeda, Riga, Helsinki, Ust'-Luga and some others want to become a regional a hub-ports[6]. It is obvious, that the basic stage of competitive struggle in this segment of sea transportations market is still ahead.

[1] It is calculated by the author on the basis: Пересыпкин В.И. Значение Большого порта Санкт-Петербург на Балтийском рынке морских перевозок//Вести морского Санкт-Петербурга. 2008. №2. с. 18, www.hafen-hamburg.de/content/view/32/33/lang,ru.

[2] www.customs.ru/ru/stats/arhiv-stats-new/popup.php?id286=364

[3] It is calculated by the author on the basis of the official information of the port Rotterdam. www.portofrotterdam.com/mmfiles/Goods%20grouped%20by%20byorigin%20and%20destination%202006_tcm26-9644.pdf

[4] Calculations of ZAO "Morcenter-TEK"

[5] Data of statistical services of Finland

[6] Hub-ports are the ports involving large parties of cargoes, distributing and delivering by small-size quantities to the port of destination by feeding vessels.

Table 1. The main container ports of the Baltic region

Ports	Container turnover, thousands TEU		
	2005	2006	2007
Hamburg (Germany)	8100	8800	9890
St.-Petersburg (incl.Primorsk) (Russia)	1119	1450	1698
Arhus (Denmark)	803	856	921
Goeteborg (Sweden)	772	811	840
Gdynia (Poland)	400	462	614
Kotka (Finland)	367	462	571
Helsinki (Finland)	460	416	431
Klaipeda (Lithuania)	214	232	321
Helsingborg (Sweden)	162	200	280
Riga (Latvia)	153	177	212
Hamina (Finland)	160	167	195
Copenhagen/Malmö (Denmark/Sweden)	155	164	192
Tallinn (Estonia)	128	152	182
Kaliningrad (Russia)	n.a.	107	181
Rauma (Finland)	120	169	174

Source: the information of official Internet-sites of the ports.

In 2007 container ports actively involve transit cargoes. 355 thousand TEU of Russian foreign trade cargoes as transit goods by total weight of 2.2 million tones have gone via four Finnish ports Kotka, Hamina, Helsinki and Hanko[7]. The rivalry of the Baltic ports for attraction of containers from a perspective and developing transcontinental railway corridor between Asia and Europe is in progress.

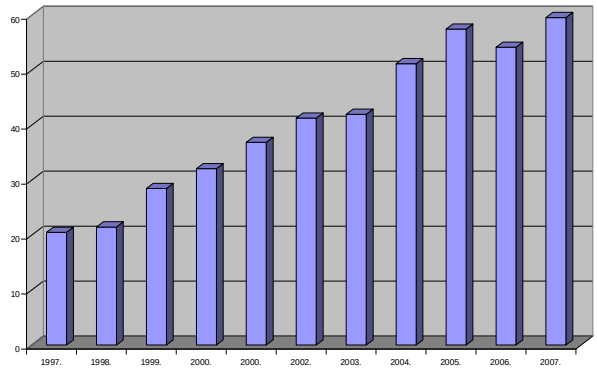
The largest port of Baltic Sea region is Hamburg. In 2007 the total volume of cargoes handling in the port was 140.4 million tones. Located on crossroads of world trade routs the port of Hamburg is the most fast-growing port in Northern Europe. It carries out function of a gate for the cargoes coming in/from Baltic basin. Located in the estuary of the river Elba, the port has direct exit to Baltic basin via Ost-Nordsee-canal. 124 feeding lines ply weekly between port Hamburg and countries of the Baltic region. The list of the key trade partners heads ports of China, including Hong Kong, then follows harbours of Singapore, Russia, Finland and Sweden.

The port Hamburg is universal port. The volume of container handling is 97 %. In spite of the fact processing of unpacked cargoes has also a great importance. Terminals of the port have necessary equipment for handling general, bulk, tanker cargoes, and also the cargoes that need special types of transportation and storage. The port of Hamburg concentrates about 40 % of all transit containers intended for Russia[8]. According to researches of independent scientific institutes, the container traffic will increase about 9.9 million TEU up to 18 million TEU in 2015[9].

The Big port of St.-Petersburg is the second-largest Baltic universal seaport. It occupies appreciable position in Baltic region including bulk-oil port Primorsk. Goods turnover in Primorsk has reached 74.2 million tones, the St.Petersburg port – 59.6 million tones in 2007. The vessel turnover of port St.-Petersburg has made 29 257 units (14 633 callings and 14 624 exits), port Primorsk - 1 481 tankers (740 callings and 741 exits)[10]. The leading Swedish port of Goeteborg occupies the third place (40.4 million tones)[11].

The St.-Petersburg port does not handle crude oil. The share of refinery oil in its turnover was only 25 % in 2007. The basic commodities are various dry cargoes: container (29 %), general (25 %), bulk (17 %), timber (4 %). Dynamics of goods turnover in the port since 1997 is shown on the diagram 2.

Diagram 2. Growth of cargo turnover in St.Petersburg port in 1997-2007 (million tonnes)



High rates of container transportations have quickly put forward the Big port of St.-Petersburg in leaders of the Baltic container market. In 2007 via the Petersburg terminals has passed more containers, than via all Finnish ports taken together. The pulp-and-paper production, saw-timbers, nonferrous metals are the main export cargoes are carried out in containers. Container turnover of the port can increase up to 2 – 2.5 million TEU during the nearest years. At the same time the share of container in total freight traffic remains still low, especially in export sphere due to great volume of usual general cargoes handling. But even in this case the shortage of throughputs from 0.5 up to 1.0 million TEU was observed in the St.-Petersburg port in 2007[12].

Ro-Ro container transportation has not received appreciable development in the port St.-Petersburg, as well as other Baltic ports of Russia. Whereas in foreign container ports such type of transportations plays very important role. For example, in 2007 Danish port Arhus, the third size a container complex of the Baltic Sea region, had been handled 417 of 921 thousand TEU, or 47 % of total volume, by Ro-Ro traffics.

Thus, ports of the Baltic Sea region show high rates of development which is defined both economic progress of the countries, and opportunities and readiness of national authorities to resolve the problems of a port infrastructure.

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[7] Пересыпкин В.И. Значение Большого порта Санкт-Петербург на Балтийском рынке морских перевозок//Вести морского Санкт-Петербурга. 2008. №2. с. 21.

[8] Порт Гамбург – ворота в мировую торговлю России. Port of Hamburg www.portofhamburg.com. С 5.

[9] ISL/Global Insight Prognosis, PLANCO Forecast of German Maritime Traffic. www.hafen-hamburg.de/content/view/32/33/lang,ru

[10] Грузооборот порта Санкт-Петербург и порта Приморск за 12 месяцев 2007 года// Вести морского Санкт-Петербурга. 2008. №1. с. 9.

[11] Пересыпкин В.И. Значение Большого порта Санкт-Петербург на Балтийском рынке морских перевозок//Вести морского Санкт-Петербурга. 2008. №2. с. 21.

[12] Зотова В. Прогноз развития транспортного комплекса Северо-Западного региона РФ//Вести морского Санкт-Петербурга. 2008. №2. с. 33.

Visions for the future Baltic Sea Region cooperation - an EU avant-garde in promoting the fifth freedom of the internal market?

By Hans Brask

The call for new and embracing visions for the Baltic Sea Region comes up very often these days, when priorities for the future co-operation are being discussed widely in the many regional fora.

One reason is of course the reform and adaptation process that the Council of Baltic Sea States (CBSS) has been through the last twelve months. The Riga-declaration of the CBSS-Summit of 3 June only partially put an end to this process as the Prime Ministers agreed on just smaller changes to the organisation and its secretariat in Stockholm. More work needs to be done. The second reason is that the European Council in December 2009 will adopt its first internal meta-regional strategy which will cover the Baltic Sea Region (BSR), high-lightening both the growing importance of regions in an EU27 and the present dilemma of the BSR: Co-operation has become mainly an EU internal driven issue and regional relations with Russia an external aspect of the EU's CFSP-policy towards Russia due to the "single voice" objective. Therefore co-operation with Russia should be treated separately and mainly within the EU's Northern Dimension policy.

Originally, the political visions of the region were dominating, not least in the beginning of the 1990ies when Uffe Ellemann-Jensen and Hans Dietrich Genscher established the CBSS. Here Baltic and Polish EU membership were on the agenda long before other political leaders in Europe dared to believe in this objective. Political stability and good neighbourly relations with Russia were essential and the development of soft security measures.

Today only few try to present new political visions for the region's future. One is MEP Christopher Beazley, who has been a driving force behind the political demand of an EU strategy for the BSR. To him the vision is still linked to the historic division of Europe after World War II. The objective of the EU Strategy should be to remedy the economic inequalities that more than 40 years of Soviet domination and occupation have caused to the Baltic States and Poland and the region in general. Others see the Baltic Sea as a political space that should strive towards establishing itself as a coherent group of countries capable of formulating and promoting common political positions inside the EU. Stronger regional institutions should facilitate this development, contributing at the same time to a clearer regional identity.

Today's visions are, however, mostly linked to environmental challenges and economic questions, reflecting that many of the original political goals have been realised, besides the "Russian dimension". The advantage of environmental and economics visions compared to political ones are that they easier allow for integration of Russia into regional projects.

The environmental visions are closely linked to the Baltic Sea. The objective is a clean and healthy Baltic Sea which is presently polluted and at risk of further pollution due to increase in oil shipping from Russia in particular. A specific problem-oriented vision can, however, be very narrow and too limiting although it touches on the region's common sea. At the same time a clean Baltic Sea vision can be an important driver for regional integration and popular support, if it can be extended to other, closely linked areas such as climate change and the energy agenda which is also often mentioned in official statements as a regional priority.

The dominating economic visions see the Baltic Sea Region as the most dynamic and innovative economic growth centre in Europe. Others narrow it down to the challenges and opportunities of knowledge driven/intensive economies where the knowledge triangle (education, research and innovation) should be at the centre of regional attention. This vision builds on the strong benchmarks of the Nordic countries and Germany in these areas (State of the Region Report, 2007). The added value is to be found in the region's ability to find regional solutions to global challenges, not least due to the fact that the EU's Lisbon strategy has generally not responded quickly to the economic challenges of globalisation due to internal political differences and institutional problems. Many of the EU-policies of the Lisbon strategy are covered by the open method of coordination which indicates that the EU competences are not strong - for example educations/universities, research, innovation. It allows for the region to play a facilitating role.

What type of regional visions do the governments of the BSR mainly base themselves on? One possible answer can be found in the different non-papers that EU-countries of the region have submitted to the Commission for inspiration when drafting a proposal for the EU strategy. Today Sweden, Finland, Estonia and Poland have elaborated such contributions and more are coming up.

In general, the regional visions are not formulated explicitly but the titles give a good idea: "A clean Baltic Sea and a prospering economic area" (Finland). "A healthy and prosperous Baltic Sea Region" (Sweden). "Cohesion and competitiveness of the Baltic Sea Region" (Poland). Here the first difference can be detected, since Poland does not give the same priority to the maritime environment as other countries of the region do.

They all, however, highlight the importance of promoting the BSR's competitiveness through scientific and R&D co-operation, new technologies, innovation policies, cluster development and the mobilisation of students, researchers and higher education institutions. The Estonian non-paper tries to cover all these areas by making reference to the European Council conclusions of March 2008 where a new EU vision is mentioned: A Fifth Freedom of the EU's Internal Market should be created. The objective is to remove barriers to the free movement of knowledge based on:

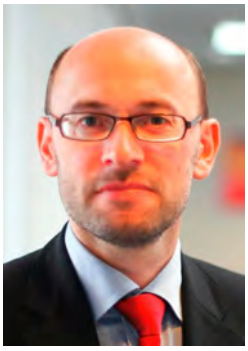
- enhancing the cross-border mobility of researchers, students, scientists, and university teaching staff,
- making the labour market for European researchers more open and competitive, providing better career structures, transparency and family-friendliness,
- further implementing higher education reforms,
- facilitating and promoting the optimal use of intellectual property created in public research organisations so as to increase knowledge transfer to industry,
- encouraging open access to knowledge and open innovation,
- fostering scientific excellence,
- launching a new generation of world-class research facilities,

- promoting the mutual recognition of qualifications.

The Danish Prime Minister has been a strong advocate of this development in the EU. In an interview with BDF (upcoming summer edition of BDF Magazine) he states that "the Baltic Sea Region has the opportunity to become a centre of knowledge, ideas and research in the areas where the region has comparative advantages". The Danish CBSS presidency in the second half of 2008 will have the chance to promote this idea.

The CBSS framework could work very well in this EU context since Russia is doing many efforts to join relevant EU research programmes and also to contribute with substantial funds. Russia has a lot to offer in this field and would be able to make this EU and regional vision come true. Perhaps the BSR could lead the way for the rest of Europe. It is not a bad way of giving fresh impetus to co-operation in the Baltic Sea Region.

Baltic Development Forum will like to contribute to this vision, and the 2008 BDF Summit in Copenhagen-Malmö will have this subject on the agenda (along with energy and the EU strategy). The Öresund Region has ready come very far in creating a Fifth Freedom and has made valuable experience. It deserves wider attention in the region.



Hans Brask

Director

Baltic Development Forum

The many challenges of the Baltic Sea Region

By Kari Liuhto

External economic relations take on a central role in the Finnish economy, and the value of our foreign trade is almost three-fourths of our GDP. Approximately 80 per cent of the flow of our foreign trade goods proceeds by sea, so examined economically, Finland is an island in the Baltic Sea.

Of Finland's foreign trade, 40 per cent is engaged in with other states surrounding the Baltic Sea. Roughly the same share of foreign investments by Finnish firms ends up in this area. With regard to the foreign investments coming to Finland, the significance of the Baltic Sea region is even greater than this. Approximately 70 per cent of the investments directed to Finland have their origin in some other Baltic Sea nation.

The economic dependency of the Baltic States respective to the Baltic region is even larger than Finland's, whilst the dependency respective to Germany and Russia is smaller than ours. Although Germany is the world's largest foreign trader, one-tenth of its trade goes on with other Baltic Sea countries. The Baltic Sea is also important for Russia. The EU makes up about half of Russia's foreign trade, and a lion's share of the foreign trade of the European Union and Russia proceeds through the Baltic Sea.

The Baltic Sea has risen during this decade to become Russia's most important export route for crude oil. Via the ports of the Gulf of Finland, over 140 million tonnes of oil from the east are transported each year. By the middle of the next decade, oil export is anticipated to total over 200 million tonnes. The increasing oil deliveries, intersecting traffic between Helsinki and Tallinn and the narrow shipping lanes concerned all add to the risk of an oil disaster in the Gulf of Finland.

Although the Gulf of Finland has developed a control system to prevent collision of ships, the system does not prevent them from running aground. The running aground of single-bottom oil tankers would more probably result in an oil disaster than those with a double-bottom, so the faster only double-hull tankers are permitted at Baltic Sea ports the better. At least one oil disaster was prevented due to the fact that a vessel which had run aground in the vicinity of Helsinki was double-hull.

According to the research performed by VTT Technical Research Centre of Finland, 50 – 60 ship collisions or accidents occurred annually during the period of 1989-2003 on the Baltic Sea. Of these, three vessels had been carrying dangerous chemicals. Despite the low number of accidents related to chemical shipments, I would venture that shipments of dangerous chemicals pose as significant a danger to the population of the Baltic Sea as oil transport. With respect to dangerous substances, the probability of personal injuries is considerable, even if the likelihood of an accident itself is smaller.

In examining environmental threats to the Baltic Sea, one should also not forget the daily nutrient loading caused by agriculture and residence. In the Gulf of Finland, the largest single polluter is St Petersburg, and for the Baltic as a whole Poland's agriculture applies. It seems that the Nord Stream gas pipeline planned for the base of the Baltic Sea may release nutrients from the sea bottom and even toxins which have been recessed there since the end of World War II. The alignment of the gas pipeline through the Baltic States and Poland would be, both from the environmental and most apparently the economic perspective, considerably more rational than a pipe built along the sea-bottom. Extending 1,200 kilometres, Nord Stream can hardly be constructed for five billion euros when we consider that the cost estimate for the 900-kilometre South Stream pipeline, intended for the base of the Black Sea, is ten billion euros.

Regardless of the fact that relations between the Baltic States and Poland with Russia are not the best possible, it is highly unlikely that the EU states concerned would cause the sorts of transit delivery problems as those incurred by Belarus or Ukraine.

The construction of a natural gas pipeline across the Baltic States and Poland would bring four EU nations into the project in addition to one Dutch and two German enterprises. This would make the gas pipeline a real pan-European project, and would most evidently improve the attitude towards Russia on the part of the Baltic Sea region's former socialist states.

A gas pipeline proceeding above ground would also be an example of how the Baltic Sea region is able to integrate Russia more closely into the European Union. This gas line could be an indication of the fact that, with Russia, we are different enough to be able to learn from each other, but similar enough to be capable of engaging in cooperation.

A functional Baltic Sea region requires cooperation with Russia, but above all it requires uniformity amongst the EU countries surrounding the Baltic Sea. The Baltic Sea requires one agenda and a uniform voice so that the matters important to the Baltic Sea countries are taken into consideration within the Union.

The European Parliament has given the Commission the task to prepare a Baltic Sea Strategy by the year 2009 which may well act as a road map for the future. On the other hand, not even a good strategy can eliminate insufficient coordination in the Baltic Sea area.

One proposal is that the Nordic Council would strengthen their role by taking the Baltic States into membership, in addition to engaging Poland and Germany more closely in their operations. Whether the solution is enlarging the Nordic Council or something else, it would be important that the jungle of overlapping institutions plaguing the Baltic Sea region could be eliminated. Without a united body, the voice of the Baltic Sea region within the Union will remain weak and disjointed, regardless of the Baltic Sea Strategy.

The uniformity of the Baltic Sea region would also contribute to the systematic building of a common identity for the region. Aside from configuring a common identity, the position of the Baltic Sea Chamber of Commerce Association (BCCA) is also worth strengthening. I also regard the establishment of a common Baltic Sea region investment agency as absolutely important. It would attract investments from outside the Baltic Sea region. The problem at the moment is that national investment offices tend to compete with each other rather than see the benefits of synergy in the Baltic Sea region. It is a rare national investment office that has observed that, due to the interdependency of economies, the accumulated impacts of outside investments are reflected throughout the economic region as a whole, rather than just one individual country.

The Baltic Sea region has, in addition to many old challenges, new phenomena to deal with ahead. Most of these new phenomena are connected with Russia. Examples include the flow of Russian investments to other Baltic Sea nations, the automotive industry boom in St Petersburg's surroundings, the transfer of Russian companies' headquarters from Moscow to St Petersburg, and the special economic zones of Kaliningrad. These phenomena are bringing Russia's economic growth closer to the Baltic Sea region and are thereby consolidating the entire region's economy. On the other hand, the invigoration of Russia's superpower rhetoric may lead to a situation in which, rather than a bridge being constructed between the EU and Russia, an advance guard of the Cold Peace is built.

Kari Liuhto

Director

Pan-European Institute

Finland

Why we need to modernise European universities

By Ján Figel'

In Europe we have come to recognise that we need to further develop as a knowledge society for our future wellbeing and economic sustainability and to keep our current influence in world affairs. Our universities, which operate at the heart of the knowledge triangle of education, research and innovation, have a key role in this, the overarching strategy of the Union for the present decade. But to put them in the optimal conditions to deliver their full potential, we need to go deep and tackle systemic reforms.

We have to respect the specific character that our universities have acquired over the centuries; at the same time, we must address their new roles. Universities have three main functions in today's knowledge society:

- Creating and safeguarding knowledge through research;
- Disseminating knowledge through education which is essential for the personal development of each individual and for the broader social development;
- Transferring knowledge to society, so that research can be used outside universities for innovation and growth.

In my view, universities should prepare for a new era by diversifying, both in offer and demand. On present trends, it is likely that universities and other higher–education institutions will rearrange into bigger or smaller units through alliances and co–operation across borders. New providers will enter the education market offering training courses in certain disciplines, using new technologies, and seeking recognition from quality–assurance and accreditation agencies.

For many years, most higher education institutions have striven to conform to the uniform model of research–intensive universities. Now, however, there is a growing consensus around the view that it is in nobody's interest that all institutions adopt the same model. Europe, the institutions and their students are better off when individual universities develop their own specific missions and profiles, addressing the specific needs of their environments and of the communities they are part of. As a result of these changes, students' choice is set to grow exponentially. Increasingly, student will have the option to leave their institution and work or study elsewhere at home or abroad. I have great expectations from this growing competition – and cooperation - between universities, both nationally and internationally.

To thrive in the knowledge era, we need to constantly upgrade our workforce in terms of knowledge, skills and attitudes. European universities, in all their diversity, are in a unique position to start serving new kinds of students; retraining our workforce and raising the general skills level of the population. To do this, universities need to open themselves up to new groups, such as students who get the chance to enter higher education only as adult learners and students from professional backgrounds who attend specific postgraduate courses. These adult learners will demand more in terms of quality, course delivery and student services. Besides, the deadline in the number of young people in many European countries mean that new student groups are an opportunity for universities which might otherwise risk seeing enrolments of students directly from secondary education fall over coming years.

Our universities, once fully modernised, will need more money to keep up with their new role in society. The European Commission proposes that each country should spend at least 2% of GDP on higher education. However, we have to be realistic and recognise that in many countries additional investments in higher education and research will not come entirely from the public purse. This means that more emphasis is needed on finding additional funding from private sources: enterprises, foundations and private households. The idea of private funding to higher education is hotly debated in many parts of the EU and each will find the solution that best suits the local conditions. But whatever solutions are found, it is clear that the impacts on access and equity must be carefully considered.

Universities must have the autonomy and means to address their changing missions. And for this they have to be accountable to society at large. Governments can enter into a new type of partnership with their universities and limit themselves to set the general frameworks in which universities can operate. In other words, universities need to be able to make strategic choices: extending their funding base, enhancing their areas of excellence, developing their competitive position and implementing the actions which flow from the choices.

Structured partnerships with the business community can make education and training programmes more relevant to society's needs and they can bring additional funding and management expertise. I have recently launched a new Forum to boost university–enterprise cooperation in the field of education. The Forum will be the ideal place for structured dialogue on issues such as mobility, curricula reform, continuing education and stakeholder involvement in university governance. Partnerships focusing on university education are as important as those on research and innovation. We intend to continue the Forum as a platform for dialogue.

But we have to recognise that education offers wider economic benefits; for instance, it improves the attractiveness of Europe as a business location. The recent agreement on the establishment of the European Institute of Innovation and Technology can reinforce Europe's capacity to transform education and research results into business opportunities. The EIT will boost Europe's competitive base by integrating innovation, research and education at the highest international standards, and by promoting a new model of working relationship for business and universities.

Our universities are crucial for the future of Europe; we need to create the conditions in which they can unleash their potential.

Ján Figel'

European Commissioner for Education, Training, Culture and Youth

We need a Baltic Sea Stern Review

By Tarja Cronberg

The deterioration of the Baltic Sea has a long history, the result of both external and internal causes. Growth in nutrient emissions in Finland and Sweden has finally been checked and the treatment of effluent in Russia has been improved. However, despite these advancements the situation is still not resolved. Getting the emissions of many Baltic coastal states under control is a challenge. Diffuse pollution originating from Baltic coastal states is also an unresolved problem.

Another reason behind the deterioration of the Baltic Sea is its internal loading. Phosphorous stored in Baltic sediments dissolves into the water in oxygen-free areas at the sea floor. This accelerates the growth of blue-green algae, which binds nitrogen from the air and increases nutrient content and algal blooms, which decompose and consume oxygen. This sets off a nearly unstoppable vicious cycle that would need a massive reduction in external nutrient emissions to break. Despite this, the condition of the Baltic Sea would improve extremely slowly. This has given pessimists cause to declare the Baltic Sea as nearly "incurable".

If there is even the slightest chance of improvement, efforts must be redoubled, regardless of whether the issue is people or the environment. Indeed, this is the situation in which we find ourselves now.

Late summer blue-green algal blooms have an adverse impact on, for example, Baltic recreational uses to such an extent that the requirements for getting eutrophication under control have in recent years been tightened in the wake of heated public debate, particularly in Finland and Sweden. Blue-green algal blooms are a warning sign for the poor state of the Baltic Sea's health. They have given citizens just cause to pressure politicians to act and make good on their promises to save the sea.

The means used to save the Baltic Sea are complex, as they should be. The problems encountered in the various parts of the Baltic Sea as well as on the open sea, in coastal areas and archipelagos each have specific attributes, which must in part be resolved through means specifically tailored for them. This makes improving the condition of the sea a challenge.

The Baltic Sea Action Plan was adopted by the Helsinki Commission (HELCOM) at its Ministerial Meeting held in November 2007. The ambitious goal of the Action Plan is to reduce emissions entering the Baltic Sea to such an extent that its good ecological status would be restored by 2021.The Action Plan requires that all Baltic coastal states also take national action, through both legislative and other means, toward achieving the goals.

With expansion of the EU, the Baltic Sea is now, for all intents and purposes, fully enclosed within its borders. The EU's commitments to protecting biodiversity within the region will also provide some degree of relief to the condition of the Baltic Sea. The Convention on Biodiversity was signed in the EU in 1993. A biodiversity strategy was drafted toward its ratification. In addition to these, the Biodiversity Action Plan and the Sixth Environment Action Plan were also drafted. Agro-Environmental Schemes under the EU Common Agricultural Policy (CAP) Agenda 2000 are also geared toward the protection of biodiversity. The Water Framework Directive (Directive 2000/60/EC of the European Parliament and of the Council establishing a framework for the Community action in the field of water policy) and Integrated Coastal Zone Management (ICZM) Recommendation are also key instruments in terms of biodiversity protection and sustainable use.

The Baltic Sea Strategy is also being drafted specifically for the EU. Sweden is planning to make the Baltic Sea Strategy a central issue during its EU presidency at the end of 2009. The goal of the Strategy is to strengthen the Baltic region's competitiveness as well as tackle transnational challenges, the foremost of which are environmental challenges.

From an environmental standpoint, Finland believes that the Strategy must comprehend environmental protection measures, eutrophication prevention, agricultural nutrient loading reductions, fish stock protection and invasive alien species prevention. Development of a joint maritime traffic image would be required to monitor ever increasing shipping traffic throughout the Baltic Sea. The traffic monitoring system currently in use in the Gulf of Finland should be expanded to include the entire Baltic Sea. Oil accident prevention would also require more effective co-operation between countries in the Baltic region.

Even though the future of the Baltic Sea seems to be headed in the right direction, I am becoming more and more convinced that the Baltic Sea would need its own "Stern Review" The review would examine the state of the Baltic sea, its development and protection alternatives as well as their social and economic impacts. **The Stern Review on the Economics of Climate Change, which was drafted by** Sir Nicholas Stern, the former Head of the Government Economic Service and Adviser to the Government under Tony Blair, **would be an excellent model for such a review.**

Indeed, a clean sea does have certain monetary value. It is a commodity or "ecosystem service", which directly or indirectly provides commodities to people. These commodities can be, for example, fish production or recreational opportunities. According to researchers, the most valuable ecosystem service is the ability of sea floor sediments to store nutrients. The oxygen-poor state of sediments endangers this service. A monetary value can be calculated for all of these. Baltic Sea protection would be given new impetus if there were a review of the sea's social and economic impacts.

Tarja Cronberg

Minister of Labour

Ministry of Employment and the Economy

Finland

Is Poland really the biggest polluter of the Baltic Sea?

By Maciej Nowicki

In the last few decades Poland achieved substantial progress in improving state of the environment. Throughout these years growing environmental awareness of private investors and rising engagement of all levels of administration resulted on one hand in using more environment friendly production and wastewater treatment technologies, and on the other hand in implementing regulations which oblige to use such technologies and result in better environmental protection.

Pollution loads discharged by Poland into Baltic Sea decreased substantially in the last 15 years. Such decrease includes also substances which are particularly dangerous for Baltic environment – nutrients. Even if the changes in emissions in the first half of 90s might be perceived as a result of economy transition, the decrease observed in the following years is undoubtedly a result of environmental investments, particularly construction and modernization of municipal and industrial wastewater treatment plants.

Figure 1. Total loads of nitrogen and phosphorus discharged by Poland to the Baltic Sea.

With regard to total load from the Polish territory one should bear in mind that according to the results of monitoring by Chief Inspectorate of Environmental Protection, ca. 15% of total nitrogen and phosphorus loads discharged by rivers come as “background” from natural sources.

In the opinion of international public and decision-makers Poland is the biggest polluter in the Baltic Sea region. Nevertheless, an assessment of Polish impact on Baltic environment must not be decoupled from spatial, demographic and economic dimensions, as these issues are strongly interlinked. If these factors are not taken into account, the conclusions might be wrong and unjst.

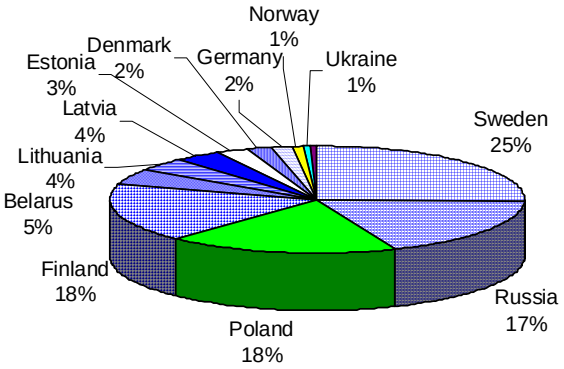


Figure 2. National shares in total Balic Sea catchment area.

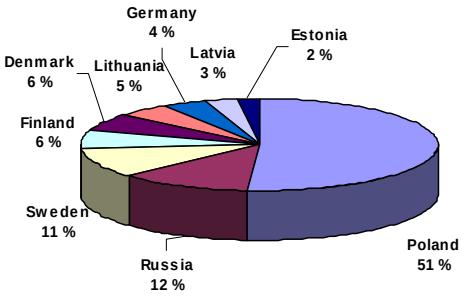
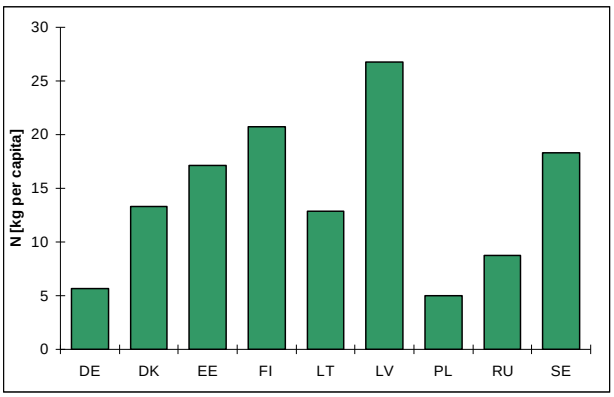


Figure 3. National shares in total Balic Sea catchment population.

Although share of Poland in the Baltic Sea catchment area is only 18%, over half of the population of Baltic Sea region lives here. Due to huge difference in population between Poland and other countries, a comparison of absolute pollution loads discharged into Baltic Sea draws a wrong picture of actual national efforts with regard to environmental protection.

Last comprehensive assessment prepared by Helsinki Commission was published in 2004 and is based on the data collected in 2000. The next edition of pollution load compilation is currently prepared and will be based on 2006 data.



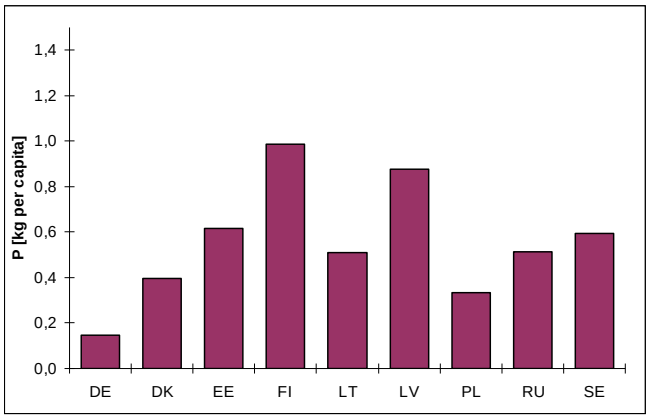


Figure 4a and 4b. National per capita pollution loads discharged into Baltic Sea.

The comparisons above show that, although absolute pollution loads discharged into Baltic Sea by Poland are high, relative per capita loads are low, particularly with regard to nitrogen, where Poland is the leader among all Baltic Sea region countries. Also with regard to phosphorus, Poland discharges less pollutants in comparison to majority of other UE Member States in the Baltic Sea region.

We should bear in mind that these indicators, both with regard to total pollution loads and to per capita emissions, will improve further after Poland matches its obligation according to – first of all – Community legislation, and afterwards – according to all other voluntary international obligations. Taking into account economic potential of Poland it should be expected that these obligations will be spread over a longer period. Due to long-term negligence Poland is obliged to reach conformity with environmental standards in much shorter period than Western Europe and Nordic countries.

Furthermore with regard to indicators above it might be necessary to review obligations of specific countries of the Baltic Sea region, according to the principle of common but differentiated responsibility.

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Maciej Nowicki

Minister of Environment

Ministry of Environment

Poland

Saving the Baltic Sea with public-private cooperation, result-orientated actions

By Saara Kankaanrinta

The Baltic Sea is a very interesting area in many ways. The biggest concern is it's ecological status: Baltic Sea is the most polluted sea in the world.

90 million people – in 14 different states - who live in the catchment area of the Baltic Sea constitute a substantial burden on the naturally vulnerable and fragile sea. But this is a possibility as well, since the Baltic Sea is of supreme importance to these countries (and companies operating in the area), in terms of economy and policy and in key areas such as security, energy, transport. Even the United States is linked to the Baltic Sea area –on the basis of bilateral agreements with Poland and the Czech Republic, the US plans to station missile defence systems on their territories.

The Baltic Sea is a good example of how the environmental policy meets energy-, foreign and security policies, and how the positive co-operation in the environmental matters is particularly important and strengthens the relations of the states in general. It is of everyone's interest that the Baltic Sea is maintained healthy, peaceful and secure.

Speeding up the implementing of measures

We are in a hurry with the Baltic Sea. It is dangerously close to the hospice phase, but there's still hope, and we need to ensure that all possible steps are taken in order to save the Baltic Sea marine environment. It is obvious that only actions across borders will achieve sufficient changes. In order to save the Baltic Sea we need to have clear vision of what should be done, strong political will to push these enhancements through, and the fastest way to implement the measures in practice.

Baltic Sea Action Group (BSAG) was founded to tackle with major challenges of the Baltic Sea with a holistic approach, but well-focused projects. All three founders of the Baltic Sea Action Group, **Ilkka Herlin, Saara Kankaanrinta and Anna Kotsalo-Mustonen** have common background in John Nurminen Foundation, which played a key role in getting St. Petersburg to implement chemical phosphorous removal to its wastewater treatment plants. As John Nurminen Foundation continues to have its focus strictly on municipal wastewaters, the new foundation scales up the concrete actions with public private cooperation to the other major problems of the Baltic Sea: agriculture, marine transport and hazardous waste.

The purpose of the new foundation is to act in concrete projects that make a difference. BSAG acts as an initiator and a catalyst. We identify and analyze the problem with experts and then gather actors needed to carry out the project - whether those being states, local governments, other public institutes, researchers, private companies or individuals.

Experience from business brings new practices and useful perspective to the field of environmental protection. With our contacts to the private sector we are aiming that the business sector will contribute actively to the projects. Our approach is very conscious of economic realities, aiming to find the drivers and incentives that spur different sectors to participate in saving the Baltic Sea. Our arsenal of methods is wide, and we try to think 'out of the box'. The very essential idea of the BSAG is finding the best and the most efficient ways of doing things, not just take the traditional approach. Here we see that the business sector has new ways and approaches to offer.

Main principle is good and genuine cooperation with every actor. One of our biggest assets is the high level political network that we have created. Many projects need a strong political backup - the funds and an identified solution are not enough.

BSAG's emphasis will be in cost-effective, well-focused and tangible actions that are essential to the recovery of the Baltic Sea. All the actions are based on best available knowledge and BSAG is working closely eg. with the Academy of Finland to focus research into direction that gives practical guidance to initiate projects. BSAG works also closely with HELCOM in order to implement The Baltic Sea Action Plan by HELCOM (adopted in November 2007).

BSAG has four programs, which all include several project possibilities. The programs are: AGRICULTURE AND BIO ENERGY, CLEAN & SAFE SHIPPING, HAZARDOUS WASTE and NEW CHALLENGES.

Strategic philanthropy creates social value

We wish to supplement the efforts of the public sector, and create social value by generating greater social benefit for comparable cost, or achieve an equivalent social benefit faster - in other words with fewer euro. Our aim is to enhance the society's capacity in protecting the Baltic Sea. The work of the non-profit and civic sector should bring more resources to the environmental protection and speed up the process in general, not to replace or diminish the use of public funds or efforts to the matter.

This has been our vision: to approach philanthropy professionally and strategically, and thus use our potential to a full scale. Our potential is created by the role of being a catalyst and solving the problem as quickly as possible by agile operations and gathering of all the forces – including resources that would not have been in the picture with the traditional approach.

There are two points of view on the best way to operate using the resources available and maximizing the "social return on investment". First, the targets were chosen strategically, emphasis on the importance to the Baltic Sea, cost-efficiency and feasibility. Second, the organization itself has to be effective and professional.

Our strategy commits us to the goal of superior performance, and it forces us to be demanding towards ourselves. Above all, our strategy defines concrete goals to serve as the basis of evaluation. We want to make sure that BSAG brings some added value to the field of saving the Baltic Sea. That is to say that we avoid being in the field just for the sake of it: in the end outcomes matter more than intentions.

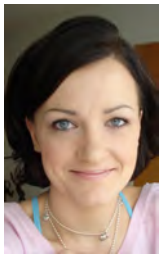
The official name of the foundation, 'Foundation for a Living Baltic Sea', has been translated to the 14 languages spoken in the catchment area, but for simplicity's sake we work with the brand Baltic Sea Action Group (BSAG).

www.bsag.fi

Saara Kankaanrinta

Co-founder of the Foundation for a Living Baltic Sea /Baltic Sea Action Group (BSAG)

Finland



Belarus and Baltic Sea Region - common interests and challenges

By Aliaksandr Milinkevich

Belarus is directly adjacent to the Baltic sea region. Five out of sixth of our neighbours are washed by the Baltic Sea. Such geographical proximity had an enduring impact on Belarusian culture, traditions and history. Over centuries, Belarus developed tight commercial, political and cultural relations with the region. One would even argue that despite being land-locked, Belarus may in many respects also be considered a part of the Baltic Sea region.

The Baltic Sea countries are of vital importance for Belarus. Its independence and future as a European democracy are largely function of how far it develops the dormant potential of the European and sub-regional cooperation and integration. The anchorage and full-fledged participation of Belarus to the Baltic Sea cooperation initiatives and networks are very important part of this potential.

So, Belarus can only gain from openness to and sustained engagement with the Baltic Sea countries which are to be viewed as not only export market and source of investments and innovative technologies, but also as a model of intra-societal relations and human development opportunities.

Nowadays, the very first glance at Belarus proves that its political and societal system differs substantially from its direct and indirect northern neighbours. The monopolisation of political sphere by a small group, eager to keep and expand its tight grip on economy and civil society, impedes on private initiative and individual creativity, generates apathy and luck of trust. Regular and even increasing attempts on fundamental freedoms and pluralistic norms keep the government unaccounted and non-transparent. The misleading figures of mechanical GDP growth in Belarus should not be taken for granted. The current short-sightedness of the government becomes more and more obvious if we contrast the policy options, competitiveness and business attractiveness of Belarus with its immediate Baltic neighbours. One has to bear in mind that our starting positions were relatively similar.

Belarus' main export positions are connected to raw materials and derivatives (minerals, oil by-products, timber), but not to goods and services made with usage of new technologies. The current structure of trade balance of Belarus with the Baltic Sea countries is one of the proofs.

Because of the government's refusal to promote pluralism, both political and economic, Belarus is not able to positively contribute to regional prosperity and security and fully benefit from relationship with Baltic Sea countries based on common values and shared interests. It creates the situation where our potential of mutually beneficial relations is extremely underdeveloped.

Belarus is interested in investments and technologies from Baltic Sea countries, in learning from them how to better guarantee sustainable development, while protecting natural resources and environment. It needs further development of trade relations. Already providing important workload and transit revenues to southern Baltic rim ports of Ventspils, Klaipeda and Kaliningrad, Belarus requires enhanced cooperation in improving ports' facilities and developing its Baltic commercial fleet.

A common Baltic-to-Black sea energy and transport network that will help to diversify and reduce over-reliance on one energy supplier is at the geopolitical interest of Belarus. Developing such infrastructure will enhance regional cooperation in fighting organized crime, arms, drugs and human trafficking. Baltic technologies, expertise and assistance in strengthening the energy efficiency and developing alternative energy sources are of paramount importance for industrial and agricultural sectors of Belarus. Nowadays, when the government took a hush and non-transparent decision to start building a nuclear power plant in post-Chernobyl and authoritarian Belarus the exchanges of experience and know-how on energy efficiency become essential for Belarus to preserve its independence. Clean technologies based on renewable sources of energy such as wind and solar powers and biomass re-cycling ought to become alternative to nuclear power making the energy consumption environmental friendly and cost-efficient.

Belarus is an important partner in finding common solutions to environmental, challenges in the Baltic Sea region. With more than 40% of Belarus' total river flow coming into the Baltic Sea, our common interest is in reducing water pollution by developing more environment friendly agriculture and better waste disposal facilities in Belarus.

In sum, Belarus badly needs the largest possible political, economic, scientific, societal contacts with Baltic Sea countries. It is in Belarus' national interest to seek to create free trade area as first step of achieving free movement of labour, capital, goods and services with the EU.

The Belarusian democratic forces are aware of opportunities and challenges that a responsible and accountable Belarus' government will face in order to be integrated into Baltic area sub-regional and European networks and institutions.

Aliaksandr Milinkevich

Chairman

Movement for Freedom

Belarus

Shipping of oil products in the Baltic region

By Erkki Kotiranta

The Baltic Sea is the fastest-growing market area in Europe with great future opportunities provided by Russia. The Baltic region comprises almost half of the land area of the EU, but the current population of the Baltic region is only 23% of the EU and they produce only 16% of the EU's GDP. Economic polarities are even more extreme: the GDP of Germany is twice as much as the GDP of other Baltic Sea countries put together (excluding Russia).

On the other hand, with an average annual growth rate of over 2.1% the Baltic economies beat the EU average. It is estimated that by 2020 the Baltic countries will increase their exports by 46%, imports by 36% and trade within the Baltic area will grow by 54%. Overall, trade within the EU is expected to grow faster in the east-west direction than in the north-south direction.

Sea transportation is of primary importance for the growing Baltic trade since it accounts for a 50% share of all transported freight. In 2003, 76% of sea freight was carried out of the Baltic Sea and 24% was trade between the Baltic countries. Rapid economic development in Russia makes the Baltic Sea increasingly noteworthy, and due to the recent enlargement of the EU, European interest in the Baltic countries is reviving, as well.

Booming Oil Exports

Rapid economic development in Russia makes the Baltic Sea increasingly important, and due to the recent enlargement of the EU, European interest in the Baltic countries is reviving, as well. According to the Russian energy strategy, annual oil production will increase to 520 million tonnes by 2020, with exports accounting for 250 Mt and Baltic Sea exports for 180 Mt. Russian authorities plan to focus on developing their oil industry until 2010 and then shift their attention at expanding the export market.

In the first half of 2006 Russian oil industry accounted for 46% of Russian exports, but the share of the gas exports was only 14%. Oil industry is almost entirely in private ownership, whereas the gas industry is mostly state-controlled.

From the European viewpoint, the transport routes of Russian oil surround the entire continent. Russia's main oil ports are Novorossiysk on the Black Sea, Primorsk on the Baltic Sea and Murmansk in the north. Europeans are understandably concerned about the safety of oil shipments and after the recent accidents, governments have stepped up the pace of passing appropriate laws.

Oil transportation on the Baltic Sea has surged by 460% since 1999, and by 210% since the Primorsk oil port was opened. At present, the monthly transportation volume on the Baltic Sea is about 10 million tonnes, and rising all the time. It is expected that in 2009 the volume of oil shipments will be 18 million tonnes per month. Currently about 40% of oil shipments are carried by 100,000 dwt vessels. Moreover, it is expected that by 2010 Russia will triple the volume of oil shipments through ice-locked ports.

Russian Transport Strategy for 2020

- Priority on multimodal transportation and containers.
- Clear up bottlenecks and increase the speed of shipments by 20%.
- Increase the share of Russian ports to 85% (from 75% in 2003).
- Build up the Russian mercantile fleet.
- Improve the infrastructure in Northwest Russia with several projects.
- Develop St Petersburg as a hub of trade and tourism.

These strategic goals clearly indicate the importance of Northwest Russia and Russia's willingness to invest in this region.

Most of Russian oil exports are shipped abroad through Northwest Russia, which includes Russia's Baltic ports such as Primorsk, which has become a major outlet of crude oil with a continuously growing significance. In the future, other products will be transported through Primorsk in addition to crude oil.

Future will tell how and to what extent Russia will use the existing pipelines. Already, Russian authorities have announced that part of the oil now carried by the Druzhba (Friendship) pipeline will be redirected to Primorsk. It remains also to be seen what is Russia's overall attitude towards export pipelines running through third countries.

In addition to tankers, also passenger and container traffic is on the rise on the Gulf of Finland. At the moment, the ports on the Gulf of Finland register a total of 43,000 ship calls per year, but by 2010 the number is estimated to rise to 54,000. It is obvious that safe navigation on such busy waters requires strict rules and supervision of the entire area.

Causes for Concern

A certain tension is developing between the EU and IMO, because the EU uses its legislative power to control sea traffic on its home waters. Conflict is brewing between IMO as an expert organisation and an authority in the global shipping industry and EU as a strong regional and political force. IMO is an indispensable global player in the shipping industry and Russia wants to strengthen its influence in IMO. Overall, EU has implemented regulations proposed by IMO, but the process is slower than EU legislation in general.

Rush Hour on the Icy Sea

Baltic Sea is a sensitive sea area: its average depth is only 54 metres, whereas the average depth of the Mediterranean is more than 1 kilometre. Another significant restriction to shipping is the winter freeze-over. During harsh winters some Finnish ports may be ice-locked for more than six months, and even normal winter conditions can prevent the year-round use of regular ships.

The term ice-strengthened ship usually refers to a vessel with the ability to manoeuvre through ice-covered waterways. This requires two things: the hull of the ship must be strong enough and there must be enough engine power for icy conditions. Yet, these characteristics do not really tell whether a ship is functional in an icy environment or not. It is one thing to commission and acquire an ice-classified ship and another to actually operate it in sub-zero conditions.

It is apparent that the EU will introduce new rules and regulations concerning safety and environmental protection. Some current examples are the marine fuel sulphur directive, regulations.

Another matter of interest is the future of Helcom after the enlargement of EU. First of all, does Russia prefer direct dialogue with the EU and IMO thus bypassing Helcom partly or completely? Secondly, when the Baltic Sea was classified as a Particularly Sensitive Sea Area (PSSA), Russia opposed the motion. Apparently Russia is concerned about potential protective measures for the Baltic Sea: for example, could Denmark impose restrictions on tanker traffic in order to control Russian exports?

Nevertheless, it cannot be overemphasised that Russia is given the opportunity to participate in the decision-making process.

Conclusions
Oversupply in tanker market will decrease.

Consolidation of freight levels will continue.

Small players will be increasingly hard-pressed.

Winter premiums will erode.

Continuing growth of sea traffic increases the risk of accidents. Therefore, There will be new shipping companies and new partnerships.

The Murmansk area is developing rapidly: the distance to European ports is only four days and to U.S. ports nine days. Our aim should be to create common rules of business in the Baltic Sea area for winter seafaring and assistance and in the qualifications approval process. The Baltic Sea as a special territory and as a semi-arctic area will set its own minimum standards for safe maritime transportation.
All Russian exports to the west cannot be carried through the Baltic area.

The willingness of European companies to make big investments in the Russian market is held back both by economic risks and complex political risks.

The Baltic Sea has become the primary energy transportation route to Europe. The construction of new gas pipelines and planning of LPG terminals on the Baltic indicate that the relevance of the region

The Challenge of New Transport Routes
Energy supplies through the Baltic to Europe continue to grow. In the Baltic region, Russia remains the main engine of growth. But the Russian economy and society are vulnerable to fluctuations in world energy prices: Energy accounts for over 60% of Russian exports and half of the federal revenue. Moreover, Russia is so enormous that producing and exporting energy alone does not bring prosperity to everybody, which is another argument for economic diversification. Europe is the most important market for Russian energy now and in the future. The best part of Russian gas, oil, coal and electricity is exported to Europe.

Future will tell how and to what extent Russia will use the existing pipelines and whether new ones will be built. The proposed BPS-2 pipeline is expected to bypass Belorussia and Poland, and part of the oil carried by the Druzhba (Friendship) pipeline may be redirected to Primorsk or Ust-Luga. In the Mediterranean, several new pipelines are on the planning stage with inevitable consequences to logistical solutions.

Baltic ports alone cannot handle Russian oil exports to the West. The Murmansk region is assuming a bigger role and in the future it will become a major energy export route. This means new challenges to shipbuilders and ship operators as the total volume of Russian oil exports through ice-locked ports is going to triple by 2012.

Erkki Kotiranta

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University reform - a global phenomenon

By Kari Raivio

In the Lisbon summit in 2000, EU approved the strategic goal of making Europe the leading and most dynamic knowledge-based economy in the world by 2010. Very soon it became apparent that the strategy is not going to succeed. By many indicators, the economic superiority of the USA was increasing, and the rising East Asian economies were closing the gap to Europe.

Reassessment of the situation in numerous conferences resulted in a decision to adhere to the goal of the Lisbon strategy but to set no target date. Important areas of development were then defined. Among these, research and development (R&D) were again emphasized, and a reform of universities was considered essential for the resuscitation of Lisbon. Economic competitiveness is the driving force, not idealistic notions about educational democracy or cultural fulfilment.

Ranking of universities has received a lot of attention from the media, decision makers, and the business world. Because ranking lists are dominated by top American research-intensive universities, with Cambridge and Oxford the sole European stars, a gloomy picture about European higher education has emerged. The most important and influential scientific publications originate in the USA. Also, the majority of Nobel Prizes after World War II have been awarded to Americans. The innovative activities of American universities are more dynamic, reflected in the number of patents and spin-off companies based on university research, but also in terms of collaboration with the private sector.

Some of the problems underlying the lacklustre performance of European universities are easy to identify. Investment in R&D is lagging far behind the target of 3 % of GDP, agreed in the Barcelona summit in 2002, the EU average being 1.4 % and only Sweden and Finland above the goal. This influences not only industrial applied research and development, but also basic research which is traditionally carried out in public institutions. Investment in higher education by the EU countries is also much lower than in the USA, both in terms of percentage of GDP (1.3 vs. 3.2) and per student (less than 10 000 US dollars PPP vs. over 20 000). The student/teacher ratio is much higher in European than in US universities, which necessarily has an impact on the quality of teaching.

Most European universities have converged upon a single mode of function, that of a research-intensive university, despite the meagre funding and lack of tradition in world class research. Doctoral degrees are awarded by most of the ca. 4 000 institutions of higher learning in Europe but only by some 250 of a similar total number of universities in the USA. Quality research is expensive, and scattering of resources means that no institution can rise to the top.

One of the recognized reasons for the mediocrity of European higher education is lack of autonomy. Detailed regulation by state authorities robs universities of their possibilities to react to the changing environment and to take advantage of their strengths. Total dependence on state budget allocations, which in many countries come with strings and earmarks attached, prevents creative new initiatives. The civil servant status of academic personnel in most European countries gives job protection but few real incentives or rewards for excellent performance. Recruitment of world-class scientists and teachers is difficult, because lack of funding and collective labour contracts prevent salary competition, a problem compounded by the high level of taxation in many countries.

Although the current unsatisfactory state of European universities has been recognized by the EU Commission, the responsibility to improve the system rests with the member states, not with the Union. The EU can publish communications and proclamations, but as long as the member states disregard joint agreements and recommendations, progress is painfully slow. Nevertheless, awareness of the problem has increased, and many countries are now taking steps to improve their universities, not only in Europe but the world over.

Germany has launched a program called “Exzellenzinitiativ”, with the purpose of elevating some universities to the top rank in the world. Over five years, a total of 1,9 billion euros will be allocated for three purposes: graduate schools, centers of excellence, and strategic development plans. In each category, funding decisions were based on evaluation by international experts of proposals submitted by universities. Nine universities received the most coveted strategic funding and the label “Exzellenz”.

At the turn of the millennium, Canada decided to boost its university system by establishing 2 000 new research professorships. These were allocated to universities in proportion to their success in competitive national research funding. Each university was required to prepare a strategic plan, delineating their strong areas and future prospects, and apply for the professorships from a foundation set up to administer the new funding. The applications were reviewed by international panels of experts to ascertain that they were in line with the strategy and that the applicants fulfilled competence requirements.

China has also launched a “top university” program by allocating major extra funding to ten of their best universities. Sweden has celebrated the 300th anniversary of Linnaeus by awarding substantial grants to advanced research programs applied for by universities and evaluated by peer review.

Competition between universities is becoming global and more intense. As described above, many countries are responding by increasing the funding of their universities, but selectively and through competition based upon quality. This will lead not only to focusing of research on limited areas, but also to a differentiation of missions. Some universities will compete on the research scene, others invest into their reputations as teaching institutions, while still others put most of their efforts on the innovation arena, in collaboration with private industry and regional developmental authorities. This is a healthy development.

The universities in the Baltic region are at different stages of development, depending on history, the economic situation, and the structure of the research institutions. The traditional Russian system of concentrating research in science academies, whereas universities were mainly teaching institutions, was usual in Eastern Europe and the Baltic states during the Soviet era. After regaining their independence in the early 1990´s, the Baltic states have already taken steps to strengthen university research. Lack of resources is the most significant obstacle, but participation in the EU research framework programs has improved both the financial situation and the participation of scientists, teachers and students in exchange programs. A complicating factor is the proliferation of private universities, fuelled by the unlimited demand for higher education. These operate on market principles and cater to the most popular fields of study, without any research component. Because of lack of accreditation, lax public control, and untested confidence of employers, the new private universities are a significant risk for prospective students.

There are good arguments for increased university collaboration in the Baltic area. Although the fundamental problems of universities are not unique to the region, certain important research questions are. The most important of these is the physical unifying factor, the Baltic Sea itself. Mounting ecological problems are threatening its health and very existence, and these problems can only be addressed through high level multidisciplinary research. No single university, research institution, or even country is able to handle the scientific challenges involved. Mare Nostrum could be the central issue, around which universities in the Baltic region could concentrate their collaborative research efforts and, simultaneously, foster positive developments in the universities themselves.

Kari Raivio

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Ranking of Swedish higher education institutions

By Maria Tengroth

In Sweden, the ranking of universities and other institutions for higher education is a somewhat controversial matter. The Chamber of Commerce and Industry of Southern Sweden became aware of just how controversial when we launched our own yearly ranking in 2006 and 2007. Our ranking received a lot of media attention and the following debate confirmed that although it is still provocative and controversial, there is a growing interest in discussing issues such as quality, competitiveness and ranking within the Swedish higher education system.

Background

Sweden has, at present, no official ranking of its higher education institutions (the abbreviation HEI will be used here). Therefore the Chamber of Commerce and Industry of Southern Sweden have taken on this task by developing our own ranking. By using statistical data from the Swedish National Agency for Higher Education we have put together a model consisting of eight parameters (e.g. density of teachers, international exchange, capacity to attract external financing, average time needed for students to graduate, number of published articles). Data is derived from the Swedish National Agency for Higher Education, with the exemption of published articles where the bibliometric database *Web of Science* from Thomson Scientific is used. The model then relates the individual HEI's results for each parameter to indexed average of 100. Finally, all eight parameters are added together and weighed to generate an overall value for each HEI. This then method generates a ranking of Sweden's current 30 HEIs that offer traditional theoretical education (art schools etc. are not included).

Results and conclusions

The result of the 2007 ranking can be summarised as follows: Karolinska institutet ranks as number one among Swedish higher education institutions, followed by the Swedish University of Agricultural Sciences and the Stockholm School of Economics. Also, three general conclusions can be drawn from the results. HEIs with more financial and organisational independency rank higher than those without and HEIs that are specialised rank higher than those which are not. It also seems like smaller HEIs with a well-defined strategy for e.g. attracting students, improving international programmes etc. appear to do better than others. It is also evident that the rapid expansion of Swedish higher education since the 1990's has come at a price. Quantity has not always been matched by quality. We therefore argue that Sweden is too small a country to host over 30 HEIs with a full-fledged education programmes. In order to boost quality and competitiveness, further emphasis should be put on specialisation and the strengthening of comparative advantages of each HEI.

Reactions

As expected, our ranking has been met with some critical comments. The most frequent is a principal and general objection against measuring and ranking something as elusive and vague as quality. The actual results seem more difficult to criticise since they are based on official statistics. Not surprisingly, those at the top of the list were considerably more positive towards the concept than those at the bottom. Nevertheless, in connection to the launch of the 2007 ranking, we noted a refreshing openness and willingness to discuss these issues from a number of HEI representatives.

Development

Judging from statements made by the Swedish Minister for Higher Education and Research, Lars Leijonborg, it seems more and more likely that rankings will become part of the future Swedish higher education system. Minister Leijonborg has declared an interest and openness towards rankings, both Swedish and international, preferably EU or OECD based. To this end, the Swedish National Agency for Higher Education has recently started to examine these possibilities further. We can thus see a clear Swedish trend towards an increased element of measuring quality and competitiveness. There has also been a significant change in the Swedish debate on higher education since we launched our ranking for the first time in 2006. This change of debate, both within public authorities and government, as well as in the general debate on higher education, is very encouraging. From the point of view of the Chamber of Commerce and Industry of Southern Sweden, we are very pleased to see that the argument that it is better to at least try to measure and quantify quality appears to be gaining strength. To refrain only because of methodological difficulties, is fortunately becoming an increasingly rare standpoint.

Future plans

Our long term ambition with the ranking is – perhaps somewhat ironically – that it will eventually be redundant. That will happen when the ranking of HEIs has become a natural and central part of the Swedish higher education system, enabling students and employers to form at true picture of the strengths and weaknesses of Swedish HEIs. Until then, we will continue our preparations for the launch of the 2008 ranking.

Maria Tengroth

Policy Manager

Chamber of Commerce and Industry of Southern Sweden

Sweden

Finnish SMEs in the Baltic Sea Region - growth potential and challenges

By Niina Nummela

Finnish exports have been under considerable turbulence during the last decade. The number of the markets has increased and the importance of more distant markets has grown. Exports as an operation mode has lost significance, as companies have moved their production abroad. And yet, there are many things which still remain unchanged. One of them is the importance of Baltic Sea Region for the Finnish economy.

According to a recent report by professor Urpo Kivikari, 40 per cent of Finnish exports is directed to the Baltic Sea Region and even 45 per cent of imports accumulate from the same area. Despite the growing markets in Asia, the most important trading partners of Finland are still located in there, and one could argue that their weight might even increase in the future.

Small and medium-sized enterprises – the motor of Finnish exports?

Baltic Sea Region is particularly interesting and important from the viewpoint of small and medium-sized enterprises (SMEs) who – mostly because of their limited resources – have traditionally internationalised by exporting their goods via middlemen to markets which are rather close to home markets. The countries around the Baltic Sea have offered them a very natural way to expand their operations close to home.

In line with other countries in the European Union, small and medium-sized enterprises have always been an important part of the Finnish economy. Their role in the international trade has been limited but increasing constantly. According to Finnish National Board of Customs, in 2006 the exports of SMEs grew with 17% being 14% of total Finnish exports. The trend continued positive also throughout year 2007. Particularly encouraging was the share of micro enterprises who continued to expand their international activities. Altogether almost 13.000 Finnish SMEs were exporting, i.e. almost 90% of exporters were SMEs. However, despite the volume of SMEs in exports, Finnish exports is still dominated by giants; 20 biggest exporters cover approximately half of total exports.

Small and medium-sized enterprises – the potential of Finnish exports?

In spite of the dominance of large exporters – or perhaps just because of it – small and medium-sized enterprises do possess growth potential. The recent positive development in exports is very welcome and promising, especially given the fact that there is still a great number of SMEs who have not internationalised at all so far. If even a small proportion of them would enter the international markets, the number of Finnish exporters would be multiplied.

Then again, the international growth of SMEs does not come without challenges. Although SMEs are by no means a homogenous group, many researchers agree that, in general, they seem to differ from larger ones particularly in their internationalisation. For example, their decision making, international activities, internationalisation processes and exporting stimuli are considered to be different. Research on small-business internationalisation is usually based on the assumption that small and medium-sized firms suffer from disadvantages compared with their larger counterparts. Operating on international markets demands resources, experience, skills and knowledge, which small businesses often lack. It is evident that the combination of insufficient resources and inadequate management skills discriminates small firms compared to larger ones. Nevertheless, earlier research among SMEs points out their lack of international growth orientation of being one of the greatest hurdles in internationalisation. Consequently, one of the major challenges in promoting SME exports is to help them to overcome this attitudinal barrier.

Small and medium-sized enterprises and the Baltic Sea Region?

In line with other small and medium-sized enterprises earlier, also the newcomers on international markets would probably start their international expansion from the Baltic Sea Region, as it would be the most attractive business area for them. However, compared to the pioneers in the market, these late starters suffer from lack of first-mover advantage and the fact that they enter a highly competitive environment. In order to succeed, they need to find innovative solutions to offer.

On the other hand, at the same time it can be assumed that our current picture of SMEs actively operating in the Baltic Sea Region will slightly change. First, in addition to the manufacturing companies, service firms and particularly the ones offering knowledge-intensive services will increase in number. Of the Finnish service firms already active in the region, the majority are client followers, i.e. they have entered the markets in order to serve better their existing customers. Yet, it can be anticipated that in the future we will also witness the rise of market seekers, i.e. the service firms who are there to attract the large customer potential of the area. Both strategies are as likely to succeed, if the companies acquire enough market knowledge and monitor the market development carefully.

Second, SMEs' activities will probably move from traditional exports towards operations which require more commitment than earlier. As mentioned earlier, manufacturing SMEs have traditionally relied on local partners in their operations in the Baltic Sea Region. Nevertheless, it is probable that in the future the strengthening competition will require a stronger local presence on the market. This is particularly decisive for service firms, whose customers rely on their services on the spot.

Finally, the value chains and networks of all companies are becoming more complex than ever, and this will also be reflected in the activities of small and medium-sized enterprises in the Baltic Sea Region. They may enter the market either as a member of the network of a larger company or in an attempt to create a network of their own. In both cases, the SME managers will need novel kind of competences to manage their company. These network competences will prove to be critical in their future activities in the Baltic Sea Region.

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Searching for a new leadership in the Baltic Sea Region

By Žaneta Ozoliņa

Almost all articles written about the Baltic Sea Region start with axiomatic statement that it is a region of huge potential in terms of economic achievement (a third of European GDP is accumulated in the area), human potential (one third of the EU population inhabits the region), and a high level of compatibility (50 per cent of the countries of the BSR are included in the list of the „top 20" most globalized countries). Following EU enlargement, the BSR is no longer a periphery or „silent corner", but more a core region of the EU in terms of growth, stability, modernization and innovation. The special role of the region was acknowledged by the EU when European Parliament suggested drafting a European strategy for the BSR. The EP suggested focusing on the „3E+S" formula, namely, environment, economy, education and security (I would add one more E – energy), thus offering keywords for further debate on a wider European level. These priorities are significant for not just the region itself, but for all Europe as it develops the resources necessary for playing a more influential role in the global arena. Two significant events mean that 2008 could become a historical year for the BSR: the European Commission begins drafting Strategy for the BSR, and in July the CBSS (Council of the Baltic Sea States) will address the future of the organization, and the the BSR creeping agenda issues.

These two mega-events lead to a few more specific questions. Firstly, in terms of the EU BSR strategy – who writes what, and for whom? This is not just a rhetorical question, but rather reveals the diversity of the countries and their priorities in the region. It is more than clear that drafting the strategy should be based on the principle of inclusiveness, even if some countries are not members of the EU and one, namely Russia, does not share the same values and policy goals. Therefore the questioned should be restructured - not starting with „who" but for „whom" and „what". This approach would presuppose that all involved parties present their vision of the future of the BSR, as well as their policy priorities and express their commitment to the regional development. This will give an opportunity to those countries more interested in proceeding with their own initiatives to succeed and not be stopped or influenced by others with a different approach to regional cooperation. This policy would help some countries to avoid the temptation of converting inclusiveness into a principle that hinders more committed from further integrating.

Second, what is the substance of the BSR agenda? There are at least three circles of issues that deserve to be included in the agenda. The first circle is formed by priorities that are relevant to both the BSR and the EU, and have an impact on further developments at the regional and international levels. I would particularly single out the Lisbon goals. The Lisbon strategy can be ignored as a political document, but no one would dare to ignore its core - competitiveness. The BSR has a potential. But... According to the EP document describing the BSR, the level of prosperity in the BSR is below only one peer regions. The BSR is home to only 27 of 500 fast growing companies named in the „ Europe 500". The second circle is formed by policy priorities defined by the EU in regard to its salient neighborhood. BSR countries are not fully exercising their cooperative instruments to enhance European Neighborhood Policy in the Eastern part of the EU. Countries still tend to operate on the bilateral level, instead of using the knowledge and experience of regional cooperation that has been accumulated in the BSR over the last two decades. The third circle contains issues of a global character – energy security, climate change, development policy and others.

The third question derives from the previous two – how to combine the diversity of actors and their interests with the three circles of overlapping EU and BSR agendas? It is easy to provide a verbal answer, but more difficult to implement it, having achieved tangible results. The answer is that the BSR needs leadership. There are still many „divides" in the BSR that leadership can mitigate. The BSR leadership should present the ability to change itself and the environment. It should demonstrate skills that are needed in permanently changing international system - such as adaptability, openness, and creativity. Countries that representing experienced (in order to avoid term „old") Europe have knowledge, stability, and the tools to cope with globalization. Although Europe's newcomers can offer valuable new visions, perspectives, dynamism, imagination and flexibility. In mid 1990s Sweden expressed its willingness to undertake this role, but failed. Leadership works if it diminishes its individual interests, and is able to share leadership gains with other involved parties.

I would argue that Latvia has all necessary preconditions to play this role. Latvia was, and still is known, as an ardent supporter of regional cooperation. Latvia was a long lasting advocate of regional endeavors in times when others were hesitating to involve themselves in activities that did not guarantee quick results. Latvia has, and still does, support CBSS initiatives, and would like to see the organization become an institution where the regional agenda is designed, debated and accepted. Latvia has stabilized its relations with Russia, opening new opportunities for a multilateral dialogue. Latvia has geographic privileges and infrastructure that enable it to serve as a bridge – economic, logistic, services and others - for regional cooperation. Latvia has a foreign and security agenda aimed at neighbors of the BSR thus involving the whole region in the expansion of the area of stability and prosperity, of great benefit to Europe.

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The third stage of regional economy - integration of the east and west

By Tapio Välinoro

The third stage of financial development between Southeast Finland and Southwest Russia has started. The export limitations set by Russia for raw wood and the structural changes in the production capacity of Finnish paper industry strengthen the impression of the new development stage.

From a transmitter of raw materials into a distribution centre

In the bilateral trade between Finland and the Soviet Union, Southeast Finland gained a strong position as a transition region for raw materials transported from the east to the west in the 1970s and 1980s. The transportation of oil-based chemicals from the Soviet Union by rail, intermediate storage of products and their loading for sea transportation gave birth to significant business operations in Kymenlaakso.

The first development stage in the economy between east and west ended in Southeast Finland in the 1990s. As the Soviet Union was dissolved and the new Russia was born, the Baltic countries continued the transition traffic using the ports of the former Soviet Union until Russia invested in its oil ports. Southeast Finland advanced to the second development stage in its role between east and west.

The growth in consumer demand in the new Russia and the inability of its production to respond to the needs led to rapid growth in imports. The ports of Southeast Finland acquired a new role. Their main task in the exports of Finnish forestry products and raw materials transported from the east was changed. The transmission of consumer goods from the west to the east became new business operations in the 1990s.

The second development stage in the interaction of regional economy between Southeast Finland and Southwest Russia, the St Petersburg region in particular, had started. The ports had to be prepared for container traffic. The load handling systems were changed. The sorting of transition goods for retail sales in Russia created a distribution centre role for Southeast Finland.

As oil income brought wealth to the Russian economy, a middle class with disposable income developed at the beginning of the 21st century. In addition to daily goods, the demand for private cars started to increase rapidly. Assembly plants of foreign car manufacturers in Russia were not able to respond to the growing demand. The export of cars to Russia brought new business operations in Southeast Finland.

The Port of Kotka invested quickly in the new situation. In addition to the car transportations arriving through Hanko, the growing role of Kotka in car transportations exceeded the capacity of Russian frontier stations throughout the border between Russia and Southeast Finland. Changes in the structure and transportation direction of transition goods brought up narrow passages in the Finnish east-to-west road network. The insufficient transportation capacity of the main roads leading to Russia impedes transit and decreases road safety. The situation is finally being repaired. The improvement of the E18 road east of Helsinki will be started in the 2010s.

Global changes speed up the new development stage

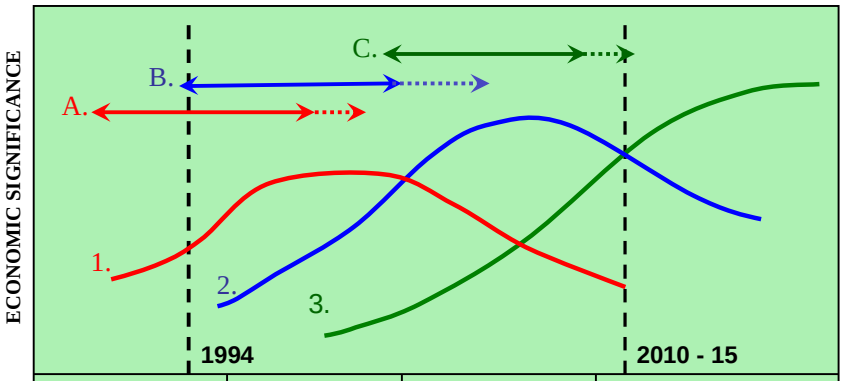
The Finnish forest industry utilised the Russian wood market that opened in the 1990s. The forest industry in Southeast Finland which constitutes 40% of all Finnish paper industry production, acquires one-third of its raw materials from Russia. The situation is changing. Russia's attempts to speed up the processing of raw wood material will tighten the availability of wood in Finland.

The transition of the growth in the paper product market from Europe and the United States to the Far East is to change the position of Finland and Southeast Finland in particular as the leading forest industry region. A fierce structural change is in progress that is sped up by wood being more difficult to acquire from Russia.

Southeast Finland is facing the third development stage in the interaction between east and west. As Russian production structures are being renewed and consumption demand is growing Southeast Finland must be involved in this development. We must secure the region's ability to compete in the transit role. We also must ensure that the region is involved in the development of the renewal of Russian production structure.

The renewed and growing production operations in Russia require competence and investment goods. They offer a market for construction in industry, commerce and housing production. They provide the possibility for becoming part of the new production chain. There will be a stage of integration in regional economy between Southeast Finland and Southwest Russia. This will be a significantly more demanding stage than the previous stages. The old Finnish saying applies: "We need to see the forest for the trees."

Development stages of Kymenlaakso



Development stage	Role	Key operations	Strategic areas of focus
A. Transit stage	1. Transition route	traffic networks and logistics services,	removal of bottlenecks
B. Creating and strengthening interaction	2. Distribution centre	terminal and frontier services distribution chains	flexibility and reactions to customers' needs
C. Integration stage	3. International production and service centre	production chains, project exports transfer of technology, int. business services	integration of production structures removal of trade policy obstacles

Tapio Välinoro

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Regional Council of Kymenlaakso

Finland

Leningrad region - capitalizing geographical advantage

By Alexei Prazdnichnykh

Both before the revolution and in the soviet times Leningrad region was but a farm and stockyard for the capital city - St Petersburg. The regional economy was based on supplying resources and raw materials to the city, such as agricultural products, lumber, fossils, power, and spare parts for the city's plants. The state of affairs changed in 1991, when USSR ceased existence, St Petersburg economy fell into a deep crisis under the reforms, and the Leningrad region (Leningradskaya Oblast) became an autonomous sub-national unit of the federation. The regional administration had to formulate region's economic strategy, to compete for markets, human resources and investment, on their own.

In fact, that proved to be a blessing in disguise. In the tough state of the economy of 90-ies, the Leningrad region fitted into its market niche and learned to benefit from its location advantage. As a result, it was able to perform well enough compared to St Petersburg, and sometimes even to demonstrate higher growth rates. The region's strategy was to concentrate on a few industries, using the region's main competitive advantages. Favorable climate, experience in agriculture and proximity of the major markets – St Petersburg and Moscow – facilitated an efficient development of agriculture and foods production. Region's location benefits, and its role of transport hub, allowed the region to successfully promote the development of port and transportation infrastructure.

The new strategy aimed at attracting investment and creating a favorable investment climate. Another advantage was the availability of vast land areas for production sites. Those two factors, along with the ones mentioned above, made for a substantial inflow of foreign investment in a variety of industries, ranging from foods to machinery. Besides, that facilitated investment in creating new production sites. As a result, the region saw a variety of industries established by investors from the USA, Germany, Finland, Denmark and other states. The most illustrative examples are, among others, Ford automotive plant, Caterpillar's production of tractors, and Nokyan Tyres.

In recent years the competitive environment for the region has become more challenging, which resulted from a tougher competition for investment on the regional level. The greatest challenge came from the city of St Petersburg, which has been aggressively bringing in foreign investment. As a consequence, increased investment to the city makes for a brain drain of human resources from the region. Other regions of the Northwest Federal District have also joined the competition for investment and they are becoming more efficient in using their own advantages. The Murmansk and Arkhangelsk regions offer rich natural resources; the Novgorod and Pskov regions have cheap labor, while the Kaliningrad region uses its attractive location in the center of Europe, as well as tax incentives.

Leningrad region's cluster portfolio is highly diversified and developed compared to other Russian regions, large part of its clusters are competitive and exhibit high productivity rates. Its key clusters are forest products, furniture, construction materials, chemical products, and agricultural products. Moreover, a number of latent clusters, among them automotive, textiles, hospitality and tourism, are not yet developed enough, but are already competitive, and have bright development perspective.

The region's strongest endowment is its Baltic Rim location, in between Russia and the EU. Region's large pool of low cost land resources is still its business environment advantage. Several region's weaknesses can also be traced, among them, lack of quality transportation and logistics infrastructure, availability of qualified workers. Apart from that, the procedure of land resources acquisition for business purposes is costly and suffers from red tape, in spite of the fact that industrial land abounds. Access to electricity infrastructure is also a problem.

Other region's business climate disadvantages include underdeveloped suppliers, lack of secondary professional education and relatively low internal market size. But these weaknesses are partially counterbalanced by the closeness to St Petersburg, where necessary suppliers, educational programs, human resources and retail distributors can always be found easily.

The competitive strategy of the Leningrad region aims at a breakthrough and implies three "opportunity horizons", which require different development models and competitive advantages. During the first stage it is critical to benefit to the full extent from positioning the region as a "Door to Russia" and bring in more investment for sustaining and developing of key clusters. Presumably, the construction materials cluster, forest products and furniture clusters, and agricultural products cluster would be most important during the first stage. The corresponding regional policy directions would be aimed at an increased efficiency of the most critical business environment factors: transportation infrastructure and secondary professional (technical) education.

The second stage implies using the region's competitive advantages and positioning it as an "Efficient Production Location". This stage's key clusters could be the automotive, heavy machinery, and possibly textiles and shipbuilding. During this stage regional policy should be focused on industrial real estate development, upgrading logistics infrastructure and construction services cluster.

The strategic goal of the third strategic horizon is to turn Leningrad region into the key element of the prospering "Integrated Baltic Rim". Innovation clusters may be of great importance to the region. During the third stage there may be the following priorities for the regional government: developing an integrated transportation and distribution cluster, a hospitality and tourism cluster, establishing innovation clusters both in the suburbs of St Petersburg and in other towns of the region that show investment potential, as well as strengthening cooperation with the leader states of the Baltic Rim.

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Russia

Today's possibilities for city twinning relationships in the Baltic Sea Region

By Mika Akkanen

The first phase of town twinning activities

The city twinning activities in Europe started in the years after the Second World War. One of their goals, which at the time was very topical and justified, was to integrate the citizens of various European countries at the grass roots level and thus contribute to reducing conflicts between nations. This is how cities with similar profiles and in similar size ranges in their respective countries became selected for twinned towns – more or less with the assistance of the governments.

The city of Turku currently has six twin cities in the Baltic area, as well as cooperation agreements of various types with a number of cities.

International interaction was not one of the priorities in the municipalities' sphere of action in the post-war decades. Typically, twin city cooperation consisted of cultural exchange activities implemented by city managements based on rather formal correspondence and other top level interaction. In addition to those who took part in the preparation and implementation of the various visits with pre-planned programme, the civil servants of the cities had little contact with their colleagues in the twin towns. The twin town friendship associations that were set up around the same period and that often were supported by the cities traditionally took part in the twinning co-operation, and they for their part gave the citizens remarkable opportunities for active participation.

Era after the great revolution

A great revolution has taken place in the twin city activities, in the Baltic region in particular, since the 1990's. Several reasons can be pinpointed for this:

- The overturning of the socialist system enabled direct cross-border contacts for individuals and organisations.
- The modern information technology (Internet, e-mail etc.) makes it possible for city employees to look for information anywhere and to keep in touch with their colleagues in other countries.
- The enlargement of the EU has enabled the use of various financing instruments in the development of municipal services. These financing instruments have at the same time placed on the municipalities the obligation to open up for international co-operation.

Today, internationality is routine in the municipal organisation. Colleagues in various countries and municipalities often know each other personally. The right partners for each matter are of course sought where they can be found, by even today the twin city relationship with its own special spirit is the easiest way of finding a partner, or an answer to a question. The interaction in the twin city network takes place on a daily basis, is fast and informal and emanates trust. This is how the original idea of town twinning is elegantly put to practice in the modern times. Joint development projects and sharing of information in twin city networks help to improve services and increase the standard of wellbeing all over the Baltic region. In this respect, there is no particular competition between municipalities.

The business sector and twin city activities

Can town twinning activities bring added value to others than the municipal organisation itself as described above? The current ease of direct contacts between countries has enabled such as companies' independent operations all over the Baltic area. How can the industries make use of our twinning relationships?

In my experience, when the twin cities have jointly taken part in preparations for a visit by a company delegation, such delegations have profited from this special relationship in the following ways:

- Access to decision-makers or information that is important for establishment or other operations becomes easier. It has for example has been possible to discuss the land use plans or economic forecasts of cities directly with the persons who are responsible for these areas – to get correct information from correct persons. The municipalities value their town twinning agreements, and this is why they wish to invest in and be committed to this type of services even at the level of principle.
- Being part of a delegation put together by a twin town (such as e.g. the Turku Region Development Centre) describes the trust our city feels for the company in question and gives the other party the message that they should take the company and its endeavours seriously, for example trusting that it is seriously looking for contacts with possible business partners.
- The government representatives in either countries, the embassies and consulates, are also happy to invest in business co-operation carried out under the town twinning umbrella and give it their own valuable support.

Turku has recently gathered plenty of positive experience of making use of the twinning relationships as described above in the business sector with such cities and St Petersburg, Gdansk and Rostock.

Economical decisions are made on economic grounds, but I feel that the city twinning agreements still play their own important role in mapping out possibilities and supporting decision-making in the modern operating environment. I hope that companies will not forget to make use of this instrument, too, in their operations.

The twinning activities have changed their form and will also change in the future, as the operating environment of the municipalities develops. Beautiful traditions and proven operating methods should be continued, but twin cities must live in the present; we must have the courage to reject what is old in order to make room for what is new and matches the challenges of a new era. Only in this way can twinning activities justify their existence and, even in the future, offer meaningful added value to cities, their residents, companies and other interest groups.

Mika Akkanen

Manager of International Affairs

City of Turku

Finland

The role of the special economic zones in attracting foreign investment to the Kaliningrad region

By Vladimir Kuzin

The special economic zone (SEZ) regime in the Kaliningrad region of Russia was established in the early 1990s, after the Baltic countries gained independence. The SEZ was launched through a Decree of the Chairman of the Supreme Soviet of the RSFSR "On economic and legal status of the SEZ in the Kaliningrad region", 3 June 1991. The SEZ regime was a tool for supporting this Russian region separated from the Russian mainland. It was introduced because the decline of the Kaliningrad economy was worse than the average Russian level due to the breaking-off of economic links.

The main instruments of the SEZ were a tax free zone and the right to ship goods to the Russian mainland, while still enjoying these privileges, as long as 15-30% was added to the value of imported goods and components. However, the SEZ regime was unstable due to it being subject to frequent changes in the regulations. This instability of the SEZ regime was an important factor in deterring domestic and foreign investment in Kaliningrad region alongside limitations on access to land and poor regional investment policy. The SEZ instability was rectified by the federal law №13-FZ "On special economic zone in Kaliningrad region" adopted on 22 January 1996.

Since 1996 the SEZ has been the most attractive component of the Kaliningrad investment image. However, some experts and politicians have attacked the regime as being merely a way of enjoying "tax free imports". These kinds of criticism and exchange rate problems (a weak rouble against the US dollar and euro drive down imports) limited foreign investment activity in the region. Foreign investment declined in 1995-1997, but investments in assets (mainly domestic) nonetheless grew at the same time.

The rouble devaluation in 1998 triggered subsequent foreign investment growth. It shot up in 1998 and has shown a sustainable increase since 1999 as investment in assets. 1999 was the turning point in development as shown by investment and industrial output growth. Much expert attention is devoted to the length of the project development cycle period. The Russian practice has showed the four years business project development period as we can see in Kaliningrad between 1995 and 1999 was a relatively short and for. Event in 1998 pushed project development activity.
The results of the SEZ regime's operation were the creation of new industries such as car assembly and television sets assembly. Moreover the regime supported the development of traditional industries, mainly food processing. By 2006 figures show that companies in the SEZ accounted for the production of 80% of TV sets and 84% of vacuum cleaners, 12% of foreign brand cars, 5.7% of furniture, 19.3% canned meat and 33% of canned fish for all of Russia. These success stories were an additional factor in stimulating investment growth.

A new version of the SEZ regime was introduced on April 1, 2006 under federal law 16-FZ "On the Special Economic Zone in the Kaliningrad region and on introducing amendments into RF Legal Acts" (adopted on 10 January 2006). The main change in the regime is in its transition from preferential customs treatment for all participants in the zone to tax allowances for new investment projects except for projects in gas and oil extraction and processing, alcohol and tobacco production, retailing and finance.

The law includes a ten years transition period for companies which have been operating in the previous13-FZ OEZ regime. Around 3,500 companies are estimated to enjoy such status.

The main benefits of the new SEZ regime for Residents (projects with the value of investments into assets exceeding 150 million roubles or approximately 4.3 million euro) include full exemptions on property and profit taxes for the first six years and 50% exemptions for the next six years and protection of the legal interests of the Residents by the Administration of the SEZ (at present this is upheld by the Ministry of Economy of Kaliningrad Region). Moreover the newly adopted federal laws of the Russian Federation on additional tax duties will not be applied to a Resident company during its operation (until 2031). The rate of land rent for an investment project cannot be changed during the whole period of validity of the rental contract. A free customs zone regime applies for residents, although customs duties must be paid in the case of delivering goods to the Russian mainland.

The main results of the new SEZ regime implementation on the registration of Residents and the associated investment are as follows: There are 48 Residents divided into three categories: domestic, foreign and combined. Collectively they have announced 27,934.26 million roubles (approximately 800 million euro) investment into assets. The domestic Residents have the biggest share – 73%, foreign Residents account for 17% and combined take up the remaining10%. Residents invested 12,237.55 million roubles (around 350 million euro) during 2007 broken down into 83% from domestic, 10% from combined and 7% from foreign Residents. Residents attract capital from different sources, with a big share of Russian bank loans, so the total amount of foreign Residents investment exceeds the foreign direct investment in Kaliningrad region volume in 2007.

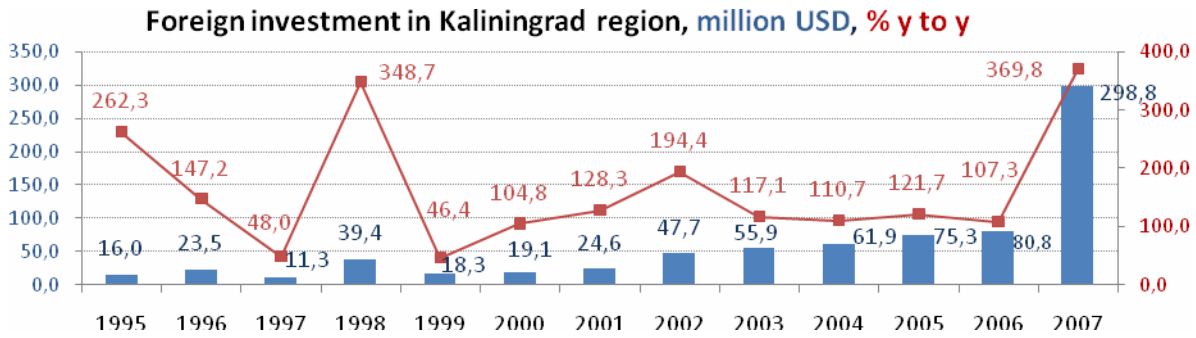
Countries of origin of Residents' investment in 2007 include Austria -1%, Czech Republic -1%, Cyprus – 7%, Lithuania – 17%, France – 22% and Great Britain – 52%.

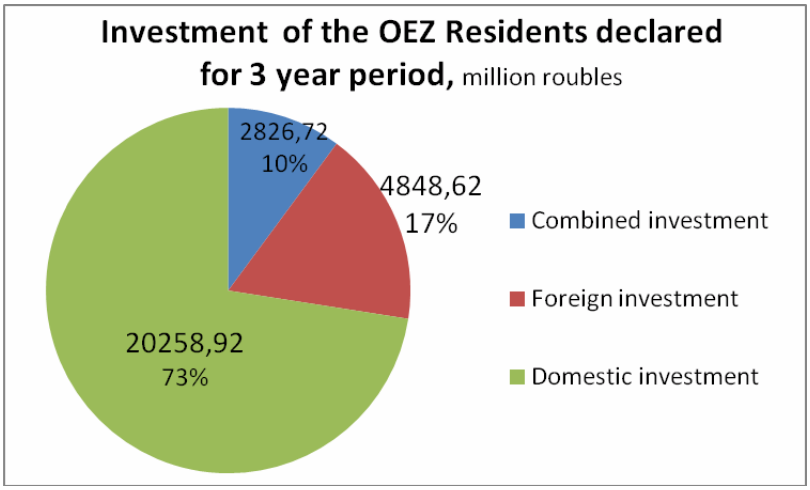
The fields of investment are in line with regional strategic priorities (energy, logistics, tourism, agriculture and food processing) established by regional law. The breakdown of Residents' projects shows logistics – 31.3%, machinery and electronics – 20.8%, real estate, agriculture and food processing – 16.7%, tourism and recreation – 12.5%, construction materials – 8.3% and other 10.4%.

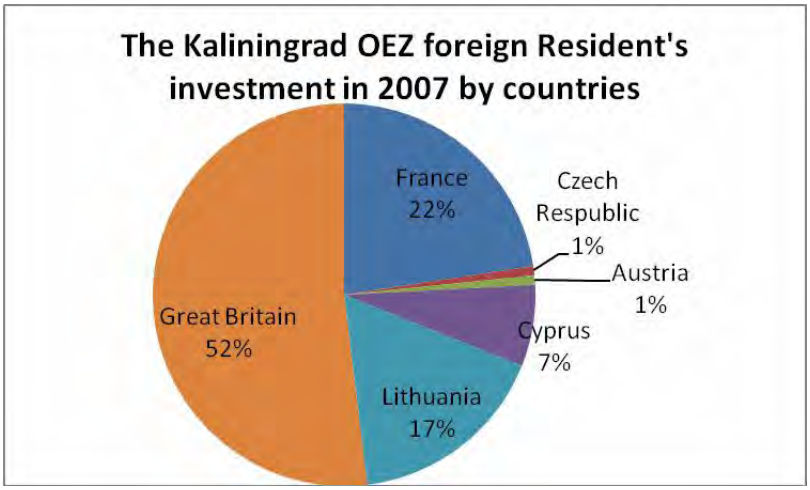
The foreign investment growth in 2007 was the result of the SEZ regime implementation. Both SEZ regimes push investment growth and strengthen industrial output. The index of foreign investment in 2007 was 369.8% and of industrial output in 2007 was 140.3%. It's extremely high growth in comparison with the base of 2005 and 2006: 127.4% and 166.6% respectively.

There are three additional factors that improve the investment attractiveness of Kaliningrad region apart from the SEZ regime. First is the pro-market position of the new regional government that took office in September 2005. Second is the establishment of a tourism special economic zone by a federal government decree, which involves federal and regional budget investment in infrastructure. Third is a gambling zone, one of only four such zones throughout Russia.

All these factors on top of the SEZ regimes are attractive to a potential investor to Kaliningrad – the Russian exclave surrounded by the EU.







Vladimir Kuzin

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The strategic planning department of socio-economic development of the Kaliningrad region

Russia

Medvedev´s new agenda for Russia - reforming a system that can not be reformed?

By Arto Luukkanen

The newly elected president of Russian Federation, Dmitry Medvedev, is now fervently supervised by specialists for Russian studies all over the world. His political agenda for the future is examined by politicians and think-tank specialists. The dilemma under the scrutiny is the obvious unbalance between the hard rhetoric's of old the president and conciliatory speeches given by newly elected president.

Mr. Medvedev - 42-year-old protégé of Mr. Putin - has promised to fight against corruption and has highlighted the need for a long period of construction inside Russia. Together with these fresh openings, Medvedev has promised friendly cooperation with its neighbours including USA and China.

Speaking to foreign reporters, the president elect said that Russia and the United States share common values and have no choice but to cooperate with each other. Moreover, Medvedev has emphasized the need to concentrate to 4 major i´s (innovations, institutions, infrastructures, investments) and has promised to transform Russia as a 5th largest economy after 10 years.

But what is more significant is his respective tone towards the civil rights. "*The talk here is about freedom in all of its manifestations: about personal freedom, about economic freedom and at last about freedom of self-expression*," Medvedev said in his famous speech at Krasnoyarsk, Siberia last February. He added, "*Freedom is inseparable from the actual recognition of the power of law by citizens*." According to Medvedev, freedom, private property and an independent judiciary would be the central planks of his administration. This is something new compared to Putin´s sarcastic attitudes towards civil rights and cold interviews with Western reporters.

Then how seriously we should take this? Should we take it as a face value? Are these nice openings made by the president-elect fabricated in order to lure the Western audience or are they just trumped-up stories for the Western armies of think-tank specialists who are busy in making their first deep political analysis concerning the new leader?

A famous Russian historian - Vladimir Shlapentokh - mentioned in his excellent analysis on Soviet system[1], that too eager reformers of the society may put in jeopardy the entire system. Nevertheless, being a true reformer requires bold assumption and true beliefs that there are real alternatives for the existing society. Shlapentokh´s speculations and dilemmas dealt mainly with Mikhail Gorbatchov and his reforms that destroyed the Soviet Union. As he aptly remarked, Soviet Union enjoyed firm content of its populations and only a small minority demanded changes in the Soviet economic system. According to Shlapentokh, it was Gorbatchov and his personality that evidently killed the Soviet beast.

To put it short, Soviet people at large directed their discontent towards bureaucracy but still accepted the Soviet dogma. Also the Western political leaders in 1990´s tried, peculiar enough, to preserve the Soviet system. For example, when inspecting the famous speech made by US President George Bush Sr. at Minsk in 1991 it is quite clear that West was not searching moment for a violent vendetta or planning to attack against its weary arch-enemy. On a contrary, it was looking forward to peaceful coexistence with the second nuclear power.

It is therefore rather fascinating to compare striking similarities between the gorbachovian reforms and the reformist rhetoric of Medvedev. When Mikhail Gorbachev came to power his first initiatives continued the political line adopted by Jury Andropov. For example, Gorbatchev followed Andropov's policies of cleaning up the party bureaucracy and he also instigated certain neo-Stalinist reforms, which were dedicated to increase workers productivity. When considering the rhetoric and bold initiatives made by Medvedev, it is quite likely, that in the short run, the practical agenda of the new president will follow above mentioned gorbachovian models.

Nonetheless, new demanding openings such as fight against the corruption and tackling with bureaucracy require tightening of the political control. However, the fight against the some part of the new elite requires the policy of involving intelligentsia for a new ally for policy-makers. This will open new perspectives to free media. If and when this happens, it will take place perhaps at the same time when Medvedev does his symbolic "patricide" and dissociates from his predecessor's policies. Perhaps Hodorkovski will be released due to Medvedev new policy.

Gorbachev himself moved from neo-Stalinist reforms to liberal reforms by the beginning of 1987. The reason why this new policy was adopted was linked with the earlier failures of reforming Soviet economy. It was then widely believed among the gorbachovian spin-doctors that the essential modification of the Soviet system would boost the economy thus saving the system itself.

The most burning quandary for nowadays spectators will be: shall Medvedev try to reform system that can not be reformed? Any attempts to adopt real principles of liberal reforms may cause mayhem to the fundamentals of the political system he inherited from Putin. The pillars of the contemporary Russia were cemented to build up new elite - "securocracy" – new ruling elite derived from the security organs. To introduce real democracy to Russia would be a death-blow to the new political order prevailing in that county.

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[1] A Normal Totalitarian Society. How the Russian Union functioned and How it Collapsed". 2001, London.

Estonia's development perspectives

By Andrus Ansip

Estonia's development has been much quicker than most of us dared to hope 16 years ago. Within the last 12 years (1995–2006), the Estonian economy has grown 2.3 times. According to the estimates of *Eurostat* our GDP per capita has reached the level of 72% of the EU average (1997: 41%), outperforming most other countries that joined the EU in 2004.

Accession to the European Union and NATO in 2004 has given extra guarantees to the Estonian economy. It has significantly stimulated internal investments and increased the credibility of Estonia in the eyes of foreign investors. As of September 2007 foreign investors have invested as FDI´s 10.8 billion euro, which is about 8050 euro per capita, into the Estonian economy. This figure is in fact the second highest amongst the Central and Eastern European countries, with only Czech Republic having higher per capita investments. It is of great significance to us that most of the foreign direct investments come from the Baltic Sea Region: around 40% from Sweden, 25% Finland, 4% Denmark, 3% from Germany and 1.2% from both Latvia and Lithuania.

Foreign direct investments have definitely been one of the key factors, which has contributed to the economic growth of Estonia. Over 8 quarters (from the second quarter in 2005 to the first quarter in 2007) our growth figures has exceeded 10 percent. However, from the spring of 2007 we have seen a small slowdown in growth figures: in the second and third quarter our figures were 7.6 and 6.4 percent respectively. The strong competitive status of our economy can be described by rising productive investments and the increase of employment and decreases in unemployment. In the third quarter of 2007 the number of people employed rose to 662100, which is the highest figure over the last ten year period. Unemployment levels have declined to 4.2 percent, which is also the lowest figure since the starting of market reforms in Estonia.

Estonia is systematic and continuous in its choices and decisions

Since the beginning of 1990s Estonia has invested significantly into the development of an attractive business environment (e.g. monetary system based on currency board arrangement, trade liberalization, non-taxation of reinvested earnings, flat-tax system, avoidance of tax exemptions etc.) and complemented this with an active privatization process. We have and will base our policies on a principle that the government shouldn't act as an entrepreneur, but should create its businesses a fair and competitive environment to act in.

The government will complement these developments with a sound and conservative budgetary policy. I'm very proud to state that from 2001 onwards government net incomes have always exceeded its spending. General government budget surplus in 2006 amounted to 3.6% of GDP and in 2007 it is estimated to be around 3%. Government debt on the other hand reached 4.0% of GDP at the end of 2006, the lowest figure in Europe.

High international rankings

Our right decisions and high potential is reflected also in various studies and indexes developed by internationally acknowledged international bodies. According to the last *Heritage Foundation*'s Index of Economic Freedom Estonia ranks 12th, similar index developed by the Fraser Institute places Estonia 14th in the world. On a global scale both the *International Institute for Management Development* and *World Economic Forum* describe Estonia's competitiveness highly: in these rankings we position 22 and 27th respectively. I find it a remarkable achievement for a country who was less than 20 years ago a state-planned economy.

All this lets us assume that our economic growth will be around 5 to 7 percent in the medium term future. We also acknowledge that one crucial precondition to our growth are structural reforms and the ability together with the willingness of people to go ahead with it. Our keywords have to be globalization, flexibility and shift towards knowledge-based production.

Openness – yes! Protectionism – no!

We welcome outside trade and competition. Rather than trying to fight globalization, we opened up our markets to foreign companies since the beginning. Estonia chose not to build up the so called "import subsidizing industries". We believe that direct comparison with the best will be one of the preconditions to a strong industrial sector.

I believe that this paradigm has succeeded to a full extent. Today we can see that it didn't create the so called "competitiveness adjustment": a state where companies would have had to adjust their behavior due to the step by step liberalization of our trade policies and the opening up of a common market with the European Union. In other words, we didn't build obstacles that would have had to be torn down in a short while anyway.

In 2006 the exports of goods and services accounted about 79% of the Estonian GDP.

Structural challenges and R&D

In the period from the 1 of July 2006 to June the 30th 2007 188 000 people found new jobs in Estonia, which is about 30% of the total workforce in Estonia. A person's readiness to accept a new job, is the key factor that describes the flexibility of an economy. Saving the jobs of yesterday, doesn't contribute into the competitiveness of our economy nor solve any social problem in the long run.

We see one of the key factors contributing to our growth openness to new technologies, especially IT solutions. In the period of 2001 to 2006 the absolute growth rate of R&D expenditure in Estonia was the highest compared to other European Union Member countries. In 2006 alone our R&D investments increased 45%. However, we must still take into consideration that in real terms the values are still very low and need to be increased significantly. The government takes R&D as one of its top priorities: we have stated in our work program that Estonia should reach its goal of 3% of R&D investments by the year 2015.

The only way that we can be winners in the globalisation process is by being even more open, investing into new technologies and stimulating new reforms and flexible adjustment. We should not cheat ourselves by believing that in the long run it is possible to compete in low-skilled sectors on the world market. We should not fear structural changes in the economy. Some adjustments and more flexibility in the labour market are inevitable, if we want to be competitive in

the future. Our future success - as well as the success of other Nordic countries - lies in knowledge-intensive products and services where most of the value is created in today's global production networks.

To support these changes, two additional development triggers have a critical role to play. Firstly - high quality education and skills development. And secondly - enhanced regional economic, political and cultural cooperation, especially in Nordic region.

Andrus Ansip

Prime Minister, Estonia

A new European Policy: the Integrated Maritime Policy, an ocean of opportunity for Europe

By Joe Borg

Europe has a longstanding and rich relationship with the seas and oceans that surround it. Its citizens have traversed vast ocean spaces in search of new opportunities, profiting from fair winds to ply their trade, and, when the going was a little rougher, pitting all their ingenuity and resourcefulness against the elements to save their lives and make their fortunes. In the process they have contributed to Europe's heritage a strong and vibrant maritime dimension. Thus, Europeans have been pioneers in the use of the potential of the sea, and sadly also in the unsustainable overexploitation of some of its resources.

Today, there is hardly a European citizen who does not, in some way or another, have a stake in our oceans and seas.

Almost 90% of the EU's external trade and over 40% of its internal trade is carried by sea, 90% of Europe's oil imports arrive by sea, and the maritime sector alone employs some 5 million people. Nor is this activity limited to Europe's coasts; the marine equipment industry in Austria, for example, employs 7000 people. We not only derive many of our jobs and our prosperity from the myriad maritime activities that exist, but most Europeans depend on these activities *literally* for the food on their table.

Yet our maritime environment is not solely the concern of sailors, fishermen, shipbuilders or seaside hotel-owners. It also plays a vital role in regulating our climate and in mitigating many of the mounting risks from global warming. We know that it can also hold the solution to many of our current energy concerns, with the potential to provide cheap and plentiful renewable sources of energy.

For this reason it is actually quite surprising that we have not developed before in Europe a comprehensive strategy covering all issues relating the seas and oceans and how they can contribute to meet the challenges we are facing today, such as climate change, globalisation, or energy sustainability and security.

The clear endorsement last December by the European Council of a long term vision and an action plan for an *Integrated Maritime Policy* as proposed by the European Commission earlier in October was not only the beginning of a new emerging European policy but a cornerstone on the way we make our policies.

For the first time in its fifty years of existence, the EU has explicitly recognised that an integrated approach is needed for the seas and oceans. Even more important, with this initiative we have looked at our oceans and seas for the first time as a subject of our policy-making. This unprecedented course of action has its origins in the compelling argument that there is a maritime dimension to virtually every major issue facing Europe today: energy, climate change, innovation, international competitiveness, job creation, environmental protection, trade, transport and so on. Whichever sector one looks at, one can see strong links that run between them and the maritime sector.

In other words, no Lisbon Strategy, no Gothenburg Strategy, no climate change and energy policy, nor even the European Neighbourhood Policy can make full sense without a marked maritime dimension.

Hence, the new European *Integrated Maritime Policy* will deliver exactly what the EU has lacked until now: a genuine, single vision of the oceans and seas. It is not just a question of fisheries or shipping, or of trade or regional development, or of research or employment or of the environment or relations with third countries. It is a policy that brings all these strands together and treats them as an-interrelated whole. It is also a policy that will feed from, and into, other Community policies, such as the policy for competitiveness, the policy for transport, the policy for regional development, or the policy for research.

In more concrete terms what we have in mind for the coming years is to take action on the following critical issues:

- Promote maritime clusters and regional centres of maritime excellence to raise Europe's competitiveness. This will particularly help smaller firms that are such an important part of Europe's high-tech maritime industries and it will be an additional element helping to improve the attractiveness of maritime careers.
- Deploy Europe's strengths to combat climate change in coastal regions, through research and innovation, through better planning for vulnerable coastlines and by taking the lead in international discussions.
- Develop a European Strategy for Marine Research and a commitment to excellence in research, technology and innovation, to help meet the Lisbon goals for growth and jobs and to fully exploit the opportunities that lie in new technologies.
- Better regulate maritime transport, helping the creation of a true barrier-free European Maritime Transport Space in the internal market and to support Europe's external trade in this era of globalisation.
- Recognise the crucial role of seaports in driving economic growth for their hinterlands.
- Examine how EU funding can best reinforce sustainable growth and boost prosperity in remote and disadvantaged coastal regions and islands.
- Ensure that all forms of economic development take account of their environmental impact, by fostering the construction of environmentally friendly shipping, reducing pollution risks and promoting ecosystem-based fisheries.
- Better use planning tools, data networks and horizontal coordination to support decision-making for marine spaces and coastal areas and to ensure international compliance with rules.

From this list it is possible to see that a careful balance between growth and environmental considerations is always at the heart of our concerns. In fact, despite the tensions between economy and ecology, I believe prosperity and jobs can go hand in hand with preserving the marine environment. To achieve this, it is often technology and innovation that hold the key. Hence, we are witnessing an increasing number of operators taking responsibility for the future of the oceans and seas by applying innovative technology on board their ships.

It is that combination of being willing and able to innovate that can render the economy and ecology mutually reinforcing: cleaner and less fuel consuming engines, recycling of ballast water and biodegradable material are increasingly being employed on board ships and off-shore platforms. Taking this one step further through eco-innovation, we find that businesses can also actually reap benefits, through new market development or reduced costs, from protecting the environment.

Our *Integrated Maritime Policy* needs therefore to be underpinned by the so-called eco-system approach. Impacts on our environment from increasing activities can and should not be pinned down to individual causes and effects. Instead, it is both the eco-system as a whole and our interaction with it which need to be the basis for the environmental and sustainability aspects of our new policy.

At the same time, there is a political imperative for us to grow, to provide jobs and wellbeing for our citizens. The integrated maritime policy is therefore not a strategy for economic growth only, or a strategy for the protection of the marine environment, but it is very much a strategy for both of them.

This is the only way we can change our current policies and move in the Twenty First Century into truly sustainable use of our oceans and seas.

Joe Borg

European commissioner for Fisheries and Maritime Affairs

Europe and Russia, new relations

By Yegor Gaidar

"God forbid us to live in time of change" – this is ancient Chinese wisdom. In 1985 the Soviet Union was a global superpower. In 1991 it was a bankrupt state begging for humanitarian aid from Europe. Today Russia is a dynamically developing country whose rate of economic growth in the past 9 years was at the level of 7% of GDP, whose budget surplus amounts to more than 7% of GDP, and which is on the third place in the world by the rate of growth of its gold and foreign currency reserves. It is not easy to get adjusted to such rapid changes – both for the Russian and for the European sides. In a situation of such radical changes, it is rather easy to make mistakes entailing very high costs.

These are the mistakes the Russian authorities may be prone to: to accept as reality the illusory belief that, because of Europe's dependence on Russia's energy carriers, the latter may have an upper hand and do anything it may fancy. This can indeed be true in the short term. But only in the short term. As shown by the experience of the late 1970s – early 1980s, energy-based blackmail in not an efficient weapon in the long run. I wish the key decision-makers in my country would understand this very clearly.

I should like to say a few words about the European standpoint in relations with Russia. The European Union's policies in the East during the last 15 years have been focused on its eastward expansion. When and if one discusses issues relating to somebody's membership in a club, is does not mean negotiating – one simply explains to the candidate the rules of game and the requirements to comply with in order to be accepted. One may, when he is ready to accept the rules, discuss the issue of possible slight exceptions from the rules which the new member might be ready to tolerate. But essentially this is not negotiations – this is explaining the behavior rules to an applicant for the club's membership. As the minister of foreign affairs of one big East European state once told me: to be in the European Union is paradise, but to negotiate the entry into the European Union is hell.

The problem of European policy towards Russia, in my opinion, is in its habitual inertia, in that it does not take into consideration the realities of the changing world, and largely builds upon the standards applied in the negotiations with the countries – candidates to the membership in the European Union. No one has ever suggested that Russia join the European Union, this is an issue beyond the sphere of political discussions. We are the European Union's neighbors, the European Union is Russia's most important partner in trade, and we are an important partner for the European Union, primarily in terms of supplies of energy carriers. Negotiating with neighbors is not the same thing as negotiating with one's family – no terms of comfortable coexistence can be dictated to one's neighbors unilaterally. One has to negotiate. The decisions made unilaterally, when they involve the interests of many parties, give rise to problems that have to be understood. One specific example of such problems is the forthcoming decision of the 27 members of the European Union concerning the recognition of Kosovo's independence in late January – early February, 2008[*]. Of course, this is a sovereign right of European states; but, when making such a decision, one should not think that it would be possible to convince anybody in the world that this case is unique, that it is not going to establish precedents, that it has nothing to do with the development of other regions in the Balkans or Transcaucasia.

I, for my part, would be very glad if no such problems develop, but I am afraid that this is beyond my power.

Yegor Gaidar

Director of the Institute for the Economy in Transition

Former Prime Minister of Russia

[*] The article has been submitted in December 2007.

Affluent Baltic region must increase its assistance

By Jan Egeland

During my years in Secretary General Kofi Annan's senior management team I saw, first hand, how effective multilateral action with heroic local and regional efforts, helped build progress and peace in such hopelessly war torn societies as Liberia and Sierra Leone, Eastern Congo and Burundi, Angola and South Sudan, Northern Uganda, Kosovo and Nepal. We also coordinated through the United Nations massive, life saving international relief in the Indian Ocean tsunami, the South Asian earthquake, the Horn of Africa, Southern Africa, the Lebanon war and the Darfur crisis. In several of these overwhelming emergencies hundreds of thousands of lives were predicted to perish. In all of these wars and disasters these sombre predictions were averted because multilateral action, building on local capacities, is today infinitely more effective than what is recognized in much of world media and national parliaments.

We fail as a collective humanity when multilateral action lacks the unity of purpose among UN member states. We fail, tragically and repeatedly, when the United Nations and regional organisations are not provided with the political will and the minimum of economic and security resources needed from their member states. The endless ongoing suffering in Darfur, in Iraq, among Palestinians and among the growing numbers of climate change victims in southern nations is a product of lack of action by all those that could have unlocked the situation.

The political leaderships in the increasingly affluent Baltic nations will have to follow the regional lead of Sweden, Norway and Denmark and invest more to fulfil the United Nations agreed goal that at least 0.7 % of Gross National Income (GNI) should go to foreign assistance. It is now a measly 0.25 % among the 22 major donors organized in the OECD. The goal of providing 0.7 % to combat poverty, disease and hunger has been reaffirmed several times by world leaders in New York, in Monterrey in Mexico and, importantly, as a legal commitment by the European Union member states. It is not an overambitious goal. When economies on all continents see exploding consumption of luxury goods, it is simply pretty stingy that most of these economies have endorsed no realistic domestic plans to achieve the 0.7 % goal. The Scandinavians and the Netherland have, in spite of unmet domestic needs, for decades over fulfilled this goal and see public support for giving one percent or more to the poorest and the neediest.

The G-8 nations, the self-proclaimed group of the worlds leading economies, agreed in 2005 upon the good initiative of the British hosts to pledge an additional USD 50 billion in foreign assistance by 2010 of which half would go to Africa. In 2006 these same leaders and countries gave less, not more, to the two billions living on less than two dollars a day. Except for the UK hosts, all the others failed to honour their commitments. The OECD could report a decrease of 5 % in foreign assistance overall from 2005 to 2006 and the G- 8 rich were no exception. The total registered foreign assistance registered was a mere USD 104 billion and less than the annual US cost to wage war in Iraq. Many of these "world leaders" now administer pitifully small investments in combating poverty, some of them less than 0.2 % of GNI, meaning that 99.8 % is spent on other public and private purposes.

But it is not only the G-8 nations that have to be the object of aggressive advocacy campaigns. The many newly rich nations in South-East Asia, in the Gulf region and elsewhere should be held accountable for taking their part in the effort to end mass misery. Today we are still far from achieving the goal of predictable minimum levels of support. Each year from 2003 to 2006 I launched the global humanitarian appeals with Secretary General Kofi Annan for 25 to 30 million of most vulnerable war and disaster victims in the world. We did not ask for more than 3 – 4 billion dollars each of these years, the equivalent of less than two café lattes per person in the industrialised world or less than two days of global military spending. We always got less than two thirds of what we asked for, even to these appeals for life saving assistance. With the exception of the Tsunami appeal and the Lebanon war appeal no emergency appeal was fully funded. Each year many places like Somalia or the Congo, where children died in the thousands for lack of funding, did not get more than 50 or 60 % of what our field workers said they needed to save the lives at risk.

Just as Iraq is the symbol of unilateral impotence in the new millennium, the positive change that has taken place in the worst war zone of our generation, the Democratic Republic of Congo (DRC), is the symbol of multilateral potency. During six terrible years of war, from 1998 to 2004 nearly four million Congolese died from malnutrition, preventable disease and violence according to the major mortality service of the International Rescue Service with partners. That is a loss of human life a great as the population of Norway, or five Rwandan genocides, or nearly 20 times the human toll in the Bosnia wars of the 1990s. Nowhere else have so many died from war during the last generation.

When I visited the DRC in 2003, a dozen or more armies were still fighting in Eastern Congo. The armed groups and militias consisted of hundreds of thousands of ruthless, undisciplined men from neighbouring states, from the main ethnic groups and from massive organised crime fuelled by the illegal exploitation of Congo's vast natural resources. Among them there were some 30.000 child soldiers. In the crossfire of the many parallel armed conflicts was the defenceless civilian population.

When I visited again in the autumn of 2006, massive positive change was taking place. More than two million of the 3.5 million displaced had returned home. A series of militias had been disarmed. We met in conflict prone Katanga, the Kivus and in Ituri many others who were impatiently waiting for the small sums of money and support that is given by the World Bank and the UN for the demobilisation and reintegration of the men who for more than a decade specialised on living and praying by the gun and who now told us they wanted to join in a peaceful society as working men. My humanitarian colleagues had for the first time access to nearly all major communities in the huge conflict and disaster prone country. The mortality rates that recorded more than one thousand deaths each day during 1998 – 2004 was finally coming down in 2006 and 2007.

What made things turn around in the Congo? After years of indecisiveness, neglect and penny-pinching lack of investment in United Nations operations, there was by 2004, finally a concerted effort from a united Security Council to provide a more robust peace keeping force, a generous and long-term push by the European Union to fund the enormous UN lead electoral process and there was more funding for our efforts to provide coordinate relief in all parts of the country. On the front-lines of this increasingly effective operation were the good efforts of dozens of Congolese and international non-governmental organisations, all the UN humanitarian agencies and a peace keeping force which received its soldiers primarily from the Asian and African nations that have with little publicity helped pacify and secure increasing parts of these enormous law-less territories.

The world is currently seeing the biggest and best network of like-minded inter-governmental, governmental and non-governmental organisations ever as channel of future investments in peace and development. Using highly specialised experts, big volume, local networks and manpower, continuous inbuilt quality control and improved coordination mechanisms, humanitarian agencies can feed, vaccinate and provide primary school for children for a couple of dollars a day even in the remotest crisis areas. Thereby the investment is, dollar by dollar, more cost-effective than anything I know in the private and public sector in any Northern or Western society.

The challenge for the Baltic Rim countries is very clear: take as a group a leadership role in global humanitarian and development assistance.

Jan Egeland

Director of the Norwegian Institute of International Affairs

Former UN Under-Secretary General for Humanitarian Affairs

Kesko - a retail specialist

By Matti Halmesmäki

Kesko is the leading provider of trading sector services and a highly valued listed company which provides products and services valued by consumers in the Nordic and Baltic countries, Russia and Belarus in close cooperation with retailer entrepreneurs and other partners. Kesko manages retail store chains, develops store concepts and business models, data management and logistics services. Kesko's operations include the food, building and home improvement, car, department store, home and speciality goods, agricultural and machinery trade.

The Kesko Group's net sales in January-December 2007 were €9,534 million, which is 9.0 % up on the previous year. Exports and foreign operations accounted for 22.8% of net sales. At the end of 2007, the number of the Kesko Group personnel was 25,900. Of these, 14,200 worked in Finland and 11,700 in other countries.

Customer satisfaction exceeding that of competitors

Kesko's strategic growth area is sales to consumer-customers. The targets are customer satisfaction that exceeds that of competitors and sales growth. Success in the consumer-customer trade requires clear customer and brand promises and delivering these promises on every visit to the store. Customer promises are delivered with high-quality and competitively priced products, a comprehensive store network and good service.

The objective is to increase the sales of all divisions faster than the market in Finland and to increase the proportion of international business. Kesko's strategic objectives include the combination of retailer entrepreneurship and efficient chain operations. K-retailers are responsible for customer service, local selections and delivering the customer promise in their stores.

Main divisions are expanding to high-growth markets

The emphasis of Kesko's growth is above all on the food and building and home improvement trade. Growth is achieved with considerable store site investments and business acquisitions supporting the growth strategy. Outside Finland, growth is sought particularly from the Russian and Baltic markets.

Kesko Food is Kesko's biggest business divison. It's net sales were €2,537 million in 2007, but Rautakesko is Kesko's largest international business unit. The sales outside Finland are about 64% of the whole sales.

Home building and improvement markets are becoming concentrated and international retail chains are establishing stores in the largest cities. The market is growing strongly in Russia and the Baltic countries, whereas growth in the established Nordic market is more moderate. The total retail market of this sector in Rautakesko's operating area is about €16 billion.

The Russian market in particular offers significant business potential in the building and home improvement trade. In addition to St. Petersburg area and Moscow, Rautakesko's objective is to open several new stores in other large Russian cities, too. Support for Rautakesko's growth is provided by investments in the joint enterprise resource planning system, centrally directed logistics network and by leveraging economies of scale in sourcing and purchasing.

Kesko Food's objective is to enter the Russian market. Possibilities in the Baltic markets are also being investigated. Expansion to the Baltic countries in the sports trade is being studied as well. Kesko will also strengthen its position in the Baltic machinery and furniture trade.

Development of electronic commerce and services

Electronic commerce is rapidly gaining ground in consumer-customer sales. Kesko's objective is to grow business and improve customer satisfaction through e-commerce and services. Kesko holds a strong position in online business in home and speciality goods with the NetAnttila and Kodin1.com concepts. There is plenty of scope for expansion in e-commerce in other product lines, too.

Best retailing competence and responsible operating practices

Developing the competence of personnel is a key factor in the K-Group's competitiveness. Emphasis areas in HR development include competence in retailing and international trading, customer and service competence and development of management skills.

The principles of sustainable development and responsible operating practices are highlighted in Kesko. Consumer-customers require that the trading sector bear responsibility for products' safety and healthiness, and also for the environmental and social impact of business operations.

Matti Halmesmäki

Kesko

President and CEO

The 2007 State of the Region Report*

By Hans Brask

At the 2007 Baltic Development Forum Summit (BDF) in Tallinn 4-6 November last year key decision makers and experts from and beyond the Baltic Sea Region representing business, politics, academia and media met to discuss and identify strategies taking the Region forward. One of the highlights was the release of the State of the Region Report, written by Principal Associate at Harvard Business School, Dr Christian Ketels.

The 2007 State of the Region Report gives a very good overview and analysis of the economic situation in the Baltic Sea Region in general and in its 11 countries. The report states that last year has seen exceptionally strong performance by the economies in the Baltic Sea Region, mainly due to the raise in labour productivity and mobilization. The region's FDI attraction has also improved significantly, while exports and patenting remain stable at high levels. The main conclusions of the reports are presented below.

Motivation for Regional Cooperation

First of all the Report provides a good overview of the incentives to strengthen regional cooperation. Why does cooperation with your neighbour matter? Why are certain regions more successful economically than others? It is worthwhile to repeat the basic argument at a moment where a lot of attention has been on the challenges and opportunities related to the European and global levels. Undoubtedly, the countries in the Baltic Sea Region can built further on their ability to optimise their common competitive potential. Neighbouring countries provide natural opportunities for economic interaction, natural markets, natural investment partners and sources of skilled employees, hence significant benefits for competitiveness and economic performance. However, most neighbourhood effects do not come automatically but have to be earned. The opportunities for the neighbourhood to generate benefits are high in the Baltic Sea Region but require political will and a strategy to overcome remaining barriers. Under the condition that the barriers can be overcome, the regional dynamics can become an important complement to the EU, pursuing deeper levels of integration and creating a platform to influence policy making in Brussels. At the same time, it is very positive that the EU has decided that time has come to elaborate a strategy for the Baltic Sea Region. It will also contribute to generating neighbourhood benefits.

Macroeconomic performance

Evidentially, regional cooperation is affected by the macroeconomic climate in which it occurs. At the global level, the environment has been very benevolent in recent years. The most likely outcome now is a slowdown of the global economy not least due to financial market problems. The macroeconomic climate is still strong. Real GDP growth remains significantly above the level in the EU-15 and has even started to outperform both the NAFTA region and the world economy overall.

Prosperity growth has accelerated and is overall on a solid path, even if the high speed of the last year will be hard to sustain. The Region continues to benefit from a solid combination of high labour mobilization and solid productivity levels. Intermediate indicators of competitiveness, often a signal for things to come, send more mixed signals but are generally also at solid levels.

At the same time the economies in the Region are entering the later stages of the current business cycle. While there is risk of overheating, the most likely outcome is for an orderly slowdown of growth rates over the coming months and years.

Competitiveness in the Baltic Sea Region

The Baltic Sea Region continues to be among the most competitive economies in the world. Where changes occurred since last year, they tended to be positive, reflecting the benign economic climate that the Region is experiencing. The Region's strengths continue to be its sophisticated companies, its asset base, its innovative capacity, and its equal rules for all in competition. Weaknesses exist in the burden that rules and regulations impose on the vitality of competition and in some aspects of the education system. The skill base remains strong for now but there are concerns whether it will remain competitive in a changing future environment. For this reason, the need to attract, develop and retain talents was a key topic at the BDF Summit in Tallinn.

The cluster portfolio of the Region is also solid, but a Region-wide strategy to develop it is required, in the face of increasing competition among clusters within Europe and globally.

From the perspective of the European Union's Lisbon agenda, the Baltic Sea Region remains in a leading position, a 'beacon for the rest of Europe' as EU Commission President Barroso commented two years ago. The countries from the Region also get generally good reviews for the direction and implementation of their National Reform Programs. Regional cooperation could, however, become a more visible part of these programs.

Attractiveness of the Baltic Sea Region as a Market for Business

The company perspective of the State of the Region Report is based partly on a set of CEO interviews conducted for this Report. As a market, the Baltic Sea Region is not perceived as integrated, largely because the differences in regulatory regimes and the legacy market structures require companies to run businesses nationally. The Region is, however, becoming increasingly important as a higher management level to increase the efficiency of business models. The lack of market integration raises cost levels for companies. Further integration will reduce these costs and can attract more foreign companies and open the door for consolidation across the Region. This process has only begun; in the past, regional integration has supported the growth of existing business models but has not led to their recalibration.

The Baltic Sea Region provides a number of qualities that make it an attractive source of competitive advantages. Its small market size, however, leads foreign companies to stay outside instead of leveraging these opportunities. Those companies that have come are able to draw especially on the skill base of the Region. Companies from the Region have seen the particular nature of local markets and business environments shape their strategies on global markets. Competing on innovation, design, and a willingness to adjust business models flexibly to the particular needs of foreign markets, companies from the Region have been successful in a significant range of businesses across the world. The

* The Report that is co-financed by Nordic Investment Bank, Nordic Council of Ministers and Baltic Development Forum can be downloaded free of charge at www.bdforum.org

market opportunities in the Baltic countries, to some degree also in Poland and NW Russia, have invigorated the Region and given companies new opportunities to develop strategic advantages.

Efforts to upgrade competitiveness in the Baltic Sea Region work generally well; better than in many other parts of the world. But the current CBSS review of public sector institutions for Baltic Sea Region cooperation needs to be ambitious in its approach to register with the business community. Company leaders themselves will need to discuss whether they should create a new Baltic Sea Region voice of businesses as a counterpart to the existing public sector structures.

Without doubt, recent years have been a good year for the economies of the Region, a trend that is likely to carry on. The challenges are further away in the future, related to the Region's position in the world economy and its demographic profile. The most immediate step to address these challenges is the creation of an effective institutional architecture that can devise and execute an action agenda for long-term competitiveness in the Baltic Sea Region. A platform for politicians, business, entrepreneurs and the academic world to meet is necessary in order to identify problem areas and opportunities for the Region. Baltic Development Forum will endeavour to plays its role in this regard.

Hans Brask

Director

Baltic Development Forum, Denmark

Market-based investment into Russian power sector

By Timo Karttinen and Pirja Heiskanen

The on-going Russian power sector reform is one of the largest industrial reforms taking currently place in the world. It was initiated in response to the increasing need for investments in added capacity. Russian electricity demand declined after the collapse of Soviet Union but started to increase again in 2000. During the most recent years it has grown alongside high oil prices and the booming Russian economy. In 2006, electricity demand increased by over 4% in Russia compared to annual growth of about 1% in the Nordic countries. On the other hand, there have been few investments into generation capacity during the last decades, and the existing capacity is rather old. The strong growth in electricity demand, together with the ageing capacity, creates a need for both new investments and energy savings. It is estimated that Russia will need an additional 180 GW or so of electricity generation capacity by 2020, i.e. almost the equivalent of its existing capacity and twice the capacity in the Nordic market. The estimated capital needed for the investments is EUR 190 billion.

The main challenge in the Russian market is to secure sufficient electricity production capacity to ensure further economic growth. The challenge is not only to attract enough capital, but also simply to carry out these huge investment projects as scheduled. And while securing the future supply of electricity, the electricity prices for end-customers should remain competitive. As there is a need for new energy investments also globally and in the markets close to Russia, global competition for power plant equipment as well as for experienced project management has intensified. In many cases today, it is in fact the availability of equipment, engineering and management resources that is slowing new investments, not the capital required.

Many similarities to the Nordic electricity market

The main idea of the reform is to open the power sector to competition by unbundling the vertically integrated companies owned by Russian energy giant RAO UES and by setting up a marketplace for selling and buying power. The market economy was seen as the best mechanism to attract investments into generation capacity and to keep electricity prices competitive, due to tight competition between the generators. The overall model resulting from the Russian power industry reform is very similar to the Nordic power market successfully implemented for over 10 years now: The generation and sales of electricity will be privately-owned competitive businesses, and transmission and distribution will remain regulated. However, there are some differences in the Russian electricity market design in comparison to the Nordic one. For instance, in Russia there are separate markets for electrical energy and power capacity: In the energy market electrical energy is bought and sold with price covering the marginal production costs. Through the capacity market, customers buy capacity to cover their peak demand, and producers receive payment for their fixed costs and capital charges. Due to the large transmission network in Russia, a so-called nodal pricing model is utilised in the energy market. In this model, transmission losses and limitations are accurately reflected in local power prices. Starting at the beginning of 2008, at least 15% of energy is sold with liberalised prices. The capacity market and financial derivatives market will be launched during 2008. All in all, the speed of the Russian power market reform is impressive. In early 2008, the average market price for energy has been about 23 EUR/MWh in the European and Urals part of Russia. In addition, power plants receive a separate capacity payment that varies per power plant; the size of the payment is around 10 EUR/MWh.

Investments require reliable price formation and stable regulation

In the liberalised power market, investments are made based on anticipated future profits. Therefore, it is extremely important to have accurate signals for investment needs. When making investment decisions in the power sector, it is crucial that one can trust that the power price is and will be formed on the basis of supply and demand, and that it won't be distorted by any regulatory mechanisms. Market-based price formation and a view of future price development is the single most important factor influencing the investment decisions. Liquid trade with electricity forwards offers a market view of future electricity price development. It is also important that market information, such as long-term forecast for demand and generation as well as transmission capacity, are publicly available so that all market actors are able to form their own view of the future capacity need and to plan new investments accordingly. In addition to average annual price, also the price profile within the year is important in determining what type of capacity is needed in the market. For example, frequent and high price peaks would make peak load capacity investments attractive, whereas big day-night price variations would give an incentive to build capacity that has flexibility in day-night production volumes.

It's not only a question of investing in generation capacity: Investments into transmission network are also needed to ensure competition between different geographical areas. Large areas with no remarkable transmission bottlenecks and a diversified ownership structure increase competition between generators and guarantee the lowest possible prices.

Since an investment into generation capacity is a long-term commitment, it is important for the investor that the regulatory framework remains stable. In the EU, for example, the uncertainty of the detailed structure of the EU emissions trading scheme after the Kyoto period created uncertainty among investors; what type of production form would be economically viable? Similarly, sudden changes in taxation or subsidy mechanisms increase uncertainty about the competitiveness of different production forms. Stable and predictable regulation reduces investment risks and thus increases the willingness to invest. As discussed earlier, an undistorted, transparent and free price formation is needed to properly signal investment needs. Possible market distortions due to limited competition in areas with transmission bottlenecks should be taken care of by market monitoring.

In a market economy, investments are made when they are economically justified. Therefore, possible government steering should focus only on setting the stable boundary conditions, such as taxation, (minimal) subsidies, etc. Likewise, incentives for continuous efficiency improvements are needed to guarantee competitive prices. With the current huge investment need, also accelerated licensing procedures are of utmost importance. Government steering that is too detailed and inflexible and neglectful of market signals may lead to inefficiency or even a capacity deficit.

A huge opportunity for foreign investors

The Russian power market reform and the need for investments offer opportunities also for foreign investors. Fortum already owns a slightly over 25% stake in the power and heat generating company TGC-1, which operates in an area spanning from St. Petersburg and Karelia to the Kola

Peninsula. The further sale of RAO UES stakes and additional share emissions will provide added opportunities for investors. The foreign investors can bring both the capital to finance the needed investments and something even more important – namely their knowledge of and experience in the efficient operation of power plants in liberalized power markets and environmentally benign technology.

Timo Karttinen

Senior Vice President, Corporate Development, Fortum Corporation

Pirja Heiskanen

Vice President Russian Generation Business, Fortum Power and Heat

Energy and Transport into the Northern Dimension?: Russian Perspectives

By Tatiana Romanova

The Northern Dimension (ND), which got its second life in 2006, is currently striving to find its place in the maze of EU-Russian relations. In particular, the idea is to develop new partnerships alongside with the two existing (on environment and public health). Two sectors were identified for these partnerships – transport and energy. What is the Russian position on developing new partnerships within the ND?

The key aspect of the ND as a whole for contemporary Russia is the interrelation between it and the overall EU-Russia dialogue. This interrelation defines the place of the ND within the EU-Russian relations and at the same time, given the fact that the ND embraces only North-Western Russia, has to be consistent with the division of competences and responsibilities within.

The Political Declaration on the ND Policy of 2006 specified that the end goal is "to make the Northern Dimension policy a regional expression of the four EU–Russia common spaces with the full participation of Iceland and Norway". This formula relieved some of the Russian concerns but at the same time made progress of the ND dependent on the success of the overall EU-Russian relations, particularly of the Roadmap for the Common Economic Space (CES).

Numerous factors prevent the CES from being a success. I would mention only two of them. Firstly, it is not obvious what a space is (whether it is a free trade area, an internal market or something else). Hence, the long-term goal of cooperation is quite amorphous. Secondly, the parties differ in how they see regulation of their economic relations. The EU insists on Russia approximating its legislation to the acquis communautaire. (The newest form of it is the so-called reciprocity principle.) Russia insists on 'legal convergence", i.e. designing common legislation together, either in the context of EU-Russian relations or within international organizations where both Moscow and Brussels are equal members. The ND, being linked to the overall EU-Russian relations became dependent on these conceptual differences on the CES.

Furthermore, numerous sector dialogues were created to further EU-Russian economic relations. They deal with energy, investments, IPR, transport, state procurement, environment, macroeconomics, competition, financial policy, telecommunication and information society, industrial policy, entrepreneurial activities, agriculture, regional cooperation. The content and progress in these dialogues also have to be taken into consideration when new initiatives are developed within the ND. The Conclusions of the meeting of Senior Officials that took place on 21 November 2007 is a good illustration of this fact (and the Russian vision). The mandate that was given to the ND Steering Group on exploring the possibilities of the Transport and Logistics Partnership clearly states that it should not contradict or duplicate the discussions between Brussels and Moscow in the framework of the transport dialogue.

So, what can ND possibly contribute to the cooperation in transport and energy?

Energy dialogue at the EU-Russian level is currently the most developed one. However, key problems of energy cooperation (even when it takes place in the ND region) can only be solved at the strategic level. Cooperation in this field is impeded by the fact that parties do not agree on the long-term goal of the energy relations. The EU promotes a wider European energy market based on the rules that are similar to the EU's whereas Russia argues for the guarantees for both suppliers and consumers, and for the reciprocity in assets' swapping. Decisions on the development of infrastructure are also taken at the level of Brussels and Moscow because of their strategic importance.

However, in my view, there is a role to play for the ND in the field of energy. Regional energy cooperation can make considerable contribution to energy efficiency and development of renewable sources of energy. Several reasons speak for it. Firstly, these questions are not politicized and there is a broad political agreement about the need to progress in them. Secondly, Nordic countries possess some important expertise in this field. Finally, a local action is required to improve energy efficiency or develop renewable sources of energy.

Furthermore, the region can contribute to the development of the transportation projects that were agreed by Moscow and Brussels in terms of practicalities, solving problems of cross-border formalities and setting a good example of cooperation between public and private parties.

To sum up, an energy partnership in the ND can be a place to demonstrate the extent of cooperation in the field of energy efficiency and renewable sources of energy but also a trial ground for the implementation of the projects that have been agreed.

Transport dialogue is a relatively new dimension of EU-Russian relations. Its terms of reference were agreed in September 2005. They presuppose harmonization of the development of transport infrastructure, enhancement of mutual understanding of legislation, compatibility of technical regulation, and development of harmonized EU-Russian position in international fora like IMO, ICAO or ILO. These issues can only be solved at the level of EU-Russian relations because of their broad, strategic nature.

However, again, I would ague that a transport partnership in the ND might have a future if it concentrates on specific projects. This would be consistent with Russia's vision. Several ideas were voiced by Moscow in this respect: the extension of the Barents link to Russia through the White Sea, the Republic of Komi and the Urals (Belkomur); high-speed rail link between St. Petersburg and Helsinki; construction of new border-crossing points to deal with the long key at the EU-Russian border. The main reason for the ND to play a part here is that it is the region of immediate contact and intensive economic interaction. Moreover, some problems have already been solved here, which can provide an example for EU-Russian relations as a whole.

Thus, conceptually, transport partnership can serve as a demonstration place, as a trial ground but also as a place for some innovative solutions.

This short overview shows that there are several possibilities for the ND to contribute to EU-Russian cooperation in the field of energy and transport. These possibilities are consistent with Russia's vision of the ND and should therefore be explored.

Tatiana Romanova

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Managing a modern business law firm through values in the Baltic States

By Aku Sorainen

Typical current organisational structures

Typically law firms in the three Baltic States have been managed in a very conservative way, which was common also in the Western Europe some 15 to 20 years ago when much of the work was still litigation driven. Partners practicing law at the same firm have often been sharing costs rather than profit. In such environment a client is "owned" by a partner rather than the firm. The firms that share their profit between the partners are often led by a strong single leader, who is almost always also the founder. Typically salaries for associates are based on a proportion of the revenue they generate. Only a few law firms have offered systematic training (at the company's cost) or career development for their personnel. Since the Baltic economies have grown rapidly, there has been a lot of work for everyone and there has been fairly little competition, including lateral hiring, between law firms.

Strengths of the above described management systems are a few: a high level of control over the clients and a fair amount of attention paid to clients because of highly motivated partners who keep contact with them. Partners have avoided taking business risk in the form of high fixed costs due to salaries of associates being tied to performance. Individual stars among partners and associates have been highly remunerated.

Yet the weaknesses are also visible: it has been difficult to develop the firm as a whole since the "stars" have been more interested in their personal practice. Also, assignments have not always ended on the desk of the best professional to handle the specific topic. This is due to the lack of "one-firm firm" culture and a high level of competition between professionals within the firm. Furthermore, it has been noted that such management systems are characterised by a fairly high turnover of personnel.

What is demanded from law firms in the near future?

The majority of the work among largest law firms has switched from litigation to consultation and project management, and clients have realised that most well known lawyers are not masters of all fields of law. The vast amount of legislation enforced and harmonized with EU directives during the past 10 years in the Baltic States, topped with substantial amount of EU case law, has made it clear to many that lawyers must specialise more than ever before. Furthermore, clients now demand better and faster service. Both the requirements mean that partners must delegate more than they have been used to. This will mean that clients will be less owned by a partner and more by the firm, while clients shall be served by teams of specialists rather than by one lawyer only.

The formation of specialist teams again requires more systematic training of personnel and less personnel turnover. This short column is about to introduce means to reduce turnover of most wanted persons in the organisation.

The role of corporate values in a modern law firm

Organisational values must be clear and understood by all. This is no different in the Baltic States. It is sometimes claimed that employees lack long term career development vision. This is understandable due to huge transformation the three countries have undergone and fast development including fast increasing salaries. It is no wonder that many employees have opted for a slightly higher salary, if the salary was the only motivator to keep them in the first firm anyhow. Therefore, sharing values is important. If employees can agree on the corporate values and thus feel that they are doing the right thing in the right place and feel that there is progress, then they are less inclined to be easy targets for other employers. The set of values described underneath are values of Sorainen and described as one possible alternative:

The first value is quality (in people, processes, and work product). The best people simply want to work with the best people. As the organisation grows, a quality management system may become needed for the purpose of securing uniform approach and efficiency of work processes.

The second value is focus on the client. It may sound as a cliché, since everyone from restaurants to ticket offices and copying firms claims they focus on great client service. But how often is it really true and implemented throughout an organisation? Law firms cannot afford to focus less on clients than anyone else. It must be in the backbone for each employee in a law firm that their main task is to provide clients with great solutions and advice.

The third value is development. Systematic training of personnel is part of it. The training must include not only legal technical skills, but also relevant business and client industry related skills as well as negotiation, communication, sales and marketing skills. This may be a huge investment by the firm and the employer wants to see the investment being profitable, i.e. personnel using the newly acquired skills for the benefit of the firm and not for the benefit of a competitor. A way to encourage and direct the development is carrying out regular development discussions not only once a year, but more often. It seems that development discussions are already becoming a part of personnel strategy in most successful companies in the Baltic States.

The fourth value is teamwork and know-how sharing. Since specialisation is inevitable and clients shall be served by different specialists rather than individual all-round partners, the specialists must be able to work in teams. Not only are they required to share information about the client and his/her matter, but also they are required to share know-how regarding best practices and thus avoid "inventing the wheel twice". Information used to mean power in the Soviet times, now keeping information to oneself is a serious sin.

The fifth value relates to ethics and respect. Some say that the new and immature business culture in the Baltic States leaves little room for business ethics. This is wrong. Ethics has become increasingly important and while the fight against corruption becomes increasingly visible and corruption is seen as non-acceptable behaviour, people feel comfortable in an organisation they vision as ethically behaving. The same goes to respect. It is not long ago that the management culture was very masculine and one leader driven. Today's specialist teams are more self driven and the leader is much more a facilitator, supporter and a person leading by setting an (enthusiastic) example rather than one trying to control and lead by commanding.

The last value is business-mindedness. A successful business lawyer can barely be anything else. He/she must produce (cost efficient) solutions and advice of high added value. He/she must show initiative, be innovative, diligent, and ready to take responsibility.

Actually, any activity and any attitude of personnel in a successful modern law firm should be traceable back to the firm's corporate values. As the French writer Paul Valèry wrote long time ago: "one who wants to do great things must pay great attention to details".

Aku Sorainen

Managing Partner at Sorainen, Finland

State corporations - state property in de facto private hands

By Iwona Wiśniewska

In 2007 the Russian economy witnessed a rise and dynamic expansion of a new economic creation – the state corporation ("goskorporatsiya"). Corporations of this kind have specific legal structure, and are exempted from direct control of the majority of state institutions. The emergence of these structures is stimulated by the forthcoming presidential elections in Russia (2 March 2008). Officials close to the Kremlin are using their political influence to strengthen their economic position by creating and controlling state corporations, among other means. The rise of these structures leads to further strengthening of the state in the Russian economy and creates new possibilities for the Kremlin elite to acquire control over assets.

A state corporation is a legal hybrid, a combination of a joint-stock company and a federal state unit. Its rights and influence have been extended while the state institutions' control over the corporation has been reduced.

General principles of the corporation performance are defined in the act on the non-commercial units adopted in 1996, while detailed regulations can be found in the acts, that are a legal basis for each individual state corporation.

Officially the state corporations are presented as a remedy for the problems of the Russian economy – among other things they were supposed to boost the economy's modernization and strengthen its innovative character. Their appearance was supposed to contribute to the development of different sectors (nanotechnology, the municipal & housing sector and other). Some corporations have concrete tasks to perform, like the organization of Winter Olympics in Russia in 2014 (Olimpstroy).

The acts enable the state corporations to take over the state property entrusted to them. The heads of the corporations, who would have full authority over the property, will be entitled to – among other actions – establish subsidiary companies, issue IPOs and make investments overseas. Requirements towards the state corporations concerning accountancy are very lenient (as compared to the joint stock companies), the state corporations also enjoy greater freedom in making financial decisions. The profits generated by the corporations will not be transferred to the state budget and will be spent on the corporations' "statutory outgoings".

Even though the state corporations can carry out business activity as rightful subjects of the market, most of them do not come under the control of authorizes state agencies. State corporations are directly supervised only by the president of the Russian Federation who appoints and dismisses its directors (director general administers the corporation property).

A characteristic of a state corporation is also the amount of budget means transferred for its needs. According to the projects, in the upcoming years the corporations will receive over US $ 33 billion (RUR 830 billion), of which US $ 22 billion were already transferred in 2007 (they were taken from the Stabilization Fund and from the sale of Yukos assets).

Each corporation has its own specifics, they differ as far as their rights and authority are concerned. Rosnanotekh and Olimpstroy enjoy the greatest autonomy and greatest authority. These corporations have been exempt from the act on bankruptcy and are entitled to tax benefits.

The idea of introducing state corporations to the Russian economy on a greater scale is quite new. The first unit of this kind that enjoyed such broad autonomy (the Development Bank) was introduced in May 2007. In early 2008 already 6 state corporations existed: the fund for reform of the municipal & housing sector; Rosnanotekh responsible for the development of nanotechnologies; Olimpstroy – the organizer of the Winter Olympics in 2014; Rostekhnologii – involved in the modernization of the Russian industry; and Rosatom – responsible for the development of the nuclear sector (for more see Annex).

The emergence of most of the state corporations involved powerful lobbying in the Kremlin – part of the ruling elite opposed the idea of administering of the public property in this manner (this idea was criticized by the former Prime Minister Mikhail Fradkov and former minister of economic development German Gref). The aim of the lobbyists was not just to create a corporation, but to take control over it. Among those who succeeded are the main initiators of Rosnanotekh (deputy head of the Russian Academy of Science Mikhail Kovalchuk and minister of education Andrey Fursenko). Both of them are close associates of President Putin and powerful members of the "St Petersburg group", both belong to the board of directors of Rosnanotekh now. Equally successful was Sergey Chemezov, current director general of Rostekhnologii, co-originator and former head of Rosoboronexport (the state arms trader). Chemezov was formerly a KGB officer who met Putin while he served in Dresden.

Undoubtedly, some of the corporations stand a chance of fulfilling their tasks (like Olimpstroy). However, it is not very probable that they will transform Russian economy as a whole, modernize it and seriously reduce its dependency over the oil and gas sector. In fact, most of these structures can have a detrimental effect on the economy. The centralization of the decision-making process (concerning investments etc.) may reduce their efficiency and their ability to react to the real needs of the market.

The state corporations may further contribute to the nationalization of the Russian economy and its monopolization by powerful state structures. As a result, the role of the Kremlin in the economy will be even more strengthened and the competition on the market further reduced.

The emergence of state corporations opens another stage of acquiring control over assets by the ruling elite. Corporations participate in the process of re-distributing of the huge revenues from the energy resources sales. Thus, officials and private persons tightly connected to the Kremlin are getting control over public property – and whatever they do, the only one they report to is the Russian president.

Existing corporations in Russia

STATE CORPORATION	TASKS	DIRECTOR GENERAL
Russian Development Bank (the act adopted on 17 May 2007).	Financing of major investment projects, mainly concerning infrastructure. The corporation budget totals US $ 10 billion.	Vladimir Dmitriyev, former head of Vneshekonombank
Rosnanotekh (the act adopted on 19 July 2007)	Support for the state policy in the sphere of nanotechnologies, innovation and implementation of prospective nanotechnology projects. The corporation budget totals US $ 8 billion.	Leonid Melamed, former manager in the energy monopoly RAO UES. However, the key person in Rosnanotekh will be Andrey Fursenko, the head of the supervisory board.
The fund for reform of the municipal & housing sector (the act adopted on 21 July 2007).	Modernization and development of the municipal & housing sector in Russia. The corporation budget totals US $ 10 billion.	Konstantin Tsitsin, deputy head of Gazprombank
Olimpstroy (the act adopted on 30 September 2007).	The organization of the Winter Olympics in Sochi in 2014. The corporation budget totals US $ 8 billion.	Semyon Vaynshtok, former head of the oil transporting monopoly Transneft. However, the political supervision over the project is carried out by President Putin.
Rostekhnologii (the act adopted on 24 November 2007).	Development of export-oriented industry based on new technologies. No information available on the amount of the investments planned.	Sergey Chemezov, former head of Rosoboronexport.
Rosatom (the act adopted on 3 December 2007).	Comprehensive administration of Russian nuclear sector and coordination of the state policy towards this sector. No information available on the amount of the investments planned.	Sergey Kiriyenko, former Prime Minister of Russia

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EU and Russia as neighbours and partners - the specific role of the Baltic Sea region

By Urpo Kivikari

All of Russia's EU neighbours are Baltic Sea states. The Baltic Sea region is made up of eight EU countries and Russia. So, developments within this region have played a crucial role in laying the functional framework for EU-Russia relations.

Whereas in the early 1990s only two of the countries on the Baltic Sea rim, reunified Germany and Denmark, were members of the European Community, now eight states out of nine are in the EU and only Russia is outside. Sweden and Finland joined the Union in 1995; Estonia, Latvia, Lithuania and Poland in 2004.

Differences between Member States need no evidence, they are so apparent. Differences can be very useful, especially in view of the opportunities for international division of labour, although in general integration produces better results in a homogeneous environment. In politics, differences between Member States are a problem for the EU, which would like to have 'one voice' when presenting stands on various issues.

The neighbourly terms between Finland and Russia are characterised as normal and even good. Politicians like to define them as 'problem-free' – but many would not go as far as to use this expression.

The relations of Estonia, Latvia and Lithuania with Russia have not yet become normal. The experiences of years next to, and as part of, the Soviet Union were heavy for these countries, and the more recent experiences of Russia have not been positive, either. Russia has not been able to conduct a truthful discussion about the history of the Baltic states during the Soviet era. The new independence of these states reduced the Eastern superpower's extensive presence by the Baltic Sea to a passage at the bottom of the Gulf of Finland and to the Kaliningrad area isolated from the rest of Russia. It seems to be difficult for Russia to accept that both the Baltic states, which are now members of the EU and NATO, and countries that joined the CIS break away from Moscow's influence and become established as fully independent states.

Poland's experiences of the Soviet Union during the Second World War and in the subsequent decades were a problematic starting point for relations between Poland and Russia, marked by both old and new sore points. For instance in November 2006, Poland's dissatisfaction with the restrictions set by Russia on Polish meat imports postponed negotiations about a new partnership agreement between the EU and Russia.

Germany is not Russia's neighbour, but as Russia's biggest trade partner, Germany has wanted to push aside the shadows of history. Mutual understanding between the two biggest countries in the Baltic Sea region –illustrated, for instance, by the plan to build a gas pipe under the Baltic Sea – is not to the liking of all outsiders. The economic area of the Baltic Sea is built on both the natural prerequisites for economic cooperation and good political relations between Germany and Russia. A functional Baltic Sea region would not be possible if these conditions were not met. All countries in the region should understand this fact.

In their relations with Russia, Sweden and Denmark need not carry the same burden of recent history as the other nations around the Baltic Sea; nor is Russia as important a trade partner for them as it is for others.

It is difficult for the EU to create a common policy on Russia, because the countries around the Baltic Sea alone have such different starting points in their relations with present-day Russia. In 1999, the EU approved the idea conceived by Finland concerning a Northern Dimension that is intended to affect, in particular, the Baltic Sea region. After enlargement of the EU in 2004, this has in practice meant the EU's neighbouring policy in relations with Russia. In its original form, the Northern Dimension did not bring the expected results on a wide front. In 2006 the Northern Dimension was revised so that it is based on equal partnership among all participants, and this may give new impetus to the programme.

The EU and Russia also need mutual partnership on the coast of another inland sea. The accession of Romania and Bulgaria to the EU at the beginning of 2007 brought the EU to the Black Sea region. In the future, the importance of this region for the Union may even increase, since among the countries in the region, not only Turkey but also at least Ukraine and Georgia have expressed the wish for rapprochement with the Union. The EU and other parties concerned will have much to do in developing this region. For developing the 'Southeastern Dimension' of the Black Sea, the EU might receive useful help and lessons from the Baltic Sea region, which has experience of the development of a functional area in cooperation with Russia.

The Partnership and Co-operation Agreement (PCA) in force is the most comprehensive manifestation of the EU's policy on Russia. Replacing this agreement with 'strategic partnership' that would extend both longer and deeper seems to be a goal that keeps escaping into the future in the same way as Russia's long-prepared membership of the WTO. Maybe it has been reasoned in Brussels and Moscow that by naming the cooperation in words that are larger than life, it will sooner or later be possible to make the contents grow to the dimensions described by the words.

When assessing the prerequisites that the EU and Russia have for strategic partnership, the central question is what sort of country and partner Russia is. The fundamental issue is whether the social and economic systems of the parties can be seen to be so similar that breeding them would result in strategic partnership. Do the EU and Russia consider that they represent the same values? Finland and the Soviet recognising the differences between the two countries' systems. Seen against the circumstances at the time, this type of 'communiqué partnership' worked well. Similar realism might also work between the EU and Russia until circumstances would enable strategic partnership that is genuinely built on shared values.

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Transit trade trough Estonia: problems and developments

By Alari Purju

The article describes recent developments in the transit trade of Estonia, evaluates its impact on economy and looks on some future development trends.

The first issue is how to measure the transit trade. The amount of transit flows of goods; services and tourists are measurable quite easily. On the other hand, to determine the size of value added created by the transit trade is a complicated task. The role of transit trade is even harder to define if the indirect impact of those activities is considered. The transport and storage services are accompanied by different financial, security and other services. In the framework of transit cluster, the re-export should also be included. Here, only directly to the transit trade services related activities are considered.

In the national accounts of statistical system, which is used to calculate the GDP, the transit trade is covered by the economic activity of transport, storage and communication. The GDP produced in this sector in Estonia was 21.7 billion kroons in 2007 or 12.1% of the total GDP. There have been made at least two research projects, which aim was to measure the GDP created through the transit trade. The measurement exercise performed by the group of researchers from the Tallinn Technical University and Statistical Office received a figure 5.7% of the total value added for the year 2000 using the production method.

In 2005, the Bank of Estonia found that the share of transit trade on the production side was 3.5% of the total value added and the consumption of the respective sector created 4.7% of the GDP in 2003. Those figures are quite close to each other. Here should be taken into account also that on the basis of other indicators it is possible to see that the growth of the transit trade was lower than the growth of the economy in 2000s which caused relative decrease of the transit trade as a share of the GDP. The railway and marine transportation have been dependent on transit trade which created 80% of the total volume of the former and 75-80% of the total volume of the latter sector in 2000s. The transit trade of goods from Russia through Estonia to Western Europe, of which oil and oil products created a major part, has been the most important item for Estonia. It is possible to conclude on the basis of these figures that the transit trade has been and still is a quite important activity for the Estonian economy and particularly for transportation sector but it is not critical for the economy as a whole.

The transit trade has been a politically sensitive issue due to the recent tensions between Estonia and Russia and claims that Estonia's fast economic growth is first of all due to absorption of profits from the trade with Russia's natural resources. Estonian relations with Russia have been especially under strain since the Estonian authorities removed a Soviet war memorial from the square in the center of the capital Tallinn to the cemetery in suburb of the city in April 2007. That move sparked riots among local Russian speakers drawing also protest from Russia.

A wide set of tools were applied by the Russian side against the companies involved in the transit trade. The strong political statements were made by the Russian authorities and the surrounding of the Estonian Embassy in Moscow by Putin´s circles close Youth Movement was tolerated by the Russian authorities during several weeks. The wide scale railway repair works were started east of Narva, the Estonian city on the border with Russia. Several companies preferred to redirect their products to the Sankt Petersburg port or to the other ports in the region. Boycotts of the Estonian food products were initiated by the activists in several Russian cities. The amount of products transported by Estonian Railway decreased during the months following April 2007 in comparison with the respective months a year earlier by 40% and did not recover up to end of 2007. The same happened to shipping from Estonian ports.

What is the price of the event for the Estonian economy? Considering the earlier estimates of the amount of the transit trade and the figures on the size of decline of trade flows, the probable size of the impact on the annual basis could be equal to 1.5-2% of the GDP. However, also the other circumstances should be taken into account. The widening of Russian ports in Sankt Petersburg and surrounding area started already in 1990s and was intensified in 2000s. These ports have been already taking over some trade from the Baltic ports. That development would happen during the coming years anyway, the recent political events just speeded it up. The very modest increase of the Russian oil supply, the fast growth of incomes and domestic demand for the oil products is another factor which would decrease the exports and transit trade of oil products through the Baltic ports.

Another important outcome of the recent events is related to the impact on the restructuring of transit trade activities on Estonia. The transport of oil and oil products from Russia through Estonia to Western Europe has been the most important part of the transit trade for Estonia. At the same time, fast increase of incomes and demand for imported consumer goods in Russia, Ukraine and other countries in the region, creates big transit trade flows of those products. Serving that trade could be an important source of revenues. Service of containers transportation is an interesting new challenge for the Estonian ports and railway. An important step in the field was taken in January 2008 when the Port of Tallinn and Ningbo Port of China signed a cooperation agreement. That agreement foresees transportation of containers from China to Europe by regular shipping route for the markets around the Baltic Sea, including Russia. The next step will be the development of Industrial Park in the Muuga Port Free Zone.

This project assumes investment not only by the Port of Tallinn to widen capacity of the container terminal, but also into other infrastructure objects like roads, border and customs services. The use of accumulated resources from the earlier transit business, public funds and the EU resources could be a good resource base for the future developments of transit trade. The high economic risk is accompanying that business also after restructuring. This risk has been balanced quite well by the high profit margins which were during good days of business for some operators up to 70% of the value of turnover.

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SGH - Warsaw School of Economics and the Baltic Region

By Tomasz Dolegowski

SGH - Warsaw School of Economics, one of the most prestigious scientific and educational institutions in the field of economics and management in Poland has celebrated one year ago 100 years anniversary of teaching and research activity. Today SGH is active in building international ties and concentrates its foreign activity also on developing relations within the Baltic Sea Region, with the universities and academic centers in the Baltic Republics and Nordic Countries. Particularly important is here our participation in CEMS (Community of European Management Schools), BSRUN (Baltic Sea Region University Network) and Erasmus exchange programmes. Very interesting from this point of view is the idea of regional networks, like BSRUN, which covers e.a. Poland, Finland, Lithuania, Latvia, Estonia as well as some Russian and Belarussian scientific institutions.

There are several serious reasons for our interest in regional cooperation. One of them is historical. Poland and Lithuania some centuries ago have created common state, *Rzeczpospolita* (*The Commonwealth of Poland and Lithuania*). In some periods of our common history even the territory of Latvia, Belarussia as well as some parts of Estonia and Ukraine have belonged to this specific political unit. This *Commonwealth* belongs now to the past and historians present very different opinions about this period of our common history, its advantages and disadvantages. The heritage and historical memory is here however still very important. As the example: Vilnius University is the part of the Polish and Lithuanian tradition… Also my family: Poles living in Warsaw, but with Vilnius roots is open for this heritage. In XIX and XX century (time of Russian domination and the lack of our national independence) many Polish young people have studied in Vilnius, Riga or Tartu. Also in the time of independence before the second world war countries like Latvia, Estonia and even Finland belonged to strategic partners of Poland - also in the field of science.

The second world war and the post-war period of Soviet domination was from this point of view very difficult, but the end of communism has created new opportunities. Problem was, that in the new period of freedom Poland and the Baltic Republics were much more interested in cooperation with the West than within the Region. Now, particularly after joining European Union, perception of the future cooperation seems to be in my opinion much more optimistic.

There is one more motivation for our interest in regional cooperation development. In many countries, particularly in Lithuania (but also in Latvia and Belarussia), lives quite big Polish community. SGH – Warsaw School of Economics is interested in contacts with that people as well as in supporting some intellectual initiatives of the scientists of Polish origin and meeting the needs and expectations of the representatives of young generation.

A group of students of the Polish origin as well as young people of other nationalities from the East (also from the Baltic Republics) studies at our university. Some of them are exchange ERASMUS students who learn here in English for one or two semesters, other however decide to study here for whole five years in Polish language - they are interested in obtaining our masters' diploma.

In the past there were some attempts to establish even the Polish minority academic institution in Lithuania. It was not very easy and has created some controversies, but in 2007 the University of Białystok has established its branch in Vilnius. We do not know how successful this project will be in the future, but SGH – Warsaw School of Economics is also ready to cooperate with them in some points.

Of course we do not want to reduce our contacts only to the Polish-language people. Last years we have observed increasing interest in students' and professors' exchange. SGH - Warsaw School of Economics hosts also and participates in many conferences, also on regional level. Our professors and students are satisfied with good relations with Vilnius Technical University, ISM University of Management and Economics in Lithuania, Mykolas Romeris University in Vilnius, University of Latvia in Riga, Stockholm School of Economics in Riga.

Some of our professors (including me) have offered the lectures at some academic centers, particularly at International Business School at Vilnius University and Estonian Business School in Tallinn. Very important is also our partnership with the above-mentioned Stockholm School of Economics in Riga – the affiliation of the famous Swedish institution in the Baltic Republics and one of the leading educational institutions in economics and management in the Region. Our cooperation in their bachelor thesis review process seems to be very important.

There are however still some mental, psychological, political and economic barriers for development of cooperation. Some of the barriers have been caused by ignorance, some by infrastructural bottlenecks (paradoxically we must remember about relatively poor transportation between Poland and the Baltic Republics). Our participation in Bologna Process creates new opportunities, but also challenges and problems. I do hope that in the near future Polish and Baltic States universities and business schools will have to cooperate with the scientific institutions in Finland and other countries of the Baltic Rim in creation of attractive joint degree programmes, similar to CEMS common diploma.

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Coastal management and regional cooperation in saving the Baltic Sea

By Samu Numminen

Coastal zones under pressure

Europe's coastal areas are crowded. It is estimated that about one third of the continents population lives within fifty kilometres from the coast. In the whole world the percentage is a lot higher. Coasts are home for a variety of human activities, which of course puts a lot of stress on their natural environment. They are hubs for traffic and trade, as well as a source for food and energy. Coasts offer places for recreation and residence, and in many places they are also biodiversity hotspots that host a great variety of plant and animal species. With urban areas covering more and more of the coastal zones, we have to be careful not to suffocate the diversity that is a precondition for our own well-being.s

What about the Baltic Sea, then? It is one of Europe's regional seas, unique in its own ways with its shallow, brackish waters and organisms that have adapted to conditions that may well be considered to be somewhat extreme. Baltic Sea coasts are also under pressure from human activities, the sea itself being burdened by nutrients causing eutrophication and massive blooms of blue-green algae. The sea is also feeding itself with nutrients that are re-released from the sediment, a phenomenon that we have only recently begun to understand more. Loss of biodiversity is also a serious risk, as well as various human-induced hazardous substances in the ecosystem. Traffic at sea is expected to increase significantly in the future, which brings along for example the increased risk of oil spills.

Thinking globally

If we wish to protect our sea, we have to look at the big picture. A holistic perspective is needed, where the interactions between human activities and natural processes are considered. This is provided by Integrated Coastal Zone Management (ICZM). It is a dynamic, continuous and iterative process designed to promote sustainable development of coastal zones. It seeks over the long-term to balance the benefits from economic development and human uses of the coastal zone, the benefits from protecting, preserving and restoring coastal zones, the benefits from minimising the loss of human life and property, and the benefits from public access to and enjoyment of the coastal zone, all within the limits set by natural dynamics and carrying capacity.

At best, integrated management of the coast will increase the viability of the coastal zone. A well-known example is the east coast of Canada, where carrying out a thorough coastal management programme led to improvements in living standards, employment and attractiveness of the region to such an extent that the direct and indirect financial returns gained exceeded the investments that were put into the planning process. By restoring and maintaining natural habitats the coasts will also be better protected for example against erosion and flooding that can otherwise lead to economical losses as well as loss of human lives.

Commitment is needed for long-term activities

If some proper planning is all that is needed, why hasn't it been done yet? There are certain prerequisites for successful ICZM. It is a long-term activity that needs long-term financing and to back this up, long-term commitment from decision makers. Successful implementation may take up to ten or twenty years, and the ICZM cycle needs to continue also after that. One of the most important needs for ICZM is the full participation of all relevant stakeholders. Information of the coast as well as the planning itself must be widely available. We also have to be able to work together and cooperate across national borders, because saving the coasts and the sea is most of all a common effort.

The European Union has noted the need for an integrated approach, and it has recommended that all EU countries should have a coastal strategy for this purpose. Deadline for these strategies was in early 2006, and it remains to be seen how the strategies will be implemented by member states in the future. Also on the European level, EUCC – The Coastal Union, an association with members in 40 countries, has promoted coastal sustainable development in various ways for nearly twenty years. In the Baltic Sea the work of HELCOM has been important, the latest product being the Baltic Sea Action Plan which aims to restore the good ecological status of the sea by 2021. This aim is also in line with the coming EU Marine Strategy Directive. The Water Framework Directive, adopted in late 2000, has its aim at a good ecological status of rivers, lakes, groundwater and coastal waters by 2015. It is good to have clear goals, but we have to remember that directives won't take care of themselves. We will have results only if we achieve the commitment of all levels of the society.

It all starts from the regional and local level

Apart from the big picture and major actors, there is also a role for us small people in helping to heal the Baltic Sea. We may feel powerless in front of big questions like climate change, but each of us can participate in one way or another. The impact of local and regional activities is shown in the local environment first, which is a good source of motivation for the people. In the Archipelago Sea area in Southwest Finland, the Pro Saaristomeri coastal forum has taken steps to make regional co-operation and participation easier. Forum activities, especially addressing coastal issues and planning river basin management on a sub-regional scale have been successful in many ways, the new-est achievement being the founding of the Fund for the Protection of the Archipelago Sea.

It has been said that the Baltic Sea needs its own Al Gore to really make things happen. It remains to be seen who, if anyone, will claim the title. Although a strong political leader is definitely needed, in the meanwhile we can all be the Al Gores of our own lives and start changing the way we take care of our environment. Climate change, for example, will not be tackled just by each of us remembering to turn off the lights when we leave the room, but it is certainly a good start. And we do have to start somewhere if we wish to enjoy the Baltic Sea and its coasts also in the future.

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Can competition protection in Poland become more effective?

by Wojtek Dorabialski

Poland's entrepreneurial spirit has sprung up at the beginning of the transition, with millions of new enterprises taking up market niches. That initial sprawl was followed by an inevitable consolidation process. The toughening of competition brought about the dangers of unfair competition practices and anticompetitive mergers. Polish legislative bodies reacted very quickly to those threats by creating the Office of Competition and Consumer Protection (OCCP) as early as in the year 1990. Since then, Polish competition protection law and practice has been steadily evolving, drawing on the EU regulations and practice.

Competition protection agencies in transition countries face additional challenges, in comparison with their counterparts in developed countries. Most Eastern European economies are characterized by high growth rates, which facilitates cartelization (horizontal agreements). Many markets are abnormally concentrated – a legacy of the former state monopolies – which facilitates abusive unilateral conduct. Placed in this difficult environment, the agencies are also relatively weak, in terms of their budgets, number of personnel and accumulated experience. What is the impact of competition policy on Poland's economy? How effective has CCPA been in pursuing competition policy goals?

Poland's OCCP can serve as an example of the problems and weaknesses of competition protection agencies in the region. A steady increase in the OCCP's budget allowed for a steady increase in the agency's employment (see Table 1). Salary levels, however, did not keep up with those in the private sector. This resulted in high personnel turnover rates for the Office, which hindered the agency's capabilities of accumulating experience and expertise.

Table 1. OCCP's budget and employment*

Year	Annual budget (mln PLN)	Employment	Personnel turnover rate
2004	21.1	259	14.7%
2005	25.4	273	19.0%
2006	25.6	282	18.4%

In addition, the law required that OCCP formally reviews all antitrust complaints submitted by entrepreneurs. Since the participants of anti-competitive agreements were not given incentives to defect, nearly all complaints submitted to the Office regarded unilateral conduct. This resulted in OCCP being overburdened with unilateral conduct cases, as can be seen in Table 2. Many of these cases regarded such non-spectacular, but locally monopolized markets, as cemetery services or waste dumping grounds.

Table 2. OCCP's administrative output*

Year	Unilateral conduct cases reviewed	Agreement cases reviewed (horizontal agreements)	Merger cases reviewed (blocked)
2004	126	26 (16)	199 (2)
2005	117	27 (16)	302 (0)
2006	170	32 (10)	251 (1)

Perhaps the biggest problem, that the Polish competition authority is facing, is the ineffectiveness of the penal system. In accordance with the EU standards, antitrust violations can be punished with a fine, up to 10% of firm's revenues. A fine serve a dual purpose: it should nullify any gains from the violation and prevent future violations. However, as one can see in Tables 3 and 4, these purposes have not been served properly, due to long lags between the imposition and the collection of fines.

Table 3. Total fines imposed and collected by OCCP*

Year	Total fines imposed (mln PLN)	Total fines collected (mln PLN)
2002	5.1	1.0
2003	11.3	(data not available)
2004	174.2	2.1
2005	38.0	2.0
2006	339.0	10.2

Table 4. OCCP's fine collection efficiency in 2006*

Fines imposed (mln PLN)	Fines collected, total	No lag	1-year lag	2-year lag	> 2-years
339.0	10.2	1.7	4.7	1.2	2.6

*Source: OCCP annual reports.

We should note here, that the problem of lagged fine collection stems mostly from the inefficiency of Poland's judicial system. The lengthy appeals process gives lawbreakers an opportunity to postpone the payments, even in cases of obvious violations. In less obvious cases, the courts often escape from judging the case on the merits, by focusing on procedural issues. The latter is understandable, since the courts are just as underfinanced and understaffed as the government sector. Somewhat paradoxically, the firms who actually pay the fines imposed by the OCCP timely, turn out to be mostly small businesses and first-time offenders, who find it too costly to appeal their case. This situation favors large companies, which face the largest fines, but can afford to enter the appeals process.

Is there a hope for a more effective competition policy in Poland? Yes. Almost a year ago the Polish competition law has been changed, and the OCCP was given full discretion on whether to review an antitrust complaint or not. In addition, the newly established leniency program, gives the participants of anti-competitive agreements some incentives to defect. This will allow the Office to refocus, and allocate more effort to multilateral violations (agreements) and only the biggest unilateral violations. Giving more focus to selected cases will result in better quality of administrative output, which should limit the possibilities of challenging the OCCP's decisions in court on procedural grounds.

In the face of low fine collection rates, the OCCP should consider toughening its penal policy. Of course, higher fines will not speed up the collection process. They will, however, additionally hurt large offenders, through the bad publicity associated with the results of antitrust proceedings. Companies will immediately notice the negative effects of their anticompetitive practices, if not on their balance sheets, then on their public relations. By drawing the interest of the media, higher fines will also help to pursue the educational and preventive goals of competition policy.

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[*]Any opinions expressed in this column represent personal views of the author, and do not necessarily reflect the views of the OCCP.

Future of the EU-Russia relations

By Kari Liuhto

The European Commission suggests that the Russian investment stock in the EU amounts to some € 10 billion. Russia's President Putin stated during the EU-Russia summit in Portugal that the Russian investments in the EU total less that € 3 billion. I doubt the accuracy of both the aforementioned figures, when I keep in mind that the United Nations reports that Russia's total outward foreign direct investment (FDI) stock, by the end of 2006, was over € 100 billion and the EU is one of the major destinations of the Russian FDI.

The question here is not statistical but rather political, since Russia seems to imply that the EU restricts her investments in the Single Market, which is not the case. All the foreign privately run companies are openly welcomed to the EU regardless of their country of origin as long as they do not create a monopoly inside the European market, they cannot be regarded as tools of any country's foreign policy and they obey the rules.

Instead of being afraid that the EU starts to exercise protectionism in order to slow down the expansion of foreign state-controlled corporations in the Single Market, I am more concerned that the Russian investment environment turns more restrictive towards foreign firms. I am not only concerned about the possible Law on Strategic Industries or Mineral Resource Act, but I am even more worried about the future development of so-called National Champions Policy, which accumulates unpredictability in the Russian investment environment, because foreign investors cannot predict what are the ultimate measures the Russian State uses when it creates these domestic champions. The non-transparent National Champions Policy is more damaging to the Russian investment climate than even their restrictive legislation is.

I would like to underline that one cannot improve competitiveness without intensive competition, and therefore, a National Champion Policy fostering monopolisation and legislation restricting foreign competition does not help Russia become more competitive. The World Economic Forum placed Russia in the 58th position among 131 countries analysed in the global competitiveness study. For instance, Chile, Thailand, Tunisia, India, Mexico, and Indonesia rank better than Russia.

Foreign investments are not only the cheapest way to obtain capital, modern technology and advanced management techniques, but the foreign enterprises per se are valuable since their business contacts build additional bridges between the EU and Russia, and hence, support European integration continent-wide. Due to differing opinions at the political level, all the additional actors are needed in keeping the dialogue constructive.

In order to avoid reciprocity of investment restrictions, one should create an independent expert team of policy-makers, businessmen and researchers to analyse how to create a free and predictable investment environment in the EU-Russia context. The EU-Russia Industrialists' Roundtable accompanied with leading policy-makers and researchers could be a convenient way to form an objective research team, which could biannually produce a report on the EU-Russia investment climate and the main barriers hindering its further development.

In addition to problems related to investments, transit of conventional goods gives us unnecessary headache. We have, each moment around the clock, several kilometres of truck lines, if we take all the customs points between the EU and Russia into account. Technical solutions, such as electronic customs declaration, are available, if there is enough political will to solve this issue.

Energy transit is an even more burning issue than conventional transit. The Baltic Sea has already become the most important oil export channel of Russia, and the amount of oil shipments is to increase sharply in the near future. At the moment, the oil shipments via the terminals around the Gulf of Finland total to some 140 million tonnes, and they are estimated to go over 200 million tonnes in the next decade. In order to avoid a looming oil accident in the Baltic Sea, no single-hull tanker should be allowed to enter this sea. Hopefully, one should not first have to experience an oil hazard before this decision will be taken. One can only guess the dramatic consequences of such an accident to the shallow Baltic Sea and the negative impact of the oil spill on the EU-Russia relations. Here one should not forget that over 6 million Russians, living in St. Petersburg and the Leningrad region surrounding it, would be directly affected by the increasingly probable oil accident in the Gulf of Finland.

In addition to oil deliveries, the Baltic Sea may become a major export route of natural gas from Russia to the EU. The plans to build the natural gas pipe, Nord Stream, on the seabed of the Baltic Sea have heated the discussion for some time. In order to create a genuinely sustainable solution for such a strategic energy project, which more than doubles the gas deliveries from Russia to Germany, I propose that the project would involve as many EU countries as possible. In other words, I propose that the Nord Stream plan would be abandoned and instead a pipe via the Baltic States and Poland to Germany be constructed, or alternatively, the second leg of Yamal-Europe via Belarus and Poland to Germany would be erected. The re-direction of the pipe would be a fundamental gesture of goodwill from the Russian side, and this gesture would definitely support the continent-wide integration in Europe.

Even if the relations of the Baltic States and Poland with Russia are not at their best at the moment, the Baltic States and Poland are members of the EU, and hence, they should be regarded as reliable energy transit countries. Moreover, the land-based pipeline is less risky operationally, environmentally more friendly, and obviously financially less expensive.

Should the Nord Stream pipe be realised, its costs will definitely go over € 5 billion, the sum indicated earlier by the Nord Stream organisation. Here one should mention that the preliminary budget of the South Stream, the 900 km-pipeline project underneath the Black Sea, is € 10 billion. With the similar cost structure, the planned budget of the 1200 km-long Nord Stream would be more than € 13 billion. As differing opinions on the real cost level exist, I propose that an independent organisation would calculate the costs of building a comparable land-based pipeline connection to Germany.

In this context, I want to stress that the Baltic States and Poland should not charge extra transit fees, since the use of the Nord Stream pipeline does not cause any extra administrative transit cost to its owners. The current ownership structure is as follows: Russian Gazprom 51%, German E.ON 20%, German BASF 20%, and 9% Dutch Gasunie. Including three companies from two EU countries in such a strategic project do not really turn this pipeline "a EU project".

The following five facts may help to analyse the strategic significance of this project for the whole EU: (1) Germany accounts for 20% of the EU economy, (2) natural gas forms already at the moment nearly 25% of Germany's primary energy consumption, (3) Germany is already now the EU's largest importer of the Russian gas with annual imports

amounting to some 35 billion cubic meters, (4) the total capacity of the Nord Stream pipe would be 55 billion cubic meters, and (5) Germany's gas dependency on Russia would jump from today's 42% to approximately 65%, if the Nord Stream pipe would operate at the moment.

One may ask whether the EU's largest economy becomes too dependent on gas deliveries from Russia, and what might be the consequences of such overdependence to other EU members and their relations with Russia. Furthermore, one may wonder the position of Ukraine and Belarus vis-à-vis Russia if the Nord Stream and the South Stream will be implemented, since Ukraine represents currently some 80% of Russia's gas transit to the west. The respective share of Belarus is approximately 15%. The non-payment of the Russian gas and other transit-related problems by Belarus and Ukraine motivate Russia to speed up the building of both the Nord Stream and the South Stream.

To end, it is essential for all the EU countries neighbouring Russia that there is a common policy within the Union towards Russia. Bilateral relations may aid common policy but they should never challenge it. I dare to argue so, even if the trade relations between Finland and Russia are more intensive than those of any other EU member state. Although Finland has also had several painful historic moments with our eastern neighbour and even some differing opinions nowadays, one should always try to search for constructive ways to go forward instead of searching for differences in opinions, systems or even values. The EU and Russia are different enough to learn from each other but similar enough to collaborate with each other. The Finnish pragmatic approach on how to conduct relations with our eastern neighbour might also be useful to some other neighbours of Russia and to the EU's Common Policy towards Russia in general.

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The Baltic Sea region: the region in global competition

By Ene Ergma

The Baltic Sea region has benefited from the political developments of the last 15-20 years more than any other region. The global standoff between the East and the West, which had its most visible manifestations in our region, has ceased. The Baltic Sea has become a uniting waterway rather than a hostile environment of distrust and conflict.

The change has been both fast and vast. We have all had to cope with it and manage it. It has been a positive challenge because the majority of changes have brought peace and prosperity to people, businesses and countries.

Still, even greater challenges lie ahead. While we have enjoyed the change of ourselves and the region and Europe as a whole, the pace of changes elsewhere in the world may have been even faster. The united Europe has been a magnificent goal to achieve, but it is an ever moving target. In order to realise what we want Europe to become in the global competition, we should start by acting locally to shape our region as a part of the strong Europe and as a pillar of European regional diversity.

The Baltic Sea region in the European Union

The EU should have its own Baltic Sea region Strategy. *The EU Baltic Sea strategy should be an internal issue of the EU whereas the instruments such as the Nordic Dimension, four common areas of cooperation with Russia and the Council of the Baltic Sea States will secure the EU foreign policy interests in its cooperation with Russia*.

On 16th November 2006, the European Parliament adopted a report on a Baltic Sea strategy. The aim was to increase the EU internal focus on the region to make most of the opportunities to develop the region into one of the most attractive and competitive areas in the world.

Many reasons speak for this outcome. Eight littoral states are members of the EU. There is both a need and the opportunities to address the challenges in the region through EU policies and instruments available for the EU and EEA members. Specific challenges are related to the vast size of the region and concurrently its connections to the rest of the EU.

The main aim of the strategy should be to strengthen the actual cohesion and integration of the EU in the region. It would reinforce the region's growth and competitiveness and thus contribute effectively to the fulfilment of the Lisbon targets.

One of the key objectives could be long-term planning in areas crucial for economic growth – such as major infrastructure projects and environmental projects.

Challenges yet to be answered

Saving the Baltic marine environment

The Baltic Sea countries have to come to an agreement by the end of this year over an ambitious Baltic Sea Action Plan as has been agreed in HELCOM.

The Action Plan, which the HELCOM Member States decided to jointly draft in 2005, sets an ambitious target of achieving by 2021 a good ecological status of the Baltic Sea - a sea with diverse biological components functioning in balance and supporting a wide range of sustainable human economic and social activities. This plan has been set as a pilot project for the European seas under the EU Marine Strategy. It could become a model to be followed by other regional marine conventions around Europe. It is designed to solve all major environmental problems affecting the Baltic marine environment.

There is a great variety of environmental challenges: eutrophication caused by excessive nutrient pollution loads of nitrogen and phosphorus to the sea originating from agriculture and untreated sewage, algal blooms, dead sea-beds, depletion of fish stocks. This calls for immediate wide-scale action to put an end to further destruction of the Baltic Sea environment to avoid an irreversible disaster.

Nord Stream pipeline

But instead – we witness today an attempt to put at risk the Baltic Sea environment by creating a superstructure at the bottom of the whole sea at extent never seen before. The preparations to build the Russian-German gas pipeline go ahead as if the experts' outcry over its dangers has gone unnoticed by the governments and politicians. The attempt to avoid partners and the need for co-operation while building reasonable European infrastructure has led to pipeline plan that should have been rejected in the first place. Why would we allow putting our common sea at risk for the unwillingness of gas suppliers to co-operate with certain partners? Do we have to bear the environmental burden because Gazprom does not like the fact that it has to cooperate with Poland? Should the Baltic Sea be polluted for the profits of a pipeline company?

The European Union has pointed out other viable options for building gas transmission systems between Russia and the rest of Europe. In fact, these routes already exist and can be taken to use with minor efforts and much less environmental impact. The Yamal gas transmission pipeline does exists and can be expanded in capacity. Another option would be to build the *Amber pipeline* through the Baltic States and Poland. Ministers of Economy of Estonia, Latvia, Lithuania and Poland have requested the Commission to co-finance the feasibility study of this project. Unfortunately, as has been proved a number of times Russia prefers to avoid cooperation on these issues with some countries. Thus – what we have to achieve is taking the neighbors in the region as logical partners rather than avoiding them.

The Baltic Sea in general has become a major hub for shipping hydrocarbons. In a few years, transit will double to 150 million tons of crude oil alone annually. To deal with this acute threat is not just an environmental, but also a security issue. A major tanker accident could lead to rising tensions with the main transit source – namely Russia, which has strategic interests connected to this transit. Preventive measures to minimise this kind of risk are essential.

Russia as a responsible actor in the Baltic Sea region

Keeping Russia engaged as a responsible player in the region is a complex task. Part of the potential of the Baltic Sea region is definitely connected to the possibilities offered by the Russian market, resources and people.

At the same time Russia has global interests and will have to pay attention to all geographical directions of its neighborhood.

It will take all the cooperation frameworks that we have to develop the relations with Russia. (EU-Russia partnership agreement that needs to be renewed, EU-Russia common spaces, Northern Dimension, Council of the Baltic Sea States, other regional organisations). At the same time we should also frankly require full cooperation in these fora.

Attempts by Russia to brake with the cooperative ties in place within our region should be firmly rejected.

Ene Ergma

President, The Parliament of Estonia

Think neighbourly, create value added

By Gediminas Kirkilas

Our Europe is a certain derivative of values. In general, ideals in politics are inseparable from our identities, interests and finally, political behaviour. Our principles and beliefs lead us through life, and finally constitute what we call 'ourselves'. There should be no room for double standards. Unfortunately, very often an uncompromising strife for benefits and pursue of interests can easily shake our values. Europe is also a confluence of our common ideals, principles and contribution. Having joined the EU in 2004, Lithuania contributed with fast growing economy, successful post-communist transformation and good neighbourly relations.

The EU enlargement has become of vital importance to the countries aspiring for the EU membership and, at the same time, has provided more opportunities and benefits for the EU itself. The expanded internal market has created conditions for the European economy to become stronger and more dynamic. Enlargement must be based on successful reforms, which should deserve appropriate stimuli. The validity of the Copenhagen criteria is unquestionable. Hence, principles of rigorous, yet fair conditionality serve for assessing readiness of candidate countries. Besides, the European Union is becoming stronger with each round of the enlargement, thus entailing positive internal reforms. I hope that the Lisbon Treaty will also encourage further EU enlargement. We had a strategic debate on EU enlargement in December 2006, where the EU leaders reached a renewed consensus on the enlargement policy. These should be our guiding principles, and there is no need to establish dividing lines in our continent.

With the EU enlargement in 2004 the question of regulated relations between the Union of 27 member states and its neighbour states to the east and the south moved to the centre of European politics. Launched by the EU in 2004 as a new policy framework, the European Neighbourhood Policy (ENP) aims at the political and economic stabilisation and the modernisation and democratisation of the EU neighbours in Eastern Europe and the Mediterranean region. The ENP gives an emphasis to the European interest "to promote a ring of well governed countries to the East of the European Union and around the Mediterranean with whom we can enjoy close and cooperative relations".

Thus, our aim in relation to the ENP is to create a "ring of friends" attaining European stability, strategic security interests and effectively promoting European values beyond its borders. The overall aim would be to bring these countries closer to the EU through the development of structural dialogues at all levels, including sectoral cooperation; through economic integration and closer participation of these neighbours in the Internal Market, as well as facilitation of people-to-people contacts.

Lithuania has been cherishing good neighbouring relations for many years. Our country has officially declared its commitment to pay a special attention to EU cooperation with neighbourhood countries and supported far-sighted policies, which might open the European Union (to the extent possible) to the outside world in general and to its neighbours in particular. We consider such openness both a benefit to our ENP partners as well as to the EU citizens. Politically stable and economically healthy neighbourhood is a condition for a long-term stability and prosperity of the EU. A more strongly differentiated approach on the part of the EU to the Eastern and Southern dimensions of the ENP is needed. Our understanding of basic differentiation is that ENP-South countries are "neighbours of Europe" and ENP-East countries are "European Neighbours".

In order to promote further geographic and political differentiation between the two regions of EU neighbourhood, we most likely need to walk off the existing ENP framework and opt for a structure that would exist independently from the progress (or the lack of it) on the ENP track (just like the Barcelona Process exists in parallel to the ENP). Further structuring of the ENP format would only limit the EU's focus on Eastern Neighbours to the issues already inherent in the ENP debate – namely, trade, transport, energy, visa facilitation and other. Meanwhile, our goal is just the opposite – to establish the ENP-East agenda more broadly on the European scale.

We therefore suggest finding a niche for Eastern Europeans in a broader European debate. The discussion launched by the French on future challenges to the EU creates a favourable environment for all of us to act in this line. Eastern countries would thus have possibility to participate in discussions on energy and other topics as equal subjects rather than offshoots of larger EU interests. In terms of framework, our proposal would be to exploit the concept of 'European Neighbours' more extensively and seek to establish a 'Europe-to-Europe' dialogue which would include – theoretically – the EU and all its European neighbours in the north, in the east, and the south-east. The actual membership may vary depending on how many European countries would buy this idea. Russia could be included or not, depending on the agreement among ourselves.

The major obstacle to the creation of such a dialogue seems to be the established frameworks of EU cooperation with its European neighbours (EEA, ENP, and Stabilization and Association Process). Among other things, these frameworks promote independent identities. We need to break down this kind of mentality. It must be clear from the outset that the new framework is not about EU membership or enlargement but, rather, about addressing together the common challenges to Europe at large. But we do not exclude the possibility that the outcome of this discussion will be the decision to enlarge.

It is also evident that the launch of this idea will need intensive preparatory work. First of all, we will need to convince the sceptics in our West and the East that a Europe-to-Europe dialogue is necessary. We should also promote Eastern Europe as a 'success story' (high growth, consolidation of democracy etc.) in the context of other EU policy directions (Middle East, Africa, North Korea etc.). We need to de-construct the prevailing image of Eastern Europe as an area of instability, depression and 'frozen' conflicts. Faster implementation of ENP Action Plans by Eastern Neighbours and successful conclusion of renewed partnership agreements would help us substantially in this effort.

It is also important to encourage regional cooperation and especially those regional initiatives which transcend the established geographical lines (GUAM, BSEC, Black Sea Synergy, Baltic-Adriatic, Central European Initiative and other). Every successful outcome in each format would only boost this region's European identity. Cross-regional ties should also be promoted, including those among the Balkan and East European/South Caucasus nations.

The long term effect of successful cooperation in a Europe-to-Europe format would be the new understanding of what Europe is and, perhaps, Europe's greater cohesion within those new limits. Europe-to-Europe cooperation could translate into three strategic partnerships: 1. Political and Security Partnership, providing for a closer political dialogue in such areas as human rights, development, and foreign policy, as well as for a closer EU's involvement in conflict resolution; 2. Economic and Financial Partnership, which would remove the existing trade barriers and establish free trade with EU. Full integration would also evolve in such areas as energy, transport, and, perhaps, financial institutions; 3. Social, Cultural and Human Partnership, resulting in free movement of people and the eventual integration of European Neighbours with the existing EU academic and social programs and instruments. All in all, greater cooperation and cohesion with the EU neighbourhood gives a value-added to our Europe of Tomorrow.

Gediminas Kirkilas

Prime Minister

Lithuania

European Neighbourhood Policy

By Benita Ferrero-Waldner

The European Neighbourhood Policy (ENP) was born of a vision first articulated five years ago. On the eve of the biggest enlargement in its history, the EU dreamed of a zone of stability, prosperity and co-operation shared with all its 'new' neighbours-to-be.

Building on the great success of the EU's enlargement process, the idea was to deepen our relations with our neighbours and in so doing to encourage them to strengthen their own political and economic reforms. The EU's neighbours are particularly important to the EU: by bolstering their stability, prosperity and security, we also bolster ours.

That vision has today become a reality. We have opened the policy to all eastern and southern neighbours who share our commitment to democracy, open society and economic prosperity - 12 countries around our borders, from Georgia and Ukraine in the East to Jordan and Morocco in the South.

The key to our approach is differentiation. Every country individually determines the nature and strength of its relationship with the EU. It's a policy of more for more: as countries go further down the reform path, more possibilities for closer cooperation with the EU open up to them: more financial support (approximately €12 billion from 2007 to 2013, an increase of 32 percent in real terms); integration with the EU's internal market; and participation in the EU's policies and programmes.

We have already seen ENP's first results: a border monitoring mission in place along the Moldovan-Ukrainian border to help address the frozen conflict in Transnistria; an agreement on easier visa procedures for Ukrainian citizens and others in the works; and a large number of twinning and TAIEX projects in place with countries across the neighbourhood.

We have also set up a Neighbourhood Investment Facility, which will provide an important new source of funding for the neighbourhood, and a Governance Facility which provides additional support to countries that have made most progress in implementing governance reforms. Neighbourhood countries are also beginning to join the EU's programmes and agencies, so that Israel, for example is shortly to join the Competitiveness and Innovation Programme.

But we have even greater ambitions. In September 2007 we held a major international conference to discuss our proposals for strengthening ENP still further. This was an important demonstration of how established the policy has become in a short space of time. It underlined the emphasis we place on joint ownership of the policy, and provided a forum to discuss how to make ENP even more effective, attractive and focused.

Building on that conference we released on 5 December a new Communication entitled "A Strong European Neighbourhood Policy". It sets out a concrete list of actions for the EU's Member States and the Commission to take in order to keep our promises to our partners of providing concrete and credible incentives for reform.

We have four objectives for 2008 and beyond:

- Greater political commitment to foster **economic integration** and improve market access. We will help our neighbours access the EU's 500 million-strong market, an area where goods, services and capital flow freely; opening up new possibilities and greater opportunities for us all.
- The **facilitation of legitimate short-term travel**, as well as more ambitious longer term developments in managed migration. We know that the freedom for people to travel to and around the EU is enormously important. At the same time the EU needs migration to cope with our ageing shrinking population. So we want less complex visa rules. But we also want all migration to be legal and managed.
- Further engagement with ENP partners in tackling frozen conflicts, using the full range of instruments at the EU's disposal to stabilise conflict and post-conflict areas.
- Intensified EU support for partner countries' sectoral reforms in areas such as: energy, climate change, fisheries, transport, maritime policy, research, information society, education, employment and social policy.

We hope that our Member States will join with the Commission in the coming year to ensure we make a reality of these proposals. And of course there is also work to be done by our partners; we will issue progress reports on their implementation of their commitments under ENP in spring 2008.

ENP is an ambitious policy, but one which has the potential to make an enormous difference to the prosperity and stability of both the EU and its neighbours. The vision contained in ENP is a radical change in the way the EU relates to its nearest friends and its nearest friends relate to us. And this Commission is fully committed to making that vision a reality.

Benita Ferrero-Waldner

Member of the European Commission

Nordic-Baltic defence cooperation

By Jyri Häkämies

Since 1991, the Nordic-Baltic cooperation has become a daily routine between eight democratic countries in Northern Europe. This cooperation takes place on all sectors from economy and labour policy to foreign and defence policy.

Defence cooperation was for a long time a grey area among the Nordic countries, probably because these countries had very different defence solutions. This was particularly clear in the case of Finland. Finland had become a UN member already in 1955, but in spite of that it had to adopt a very cautious line in its relations with other Nordic countries. Still in the late 1960s Finland had to abstain from closer economic cooperation among the Nordic countries (NORDEK).

After the end of the Cold War, intergovernmental cooperation in Northern Europe has rapidly increased. In 1994, Finland and Sweden decided to join the European Union and the Partnership for Peace -arrangement with NATO. A few years later Estonia, Latvia and Lithuania joined both organizations. New forms for the Baltic Sea area and Nordic-Baltic cooperation were also developed.

Infrastructure support

Nordic-Baltic cooperation in the defence sector was launched immediately after the Baltic countries regained their independence in August 1991. Estonia, Latvia and Lithuania had to start the construction of their national defence systems virtually from the zero point. After the withdrawal of the Soviet (Russian) troops from the Baltic countries only partially demolished empty military bases and buildings were left behind.

The Baltic countries had not had national defence forces since the Second World War. Instead, Soviet garrisons were filled with conscripts and soldiers from distant parts of the country. The assistance provided by the Nordic countries was therefore welcome. During the first half of the 1990s, the possibility of the NATO membership was not taken too seriously by the Baltic countries. Neither NATO at first cherished such an idea. National defence system in the Scandinavian style was therefore at that time the most natural choice.

Extensive assistance programmes were launched quickly by the Nordic countries from 1992 onwards. The reasons for this were obvious. It was thought that a military vacuum in the Baltic countries would create instability for the whole Northern Europe. Finland, Sweden and Denmark were active and had each a target country of their own. Finland provided Estonia not only materiel assistance but also started to train future Estonia officers in the National Defence University (Maanpuolustuskorkeakoulu) and other military institutions. A similar procedure was adopted for the training of Estonian border guards. Later Baltic military training institutions have been provided different types of support.

It was first during the latter half of the 1990s, when the possibility of the Baltic countries to join NATO became a topic of political discussion. After the admission of Poland, Czech Republic and Hungary to the alliance it was realized that there could be a continued extension process, where the three Baltic countries and other countries of the former Eastern bloc would also have their place. Along with this development, assistance programs started to pave the way towards filling the membership criteria that NATO had put for its potential new members.

One element in the defence sector cooperation has been joint ministerial meetings between the eight Nordic-Baltic countries. These meetings were organized since the latter half of the 1990s both as internal events and as meetings with external parties. One of the high moments was the meeting of the Nordic and Baltic defence ministers in Turku in May 2001, with the US secretary of defence Donald Rumsfeld as a special guest. Later on another similar meeting was organized in Estonia.

Towards Operational Cooperation

During the last few years, Nordic and Baltic countries have launched new cooperation projects directed to militarily less developed new democracies. One example of this is the training program arranged for Ukraine to support it in building more effective national defence. Joint development programs deal with such issues as strategic planning, parliamentary control of the military, procurement processes, training, technology and research and public policy. There are some plans to widen this cooperation soon to new countries such as Moldova, Georgia and Armenia.

As said before, the content of Nordic-Baltic defence cooperation has developed remarkably. If the 1990s was the decade of support and assistance programs, after 2001 we have entered an era of more equal operational cooperation, both at the bilateral and multilateral level. As my predecessor Seppo Kääriäinen pointed out in the joint article with the Estonian defence minister Jaak Jõerüüt, different defence solutions are not an obstacle to mutually beneficial cooperation.

What does this era of operational cooperation mean? Estonia, Latvia and Lithuania are sharing with the Nordic countries the idea of peacekeeping and crisis management cooperation. Quite soon after finishing the first stage of building national defence forces, all three countries volunteered to international operations. For them it was quite natural that they sought particularly cooperation with the Nordic countries. In addition to joint operations in places like Kosovo, the Baltic countries gave their contribution to both NATO and US-led ad hoc –coalitions for example in Iraq.

On the first of January 2008, the so-called Nordic EU Battle Group will become operational for the next six months. It will include troops from the lead nation Sweden, Finland, Norway, Estonia and Ireland. The Nordic battle group had in November its last exercises and now waits, if it will be called into action in one of the crisis areas of the world. Latvia and Lithuania are participating in the same spirit in other battle groups. It is also quite possible that the Nordic battle group will become operational in 2011 again. In addition to the EU battle groups, Baltic countries are participating in exercises and operations of NATO's reaction forces (NRF). Finland will analyze experiences gained from EU Battle Groups and, on the basis of this analysis, will consider the participation in the NRF.

The integration of the Baltic countries into European and North-Atlantic defence structures has now been more or less completed. In spite of their relatively small sizes they have found themselves a role in common operations and structures. Estonia can again be an example. Estonia's defence minister Jaak Aaviksoo has recently announced that his country will inside NATO specialize in the preparations against the cyber war. This is a wise decision, for several reasons. Estonia has been exceptionally advanced in creating an information society. Last spring Estonia was also a target of cyber attacks against its vital systems and infrastructures. The United States is NATO's leading country in military capabilities, but smaller members can have strong niche areas as well. It is obvious that Estonia's specialization will benefit all countries in its vicinity, including Finland and other Nordic countries.

Jyri Häkämies

Minister of Defence

Finland

A EU-Strategy for the Baltic Sea region: making a success of the 2004 enlargement

By Christopher Beazley

The European Union is, and always has been, a framework through which its members receive mutual support and solidarity. As the Union has developed the areas of support and solidarity have also evolved. The Union is now the world's largest market with almost half a billion people living within its borders. The EU is a global actor, in trade and aid, and its shared border with Russia offers new challenges and opportunities for the EU structures and its Member State Governments. The Baltic Sea Region is central to the challenges and opportunities of a well functioning EU of 27 states operating in the global economy. There is much the region can offer the EU both in terms of economic focus and in contributing experience to the developing relationship with our largest neighbour.

The EU enlargement of 2004 finally ended the division of Europe which began in 1939. This however is not the end of the story. Membership of the EU of 27 is the beginning of the re-unification process in the Baltic Sea Region. There is much to be done to re-unite the economies, infrastructure and geopolitical focus of the EU Member States around the Baltic Sea. 60 years of division have resulted in differing experiences, perspectives and economic performance between the 8 Member States. For EU membership to be seen as the answer in itself is too simplistic; of course the economies of the region will begin to look and perform alike eventually by the very fact that they are operating in the same market, but this will take time. In the 1930s for example, the economies of Finland and Estonia were roughly the same size, now Finnish GDP is around €148 billion whereas Estonian GDP is €11.5 billion, even with impressive growth rates recently seen in Estonia, as with the other newer Member States in the region, it will take a considerable time to reach parity if it is just left up to the market. That said, the accession of Estonia, Latvia, Lithuania and Poland to the EU has afforded the EU and the Baltic Sea Region with a new competitive advantage. The region boasts economies with hi-tech companies able to compete on the global economic stage and points the way for the rest of the EU to follow. The region also has much to contribute to European growth and competitiveness thanks to the highly skilled workforce that is a common feature across the region. Therefore it makes clear sense, to further develop specific EU projects and programmes, not only to help re-unite and re-balance the region but also to maximise the economic potential which is latent in the region for the benefit of the Union as a whole.

The EU does support many significant projects in the region through the EU budget, and indeed the work of INTERREG is notable in delivering specific projects to the benefit of the region, such as the EcoForum Baltic. EU support for cross-border territorial co-operation is also noteworthy as is co-operation across sea borders, thanks to the wider scope under Regional Policy rules allowing co-operation across coastlines separated by up to 150km to be supported. While the detail of EU programmes has been adjusted in many areas of EU activity to reflect the realities of the 2004, enlargement it is at the level of over-arching policy that requires attention in order to bring about the necessary reforms of EU policy towards the Baltic Sea Region. At the beginning of the current mandate of the European Parliament, MEPs from the 8 Member States surrounding the Baltic Sea and some others from further afield formed an Intergroup in the European Parliament to examine and discuss EU policy towards the region. It quickly became apparent that in order to right the balance and encourage the recovery from economic dis-location that was a by-product of the divided Baltic Sea, a specific strategy was required. In 2005 we formed a Working Group, chaired by Toomas Hendrik Ilves, to draw up such a Strategy. The document which emerged from this process "An EU Strategy for the Baltic Sea Region" was presented to European Commission President José Manuel Barroso in November 2005 and was followed up the following year with a European Parliament Report, written by Alexander Stubb MEP on "a Baltic Sea Strategy for the Northern Dimension". The central idea in both of these documents was that the Baltic Sea Region is now re-united within the EU and with 8 out of 9 of the littoral States as EU members the potential of the region should be maximised at EU level.

The Strategy envisages EU action in four areas; the environment, the economy, culture and education and security and solidarity. With the Baltic Sea almost an internal EU Sea, the special and fragile state of the ecology of the Baltic Sea is in need of particularly urgent EU action and support. The Northern Dimension programme has done much in the St. Petersburg region to improve water quality and reduce pollutants. However, the effect of eutrophication and concerns over the increasing levels of oil tanker traffic are matters of considerable significance for the whole region. On the economy, a policy area of crucial importance to the Union's employment and growth agenda, the strategy calls for the full implementation of the EU's Single Market Four Freedoms throughout the region in order to fully tap into the rich seam of dynamism and opportunity the Baltic Sea Region has to offer, energy security and supply is also of note in the Strategy. The Culture and Education category celebrates the vibrant culture of the Baltic Sea Region and encourages EU policy to support the creation of centres of excellence to further develop the region's advances into the new economy. Under Security and Solidarity the Strategy, the Strategy focuses on the problems of human trafficking and an increased level of co-operation with Europol on smuggling as well as action to reduce the queues at the border with Russia.

The European Parliament's Baltic Europe Intergroup is now liaising with both the Council of Ministers and Commission to encourage the formal adoption and implementation of the EU-Baltic Strategy so that it may be in place and well under way during this Parliament's term of office.

Christopher Beazley

Member of the European Parliament

Elections in Russia - what turn in the relations to the EU?

By Henrik Lax

The Russian parliamentary election concluded as every forecast had predicted; United Russia, headed by President Vladimir Putin, won a landslide and will have a two-thirds majority in the state Duma. The overwhelming victory of United Russia is a sign that the West has failed to understand Russia. The Russian society is very complex and hard to understand for a non-Russian. President Putin has used every possible means to exploit the insecurity experienced by fellow Russians. The election outcome clearly shows that his strategy to put emphasis on security, stability and restoration of national pride has paid off.

I think the reason why Mr Putin and United Russia not only had to win the election, but get a high voting turnout has to do with Mr Putin´s own future. This result will give Mr Putin a mandate to remain in power after he steps down as president in 2008, a totally new situation that would entail opportunities, but also threatening risks. How will this effect the cooperation between Russia and the European Union? What will the impact be for the Baltic Sea Region? Can we in Finland feel secure with the far-reaching plans for the Nord Stream pipeline to be drawn in Finnish territorial waters?

Just prior to the Russian election I visited Moscow, as a member of a three-man's delegation from European Parliaments Liberal Group. The aim of the visit was to get an idea of the chances to reach a new partnership agreement between the EU and Russia. The old agreement will soon expire.

Our visit was of course heavily affected by the upcoming elections. I must admit that I was appalled by the harshness of action on behalf of the authorities. Many opposition demonstrators were arrested and brutally terrorized. United Russia, the main pro-Kremlin party, pushed the government authorities to use their power to threaten both the opposition's candidates as well as campaign workers. Mr Putin´s accusation that the oppositions parties are anti-Russian and that they are forming coalitions with Russia's "evil" neighbouring countries definitely surprised me.

Despite these atrocities and the fact that the elections in Russia failed to meet any standards for democratic elections, we need cooperation. If we want to have a secure future in the Baltic Sea region, I realize that it is crucial not to close the doors between Russia and the EU. With a secure future I refer to safety, but also to stability in energy supply and legal ways of doing business. Both Russia and the EU emphasize the importance of having a new partnership agreement. The recent parliamentary election, however, may obstruct a sincere dialogue between the two parties. The question that remains is: "How will the two partners come to an agreement" if not even fundamental notions such as human rights, democracy and the rule of law are equally defined?

The Russian business indeed understands that the rest and the west is a huge marketplace, with harsh competition. Important to note is that the commercial interest of big businesses is closely linked to the foreign policy of countries, and therefore a partnership agreement between Russia and the EU is crucial for the business.

At the moment, power in Russia is synonymous with the president. This might change after the presidential elections in March 2008. All the businesses, the financial institutions, the bureaucracy, and everyone else nervously await how the power will be divided after the presidential elections. How should one position one-self to be able to keep the business and the power of today?

What turn will the relations between Russia and the EU take? The official Russia claims that it can do without the EU. Russia is not interested in strong formal links with the EU but prefers to play out countries against each other. The Russians cannot see why human rights should influence discussions on energy supply.

Many experts with whom I spoke clearly stated that Russia indeed is in need of western know-how to solve its deep societal issues. I agree with the experts. The future of the Baltic Sea region is dependent upon how these relations will evolve. One thing is sure, much depends on how Putin will play the hand he has won. Equally important is how Finland and other EU-member states play their cards.

Business wise both Russia and the EU are dependent on each other. The EU is in sincere need of gas and Russia needs export revenues, thus the birth and geographical placing of the Nord Stream project is understandable. The Baltic Sea is the most important export route for Russia.

The pipeline plans, though, have terrified the citizens of the Baltic Sea region. I do understand this feeling, but instead of regarding the Nord Stream project as a treat, we should seize this opportunity and see the pipeline as a first step in a confidence building exercise between the EU and Russia. Before the project can become reality, the EU shall demand a thorough environmental impact assessment. Furthermore, the EU must demand a guarantee that will secure the Baltic Sea region if the pipeline will cause any damage to it. Finally, the operation of the pipeline should be made transparent by appointing a supervisory board with representatives from all the countries bordering the Baltic Sea.

There is a clear need of confidence building measures between Russia and the EU. It could be tactically wise if the EU started this process by putting emphasis on soft security issues, such as the environment, in order to get Russia on board. It will still take a long time before Russia will become strong, countable and predictable. To find a common path between the EU and Russia, the EU will have to show firmness, patience, unity and consistency.

Henrik Lax

Member of the European Parliament

The Baltic Sea - beauty in serious danger

By Pertti Salolainen

The Baltic Sea is a sea of contradiction. On the one hand, being a product of the last glacial period, the Baltic has many unique characteristics. It is a sea of beautiful coasts and archipelagos and unique species. On the other hand – and what is frightening – is that the ecosystem of the Baltic Sea is very fragile and at the same time it is one of the most polluted seas in the world. Over the past 100 years the Baltic Sea has changed from a clear-water ecosystem to a eutrophic, nutrient-rich marine environment.

The Baltic Sea is very seriously sick and in need of intensive care. The most serious symptom is the continuing eutrophication. Nowadays, the Baltic Sea contains four times as much nitrogen and eight times as much phosphorus as it did in the early 1900s. This causes severe environmental degradation of the marine ecosystems. The most obvious effect is the yearly occurrence of algal blooms. In the summer, vast areas of the Baltic Sea are covered by greenish toxic slime which makes it impossible to swim in many places. On top of that, a staggering 70 000 km² of the Baltic sea-beds are totally or almost totally free of oxygen and by that biologically dead.

Causes of the disease

A good starting point for the curing actions is that the causes of the malaise of the Baltic Sea are well known. A significant amount of the nutrients come from agriculture in the region. For example in the case of Finland, agriculture is the worst polluter of the coastal waters. And this necessitates major reductions in the release of nutrients.

In addition to agriculture, cities and other human settlements, heavy industry, traffic and shipping are important sources of nutrients. Moreover, oil shipping, especially from the Russian harbours in the Eastern Gulf of Finland but also from many other harbours, causes a very severe threat. The Baltic Sea is one of the busiest oil shipping routes in the world. A big oil accident at sea would cause tremendous and long lasting damage to the Baltic marine environment.

In the near future, the greatest threats to the Baltic Sea include for example Poland and St. Petersburg. If no concrete measures are taken in use, the release of the Polish agriculture into the Baltic Sea is expected to be doubled in relation to the present level once the farming subsidies from the EU begin to really affect Poland's agricultural production. Both the Common Agriculture Policy and the Baltic Sea Strategy need to tackle this problem.

Another ticking time bomb in the Baltic Sea Region is St. Petersburg. A lot of valuable work has already been done for the sewage treatment but this work could go down the drain if the waste from the growing agriculture and food production in St. Petersburg and in its neighbouring areas may run straight to the water systems. Given the massive size of and the number of animals in the piggeries and poultry farms in the area, they put a huge strain on the Baltic environment if measures are not taken.

Cooperation and political will needed as medicaments

In order to tackle the disease of the Baltic Sea, more cooperation and political will is needed. For example in the Finnish Parliament, the worry about the Baltic Sea is common to all political parties. Recently, the Foreign Affairs Committee announced its report on the Baltic Sea and the Northern Dimension. The report was a strong statement from the Committee to the Government for renewing its policy towards the Baltic Sea.

Finland has been active in promoting the politics of the Northern Dimension within the European Union. According to the Foreign Affairs Committee, both a Baltic Sea Strategy and Northern Dimension Policy are needed and any dispute about their interrelationship should be forgotten. The European Commission and Parliament are working on the Baltic Sea Strategy which would be an internal policy. It needs to concentrate in the activities of the European Union in the Baltic Sea Region and one of its main objectives has to be to unite the Baltic Sea Region into a strong entity within the EU. Especially large countries such as Germany and Poland have to be closely involved in the rescuing process of the Baltic Sea.

The Member States located on the coast of the Baltic Sea need to find a single voice with which to speak in the European Union in order to make a difference and to emphasize the importance of the Baltic Sea for the whole Union for example economically. After all, the Baltic Sea region is one of the most dynamic parts of Europe. In particular, Finland and Sweden, which holds the EU Presidency in 2009, should cooperate and take an active role in pushing for a Baltic Sea Strategy within the EU and promoting cooperation in the Baltic Sea Region as a whole.

The Northern Dimension creates ways for effective activity in the North Western areas of Russia in the fields of environment, social and health policy and traffic and energy efficiency politics. After the reform carried out during the Finnish EU Presidency in 2006, the Northern Dimension Policy works rather well at the moment. In relation to the Baltic Sea Strategy, the Northern Dimension could act as EU's external interface with Russia. It is crucial to recognize Russia's role as one of the key players in the Baltic Sea Region. Stating this, both the economical and environmental aspects should be taken into account.

The recent adoption of the HELCOM Baltic Sea Action Plan in Krakow is a significant sign of the political will of the countries in the Baltic Sea Region to work together to reduce the pollution to the Baltic Sea by 2021. The plan puts its emphasis especially on curbing eutrophication, preventing pollution involving hazardous substances, improving maritime safety and accident response capacity and halting habitat destruction and the decline in biodiversity. One of the main objectives of the HELCOM Baltic Sea Action Plan is to achieve "clear water" which involves proposing provisional country-wise annual nutrient input reduction targets for both nitrogen and phosphorus.

The HELCOM Baltic Sea Action Plan is a result of active participation of all major stakeholders in the region, and it realizes that close cooperation with Russia is crucial for progress to be made in rescuing the Baltic Sea. Russia is the only country in the region that belongs to the HELCOM but not to the European Union. From the point of view of the Northern Dimension Policy, the HELCOM Baltic Sea Action Plan can be considered instrumental to its implementation. Overall, what is important now is that all parties commit themselves to the implementation of the Action Plan. Adopting the plan was an important step but a lot of work is required in order to assure its implementation.

In conclusion, the rescuing of the in many ways precious and unique Baltic Sea requires ever stronger political will and cooperation. For this, action and commitment of every one of the nine countries surrounding the Baltic Sea, the whole EU and Russia are needed.

Pertti Salolainen

Minister

Member of the Parliament of Finland

Chairman of the Foreign Affairs Committee

Investment climate in Russia: a Russian paradox?

By Blanka Kalinova

Russia's FDI inward stock amounted to more than USD 270 billion by the end of 2006 and inflows have continued to grow in 2007 to reach probably a record level (USD 37 billion from January to September 2007 according to the estimates of Russia's Central Bank). At the same time, most investor surveys and international comparisons continue to see Russia's investment climate as uncertain and risky and less favourable than in many other emerging economies. The question is how to explain this contradiction and understand why foreign investors, despite their reserved views on Russia's business environment, are ready to increase their commitments in the country. One possible explanation is expected high returns on investment, especially in the energy and natural resources sector which represents an important part of Russia's FDI, make foreign investors somewhat less "sensitive" to traditional investment barriers such as red tape and even corruption. However, this is obviously only a part of the answer.

What exactly do recent investor surveys and international comparisons say about Russia's investment climate? Some of these analyses are typical business surveys, based on questionnaires addressed to business representatives in the countries analysed. These include the EBRD/World Bank Business Environment and Enterprise Performance Surveys, regular questionnaires addressed by the Russian Centre for Economic and Financial Research (CEFIR) to firms operating in Russia and the World Bank Survey of Competitiveness and Investment Climate in Russia. Some others, such as the World Bank Worldwide Governance Indicators, the Index of Economic Freedom, the Competitiveness Indexes by the Institute of Management and Development and the World Economic Forum are essentially perceptions-based indicators based on experts' evaluations of various elements considered relevant for political and economic developments. These studies present country rankings allowing for international comparisons and provide time-series that assess and compare the evolution of the business climate in individual countries. The World Bank "Doing Business" database belongs to the category of facts-based indicators, which compare selected measurable facts considered to be important elements of the business climate, such as costs, time and number of procedures for starting or closing a business in analysed countries.

Although it is difficult to sum up findings based on diverse methodologies and data, certain patterns characterising recent developments in Russia's investment climate can be identified.

Since 2000, two periods of perceptions of Russia's business environment have been observed. Most surveys confirm that favourable developments took place between 2000 and 2003, reflecting the gradually improving macroeconomic situation after the 1998 financial crisis and the government's sustained reform efforts, in particular with respect to reducing the tax burden and facilitating licensing and inspection requirements. However, from 2004 onwards, the favourable trend appears to be less straightforward and several surveys indicate deterioration in the perception of Russia's regulatory environment by both insiders and external observers. For example, Russia's performance has worsened since 2004 according to the World Bank Governance Indicators of Government Effectiveness and Regulatory Quality and has not significantly evolved for the Rule of Law and Control of Corruption. The diminishing of the favourable trend means that the Russian government has not fully taken advantage of positive economic developments to pursue a more ambitious reform agenda.

Another observation that can be made from recent business surveys and assessments is that despite some progress, especially between 2000 and 2003, Russia's business environment is still perceived as inferior compared to the benchmark represented by developed countries. It is also less favourable in certain respects than in the countries which are Russia's main potential competitors, in particular Brazil, China and India. For instance, Russia's 2006 scores for the World Bank Governance Indicators of Government Efficiency, Regulatory Quality and Rule of Law are considerably lower, both compared to the OECD average and in relation to Brazil, India and China. A number of other international comparisons also show Russia's ranking behind these three countries (i.e. Economic Freedom of the Heritage Foundation, Bertelsmann's Management Index) or behind at least two of them (i.e. World Economic Forum's Global Competitiveness and Institute for Management and Development's World Competitiveness).

The third and perhaps most striking observation is that many available surveys and comparative assessments reveal particular features which, though not specific to Russia, are particularly pronounced in this country. One such salient element is the large gap observed between formal restrictions, which could be considered relatively moderate, and higher than usual informal barriers faced by business operators and investors in Russia. This feature is usually reflected in Russia's very low rating in corruption and elements relating to the rule-of-law which are reported by most available studies. Some surveys capture specific difficulties met by various types of firms in Russia. The World Bank Survey of Competitiveness and Investment Climate in Russia highlights that more acute barriers are faced by small and medium-sized enterprises than by large firms, in particular with regard to regulatory and policy uncertainty. The regular surveys by the Centre for Economic and Financial Research (CEFIR) show persisting regional differences in the implementation by regional and local authorities of legal and regulatory measures. Unequal treatment of different types of firms at the regional and local levels thus appears to be one of the most serious problems in Russia's business environment.

Existing investor surveys do not yet adequately cover responsible business conduct practices, although these have become an increasingly important element for evaluating reliability and credibility of investment partners. Weak observance of standards of responsible business conduct could be one of the other reasons why some emerging market economies, especially Russia, are not perceived as fair and reliable investment partners, even if their investment conditions are considered relatively favourable.

The ambivalent attitude of the Russian government toward foreign investment could be another reason why Russia is not yet seen as an investment-friendly destination. The 2005 legislations on Special Economic Zones and on Concessions have been viewed as a positive sign towards private, including foreign, investment. However, these initiatives have brought only limited results to date. The law on strategic sectors, proposed by President Putin in April 2005 but still waiting for approval by the Duma, was initially welcomed by foreign investors hoping to see ad hoc decisions being replaced by more predictable and clear authorisation procedures. However, in its current form the draft bill has a large sectoral coverage going beyond the traditional areas of national security interests as it also includes, for example, natural monopolies. Finally, the most controversial aspect of Russia's investment climate is

growing state-control over large segments of the Russian economy.

The "Russian paradox" thus seems to reflect the dual character of the Russian economy and some ambivalence in Russia's international economic opening. Some segments of the Russian economy have become increasingly open to private, including foreign, investment and internationalised through their investment abroad. This is the case, for instance, for mobile telephones, retail distribution and, to a certain extent, the electricity sector. At the same time, some other sectors, especially oil and gas upstream activities and energy transport have been increasingly subject to state control and political interference and their governance structure has become less transparent, with negative consequences for their business credentials abroad.

The remedies to deal with the Russian paradox are relatively easy to define in general policy terms: enhancing policy transparency and predictability, accepting liberalisation commitments in particular in the WTO and the Energy Charter Treaty, clarifying the legal investment framework, especially for strategic sectors and energy investment and, last but not least, promoting an active competition policy to ensure a level playing field for all firms. This is of course easier said than done but, without reinvigorated reform efforts, Russia's modernisation and diversification process will have difficulty advancing.

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The article is partly based on material collected for the next OECD Investment Policy Review of the Russian Federation, which will be published in 2008. The article does not necessarily reflect the views of the OECD and its member countries.

Russia forerunning EU in power sector forum

By Seppo Remes

Russia is the fourth largest user of electricity in the world, with roughly 210,000MW of capacity. A large part of the capacity is co-generation, adding heat to electricity generation. Until now practically all of the distribution, transmission and supply has been controlled by one company, RAO UES; in generation, UES controls almost everything except nuclear power. It is in a separate legal entity, Rosenergoatom, which will also in the future remain a 100% state-owned company. UES was organized as a holding structure, with subsidiaries in more then 70 regions – all of them vertically integrated monopolies with generation, distribution and supply businesses – and some 40 federal power stations as well as all Russian transmission lines. UES itself is 52% state-owned and its subsidiaries are owned 49-100% by UES. Mostly, the ownership of UES and the subsidiaries differs. UES was, and still is, everywhere in Russia; there is no corporation or any other institution comparable to it.

The reform of the Russian power sector started at the beginning of this decade, on the initiative of Anatoly Chubais, CEO of RAO UES. The very core of the reform has been to separate competitive businesses from natural monopolies, both legally, functionally and regulatory. Consequently, competitive parts – generation companies, supply/sales companies and service companies – have been separated into legally different companies from natural monopolies – from transmission company, distribution companies and system operator company. The competitive sector is in the process of full and complete market and price liberalization: all legal and regulative decisions have been already taken and confirmed by the Duma and Government. Thermal generation, supply and service companies will also be fully privatized.

The reform task was extremely difficult and complicated, in all respects. More than 70 vertically integrated regional companies - Energos - had to be divided into generation, distribution, transmission lines, supply and service companies on pro rata basis. After this, regional generation companies that were close to each other, were merged; the same took place with regional distribution companies. And you should remember that almost all of these companies had different shareholders, from whom it was necessary to gain support for the restructuring. The fact that the support was received has in turn provided evidence that valuations of different shares for mergers were done in a fair way. Thus, 14 regional power and heat companies were created. In addition, federal power stations and some of the largest stations inside regional Energos were merged into 6 thermal generation companies, combined by the extraterritorial principle and in a manner where each of them include both gas and coal-fired power stations. Average capacity of wholesale generation companies is 9.000MW and for regional power companies varies between 2.000 – 10.000MW. Furthermore, one big hydro generation company was created, putting together both federal hydro stations and larger hydro stations from regional Energos, with a capacity of more than 23.000MW. We can conclude that 14 regional and 7 federal generation companies, plus Rosenergoatom, will guarantee the existence of competition in power generation.

The Russian government has decided to fully privatize 20 of the 21 newly-created generation companies. Roughly half of them have already been privatized, usually by a combination of a sale of the government stake and a new share emission to attract money for necessary new investments. New owners are both Russian and foreign: Enel, E.On, Fortum and probably also French, Czech and Asian companies. Income from privatizations is re-invested in power grids, distribution and hydro generation. I do not have any reasons to doubt that the process of privatizations will be finalized: there is an urgent need for huge investment in the power sector – a figure of USD 100bn in 5 years has been on the table - and it is not rational to burden only the state budget with those investments. Market and price liberalization is meant as a kind of guarantee of attracting private investments. Today, already 20% or so of electricity is sold at liberalized prices and the figure will gradually increase, twice a year, to reach 100% at the beginning of 2011. The new domestic gas prices system, netback pricing, tied to export prices, is being introduced in a synchronized manner along with the power market liberalization, to enable an increase in gas production and sales to domestic markets, including power stations.

The high-voltage grid will be 75% owned and controlled by the Russian government: it is the skeleton of the wholesale markets and cannot be in the hands of market players if fair access to the net for all generators and sales companies is to be guaranteed. The Russian state also wants, at least for the time being, to control distribution companies via national distribution holding, under which 11 inter-regional distribution companies will be created. Because of the monopolistic nature of the business, direct regulation is needed. However, it will no longer be the cost-plus method (which punishes those who are more effective), but a system of RAB; a regulatory asset base tariff system. RAB guarantees each distribution company a certain IRR, let's say 11% annually, which enables new investments; tariffs are defined for 5 years and those able to be more efficient will improve their profits. For the next 5-year period, the regulator defines new tariffs from the more efficient production levels achieved by companies during the last time period. Thus, the market mechanism functions even in a monopoly sector, and in the interests of consumers and businesses.

Russia will have some special features in its power sector, not typical for example in well-functioning Nordic markets. The first is the existence of a centralized System Operator, which is responsible for the demand/supply balance, safety and security reserves in the system, including the assessment of the need for new investments. Its supervision systems are already synchronized with the Russian trading system, ATS, thus enabling market signals to be directly channeled to system balance and security management. The other element is a capacity payment system: as well as electricity trading, existing and yet-to-be-constructed capacities are traded on markets. Capacity payments cover the fixed costs, while electricity payments cover the variable costs. Capacity payments allow markets to react earlier to foreseeable capacity deficits; selling yet-to-be-constructed capacity beforehand gives "investment guarantees" for new construction, and thus, most probably, greatly smoothens market volatility. Markets do not need to wait until there is deficit of capacity but can start to build it earlier than in a system of pure electricity sales. System security will also improve.

It is of utmost importance for the future, to prevent the creation of any monopoly structures on the markets. UES is suggesting a change in the law allowing the Antimonopoly Agency to interfere immediately when the share of any company in any regional free-flow markets (perhaps some 10 areas in Russia) grows over 20%, including measures such as very high penalties and the spin-off of some power

station(s) from the company. It is also very important to get binding guarantees and an absolutely transparent system of third party access to trunk and other gas pipelines. We are convinced that the Russian government shares our worries of the risks of monopolization and will support these UES proposals.

It is no exaggeration to conclude that Russia is ahead of the EU in the reform of the power sector and power sector monopolies. We have been able to create very sophisticated markets, with new elements, and with rational elements to the regulations. 1 July 2008 UES ceases to exist, giving thus impetus both for economic growth and market reforms in Russia.

Seppo Remes

UES, Member of the Board

EOS Russia, Chairman of the Board

Russia

A Baltic perspective on OMV's bid for MOL

By Kalman Kalotay

Activities of the Austrian oil company OMV and its Hungarian peer MOL seem to take place faraway from the Baltic region. Therefore, for a Baltic observer, their fierce fight for market leadership in Central and South-East Europe could be a distant event. But the Baltics and Central Europe are linked by countries such as Poland and Germany, and share various common characteristics. If Russia is counted apart, both subregions are home of fairly small net oil importing countries; and the relatively small oil companies of both areas focus mostly on downstream activities. In the same vein, in many of these companies, State ownership is important (just like in the case of Russian firms). Moreover, in the transition economies of both subregions, foreign investors are important players in the downstream oil and gas industry. Hence the outcome of the fight between the largest State-controlled and private oil firms of Central Europe could influence Baltic thinking on similar issues.

A glimpse at the Baltics and Central Europe in the European oil industry

The European oil industry consists of three types of companies (see table):

- in Western Europe, there are large privately owned transnational corporations (TNCs), such as Royal Dutch Shell (UK/Netherlands) or BP (UK), of market values and turnover in hundreds of billions of dollars;
- in Russia, State-owned Gazprom rivals in size with privately owned TNCs; and so do fast growing Rosneft (again State-owned) and Lukoil (private), with market capitalizations of over $50 billion;
- compared to these Western and Eastern giants, even the most advanced champions of the Baltic region or Central Europe are dwarves (with the exception of Norway's Statoil, and Germany's E.ON − but the latter is usually classified as a public utility firm, and not an oil and gas company per se). Another specialty of the Baltics and Central Europe is the importance of foreign direct investment in the downstream oil and gas industry in their transition economies (including Estonia, Latvia, Lithuania, as well as the Czech Republic, Hungary and Slovakia). As for the list of lead investors in oil and gas, they are somewhat similar: the three Baltic States are split between Germany's E.On and Russia's Gazprom (and Poland's PKN Orlen in Lithuania), while in Central Europe, they include E.On again (in Hungary's natural gas industry), Poland's PKN Orlen again (in the Czech Republic), as well as Hungary's MOL (in Slovakia).

Size differences mean that even if the smaller TNCs of the Baltics and Central Europe envisage fast growth in the near future, and two of them combine their resources through a merger, they still can not compete with the size of either Western or Russian giants. No wonder that with the exception of the Hungarian State, which in 2004 took the risk of selling all but one of its remaining shares in MOL, the governments of these countries are hesitant to divest from their national champions.

Within this European context, Austria's OMV and Hungary's MOL have followed different corporate strategies.

- Founded in 1956, OMV, the larger of the two competitors, has remained a company controlled and influenced by the State (31.5% ownership as of today). In addition, the International Petroleum Investment Company of the Abu Dhabi State controls more than 17% of the shares.
- In turn, MOL, the smaller but faster growing company, which was founded only in 1991 from various elements of the State-run petroleum industry of Hungary, has become a company partly owned by management itself, and partly by institutional investors, mostly from abroad.

The geographical reach of the two companies also varies. Some of the key affiliates of OMV include OMV of Libya (exploration and production), Ring Oil (Russia, exploration), Petrom (Romania, integrated oil and gas company). OMV is also minority, but important, shareholder in the Bayernoil Raffineriegesellschaft (Germany, refinery), Petrol Ofisi (Turkey, retail and wholesale), and MOL proper, in which it owns a 20% share. This picture indicates that OMV has a broad geographical spread in exploration than MOL, and its geographical interests include both the area West of Austria (e.g. Germany) and South-East Europe.

In turn, MOL's key shareholdings include BaiTex (Russia, exploration and production), Italiana Energia e Servici (Italy, refinery), MOL Romania (retail and wholesale), Slovnaft (Slovakia, refinery and trade), and Energopetrol (Bosnia and Herzegovina, retail and wholesale). It is also a minority shareholder in Croatia's INA. Compared to OMV, MOL explores more in Russia, and focuses its downstream interests in a geographical area spanning from Slovakia through Hungary into Croatia and Bosnia and Herzegovina. This way, it plays an important role in countries in which OMV has a relatively weaker position, plus it is a major competitor to OMV in Romania.

It was not in the autumn of 2007 that MOL has been mentioned for the first time as a potential participant of a merger. In 2004, it was thought to be in merger talks with Poland's PKN Orlen, a company with roughly equal size of MOL (table 1), and a complementary profile, with a presence both in the Baltics and Central Europe (owning the Mažeikių Nafta refinery in Lithuania, the oil company UniPetrol in the Czech Republic, and petrol stations in Germany). It is also understandable from the point of view of MOL that a marriage of equals with PKN Orlen would have been preferable, while seen as a potential threat for OMV's geographical ambitions. In addition, MOL, as well as OMV, have been rumoured from time to time being a potential target for Russian oil and gas firms.

MOL is an attractive target for OMV because it is a new and very dynamic private company; it has modern and efficient refineries near Budapest and in Bratislava (Slovakia); it has an attractive geographical presence in fast growing markets; and thanks to its good management, it is one of the most profitable oil and gas companies in Europe (table 1). Indeed, in 2006 only global gas monopolist Gazprom could boast a higher net income ratio (21%) than MOL (13%). Conversely, OMV was in the low profitability ratio, with 7% only. Hence, once taken over by a less efficient firm, MOL would risk being the cash cow for bankrolling the less efficient activities of the buyer and dominant partner.

The OMV "bid" and the lex MOL

While the open battle for the control of MOL started in September 2007, the two parties began discretely their preparations at least two months before. MOL management started buying back its own shares, in order to exceed 25%, a threshold that enables them to block any change in the charter of the company. In turn, OMV began to increase without fanfare its share (from 10 to 20%) in MOL. OMV's purchases were this time were made secretly and hence the first speculations were that it was acting as a front man for a Russian firm.

OMV did not make an official bid for MOL in a legal sense but published, on 25 September 2007, a "Declaration of Intent to combine OMV and MOL". It offered a significant premium over MOL's share price, in exchange for letting it control the firm. In particular, it invited the company to drop from the charter of the company the special provision stipulating that no stakeholder may have a voting right in excess of 10%, even if its ownership share is above that level. OMV claimed the merger would result in major synergies in a company that would be equally controlled and traded in Austria and Hungary.

In response, MOL criticized OMV for not presenting a formal offer to shareholders according to relevant capital market regulations. It also argued that OMV's approach substantially undervalued MOL and would destroy value, due to potential losses arising from a disposal programme that would be required by anti-trust authorities. MOL pointed at two areas of value destruction: refineries; and petrol stations in Austria and Romania. In general, MOL argued that they are a more modern and efficient private firm, and for this reason, being bought by a State-owned entity, with its strategy influenced strongly by the home government, would be a step back in development. In addition, that would lead to another type of value destruction, as well managed assets would pass into the hands of less efficient managers. Although the Austrian minister of economy suggested that Hungarian State, too, should buy 25% of MOL before the merger, the Hungarian Government did not accept it, not just because the State had no $4 billion in the budget to do so, but also it could be asked why to go back in history if the fully privatized firm performs well.

In a controversial counter-move, the Hungarian parliament decided instead to promulgate in October 2007 a new law on strategic companies (gas and electricity firms). This law dubbed "lex MOL" mandates that the sale of principal assets of strategic companies require approval by the highest body of the company, plus any official takeover bid should include a business plan, submitted to the Securities and Exchange Commission. In addition, management of the target companies would be entitled to carry out certain measures, such as buy more treasury shares or raise equity, even after learning about an official bid. This law is under investigation by the EU. However, it is not expected to change radically after eventual objections from Brussels, as it does not directly affect the right of establishment of EU companies, nor does it discriminate by nationality. In turn, it is legitimate to ask if this reaction to the OMV bid was excessive, and would hinder future efforts towards the consolidation of the industry.

The conflict seems to be in a long-run stalemate:

- OMV has indicated that it can wait for a long time. It can also convince the institutional shareholders of the MOL to take advantages of the short term gains offered by the OMV bid. With that, it can further increase its shareholding in MOL up to 25%. (Beyond that, it would be legally bound to make a public bid.) However, it can do nothing to eliminate the 10% voting cap unless the companies general meeting votes so, and consequently, the 25%-plus blocking share owned by MOL management. That may be a costly use of financial resources, and detrimental to OMV's already not-so-high profitability.
- In turn, MOL's management may be obliged to hold on to its shares in order to block OMV permanently, and this can affect its plans to continue growing abroad quickly. Alternatively, it can search for another, more equal merger partner, such as PKN Orlen of Poland, which, as mentioned above, was already thought to be in merger talks with MOL in 2000.

Consequences for the Baltic region

The Baltic region is probably faraway from the OMV-MOL conflict, although it may feel its implications:

- To varying degrees, E.On and Gazprom are both present in Austria and Hungary, and hence will be affected by the outcome of the MOL/OMV case.
- If PKN Orlen, which is already present in both the Baltics (Lithuania) and Central Europe (Czech Republic), were brought into the consolidation of the industry, the Baltic region would further be involved in the solution of the MOL/OMV competition.
- Independently of the final outcome, the OMV bid should have far reaching consequences for the future of privatization and private ownership of oil and gas companies in the Baltics (as well as other parts of Europe). In brief, it should have a major negative, chilling effect on privatization plans, prompting governments keeping or increasing their shares in strategic companies, instead of selling them. We should also take into consideration that, while in various transition economies such as Lithuania and Poland, the state has kept only minority interests in oil companies, Neste of Finland and Statoil of Norway are still majority State owned.
- The lex MOL and its acceptance or rejection in Brussels will have far reaching implications for EU member countries' similar legislations on hostile takeovers. In other words, it will indicate to the Baltic members of the EU how far they can go with severing the legal protection of "strategic" companies.
- The MOL/OMV case can also affect eventually how many future takeovers will take place in the Baltic region, and under what conditions.
- The OMV/Mol case can also affect the ways how in the future private oil companies will design their own internal rules aiming at preventing hostile takeovers. Voting caps, in particular, may become popular.
- Finally, the MOL/OMV case has also implications for the attitude of small national oil companies of net importer countries with large Russian TNCs. They can better understand that it is illusory to believe that a Central European, or Baltic, downstream champion, created from the merger of two, or various, national firms, would stop the expansion of Russian firms into the subregion. On the contrary. These "champions" would be still too small compared to the Russian giants, but sufficiently large enough to be attractive for them in their quest of better controlling the downstream activities. Moreover, even if these firms grow their exploration activities quickly, they will not match the huge upstream reserves of Russian companies.

- Baltic and Central European oil firms are obliged to cooperate closely with Russian (or CIS) upstream firms, independently of the level of consolidation in the industry. Russian companies can also prefer cooperation with, rather than takeover of, local firms if that is a less costly, more stable and more efficient solution to the question of control over the downstream market. They may also take into consideration that more State interest in oil and gas firms is not a Hungarian, or Central European, or Baltic, specialty but a global trend, started by some countries including Russia itself. Hence, conflict minimizing strategies are needed to placate increasingly heated national interests in host countries, prompting all TNCs, including Russian ones, to adopt the cooperation/joint venture route with local partners, whenever possible.

OMV promised it could wait up to two years for MOL's answer. A sequel to this analysis is then due in late 2009.

Kalman Kalotay

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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 1. Financial performance of selected European oil and gas firms, 2006

Company	Home	State ownership	Market value end 2006 ($bn)	Turnover year 2006 ($bn)	Net income ($bn)	Profitability
Gazprom	Russian Federation	50.1%	271.8	60.1	12.6	21.1%
Royal Dutch Shell	United Kingdom /Netherlands	-	214.0	318.8	25.4	8.0%
BP	United Kingdom	-	208.8	265.9	22.0	8.3%
E.ON*	Germany	-	93.2	85.6	6.7	7.9%
Rosneft	Russian Federation	50.1%	83.9	33.1	3.5	10.7%
Lukoil	Russian Federation	-	73.6	67.7	7.5	11.1%
Statoil	Norway	64.0%	59.4	69.6	6.7	9.6%
OMV	Austria	31.5%	18.7	25.3	1.8	7.3%
MOL	Hungary	0.1%	15.0	14.2	1.9	13.2%
Neste Oil	Finland	50.1%	8.8	17.0	0.8	5.0%
PKN Orlen	Poland	10.2%	7.1	14.2	1.6	11.1%
Lundin Petroleum	Sweden	-	3.6	0.6	0.1	18.0%
Lietuvos Dujos	Lithuania	17.7%	3.3	1.4	0.1	9.2%

Source: The author's collection, based on company reports, and data derived from the FT-Europe 500.

Imatra - a Finnish border town in the economic region of St. Petersburg

By Pertti Lintunen

Imatra became a self-governing municipality when the rural municipalities of Ruokolahti, Joutseno and a small part of the Jääski rural community were joined together after the WWII 60 years ago. Later on, Imatra was granted town rights. The greatest part of Jääski including the industrial community of Enso, which is today known as Svetogorsk, was left on the Soviet Union's side. Being both situated close to the border, Svetogorsk and Imatra are neighbouring towns. Currently, Imatra has approximately 30,000 and Svetogorsk 16,000 inhabitants. Approximately two per cent of the inhabitants of Imatra have an immigrant background, most of them originating from Russia.

The border

Southeastern Finland boasts three international border-crossing points (Vaalimaa, Nuijamaa, and Imatra) for road traffic, one international border-crossing point for rail traffic (Vainikkala), and the Saimaa Canal for water traffic. Every year, the volume of traffic increases at all border-crossing points. A significant proportion of imported goods passes to Russia through Finnish ports as transit traffic. For example, an estimated number of 700,000 cars will be imported via Finland to Russia this year. The increasing heavy vehicle traffic is placing pressure not only on the roads in Southeast Finland but also on the border-crossing points, where they create queues and other inconveniences. Not only do these problems continually increase in severity, but it also appears that no quick solutions are to be found. Currently, a daily average of 1,500 vehicles crosses the border at the border-crossing points in Southeast Finland, of which the proportion of Imatra is approximately 300. The Finnish Road Association has estimated that the border traffic will increase 50 per cent by 2012.

Imatra has a unique location at the Finno-Russian border. The border-crossing point is located in a place, where the urban structure and services are immediately available on both sides of the border. No similar conditions exist anywhere else at the Finno-Russian border. The border-crossing point is unique also because it features both road and railway connection. In addition to this, border can be crossed by using a bicycle, which enables quick visits to the neighbouring town. The border-crossing point is open 24 hours a day apart from the railway traffic. The railway connection does not yet serve international traffic but is mainly used as a timber transportation route from Russia to Finnish wood processing plants, to which separate contracts are applied. In the near future, the objective is to start a 24-hour international border-crossing point also for railway traffic.

The location of Imatra facilitates the development of trade and business operations by utilizing the advantages offered by the border region. At its best, this cooperation promotes employment and welfare on both sides of the border. The giant American International Paper (IP), the owner of a big pulp and paper combine and a major employer in Svetogorsk, offers a good example. In addition to providing jobs, the mill supports the repair of streets, kindergartens, schools, and the hospital in the town. Every day, approx. 30 persons commute to the mill from Finland, most of them from Imatra. In addition to this, the mills buy subcontracting services from Finnish companies, especially in fields of maintenance and construction.

St. Petersburg

Imatra is situated only approx. 200 kilometres from St. Petersburg, which together with its neighbouring regions forms a metropolis of almost 7 million inhabitants. Measured by its population, St. Petersburg is by far the biggest economic area in the Baltic Sea region, while being the 4th largest city in land area. Since its foundation a good three hundred years ago, St. Petersburg has generated job opportunities, entrepreneurship, and vitality in its surrounding areas, which has also benefited the people living on the Finnish side of the border. The 70-year period of communism – referred to by one Finnish expert as "a temporary market disorder" – and the compulsory deliveries after the WWII broke off this natural and historical connection between the border regions. These bitter memories live on in the minds of the people, but the times are changing and the historical connection is about to be revived.

Throughout the 2000s, the Russian economy has been growing an average of 6 per cent a year. The fast development of the economy in St. Petersburg and the growth of consumer demand in particular are reflected in the trade and tourism sectors of Southeast Finland. When an international border-crossing point started in Imatra in 2003, some 50,000 Russian tourists visited Finland. During the past four years, the number of tourists has tripled, almost reaching 150,000 in 2006. The amount of tax-free sales in Imatra and the nearby City of Lappeenranta has increased to over 20 million euros a year. From this, the proportion of Imatra is approximately one third. The strong growth continues. In the period between July last year and July this year, tax free sales increased over 70 per cent in Imatra and over 50 per cent in Lappeenranta. It should be noticed, however, that the share of tax-free sales only account for one fifth of the total volume of sales made by Russians in Finland. Imatra also ranks high in the accommodation statistics. Studies show that the occupation ratio of hotels in Imatra is one of the highest in the entire country, which is the result of the growing number of Russian tourists in particular. For instance, the occupation ratio of Imatra Spa, a popular tourist destination, has during the recent years constantly been over 80 per cent.

Pertti Lintunen

Mayor

Town of Imatra

Russia's policy towards Central - Eastern Europe after the EU enlargement

By Marek Menkiszak

The year 2004 has brought historical geopolitical change in Europe. Double, NATO (March) and EU (May), enlargement to the east has symbolically ended, after almost 60 years, artificial division of Europe bringing countries of Central and Eastern Europe (CEE) back to the family of democratic Western nations. This made the relationship between the enlarged EU and its major eastern neighbour - Russian Federation even more important. In Moscow these events were received without enthusiasm. The Central – Eastern Europe couldn't play any more a role of a buffer zone between the West and CIS area as some Russian politicians and experts suggested in the 1990s. Russia, counting its hypothetical losses, made a lot of effort for the last few years, and especially last months, before the 2004 enlargement to encourage Brussels to make as many economic and political concessions as possible. Moscow cared first of all about its delivery of energy resources and steel products to the new member states, its transit to Kaliningrad enclave and further to the west, EU veterinary and antidumping procedures, visa regime and the situation of Russian-speaking population in the Baltics. These concerns were partly addressed by the EU in joint statement of April 2004 paving the way to end the crisis over protocol on extension of the PCA to the new EU members, signing of which Russia made conditional on accepting its postulates.

Contrary to some Russian prognosis, new environment of CEE – Russia relations has helped to increase dynamic of the economic and political relationships. Moscow, after some time, has reacted to the EU enlargement by the activisation of its policy towards the countries of the region. It was reflected both by the diplomatic exchange and economic activity. Between the beginning of 2005 and spring of 2006 Russian president Vladimir Putin paid visits to Poland, Slovakia, Hungary and Czech Republic (except the first case, it was the first visit of the Russian leader after more than 10 years). Between the end of 2004 and mid 2005 Russia and some CEE states (Poland, Hungary, Slovakia and Czech Republic) signed new framework agreements on economic cooperation. During the next one year period intergovernmental committees on economic cooperation were reactivated between Russia and Hungary, Czech Republic, Slovakia, Poland and Slovenia, often after few years of inactivity. Moreover, the Russian investment has grown visibly in most of the countries of the region, especially in energy, chemical sector, steel and machine industry. Trade volume has boomed (144 % rise with 6 CEE major partners between 2003 and 2006), however partly due to rise of prices for the Russian energy resources exported to the region. These all has marked kind of “return of Russia” to the CEE.

Worth to note was certain evolution of Russia's approach to the CEE states after the EU enlargement. In Russian official political rhetoric relations with CEE in the period immediately after the enlargement were often associated with crisis in the Russia – EU relations, which became visible especially since the end of 2003. New member states, sometimes described in Russia as the “newcomers”, were often collectively blamed for this crisis. They were accused for bringing to the EU its “Russophobia” and burden of prolonged problems with Moscow.

As Russia – CEE / EU relations has developed, after some one year period we could speak about a certain division of CEE in Russia's eyes. “Good neigbours” were those who pursued policy labeled in Moscow as pragmatic: they made no serious attempts to decrease their energy resources dependency on Russia, were open for Russian business and for infrastructural projects, not rising problematic issues originated in turbulent history, avoiding criticising Russia's internal and foreign policy, open for Russian postulates towards EU and NATO and not very active in the Russian/EU “common neighbourhood”. Hungary, Slovakia, Bulgaria, Slovenia and Czech Republic could be to a large extent place in this group. Other group of “bad neighbours” were those whose policy was largely the opposite. Poland, Estonia, Latvia, Lithuania and to some extent Romania could bee seen as the part of this group. Moscow has publicly complemented the countries of the first group sometimes rewarding them by the certain opening of its market (in energy, consumer and agricultural products) and some symbolic political gestures (like Moscow’s expression of moral responsibility for Soviet military interventions in Hungary in 1956 and 1968 in Czechoslovakia, return of Sarospatak library to Hungary or placing Russian – US summit in Slovakia). Countries of the second group were often sharply criticised and most of them faced different types of economic sanctions from Russia (like blocking Russian oil transit in Latvia, oil supply disruption in Lithuania, temporary rail transit disruption and cyberatacks in Estonia, embargo for export of Polish meat and agricultural products).

During 2007 however, along with visible warming up of Latvian – Russian relations (as common border was legally regulated and economic relations developed) and certain cooling down of Russian – Czech relations (because of Russian campaign against projected radar deployment in Czech Republic as an element of the US strategic missile defence system) the picture has became more complicated. What is the result is rather Russia's individual approach towards particular CEE states based on Moscow's balance of interests. The region has been ultimately fragmented for Russia. On the other hand Moscow clearly tested EU solidarity with its campaign against Estonia and conflict over meat ban and new PCA with Poland. Futility of such Russian attempts to undermine this solidarity has become apparent.

Concluding, it is worth to note certain trends of Russia's policy towards CEE. Moscow to some extent “has discovered” CEE making its policy towards countries of the region visibly more active in the last few years. It was obviously connected with their membership in the European Union. Russia improving its, already important, economic position in the CEE to some extent has used countries of the region as a gateway and an instrument of its expansion in the EU common market. As a consequence CEE region is loosing its former specific for Russia becoming integral part of Moscow's European policy. Certain specific however still linger in the security sphere as Moscow tries to maintain old, partly legally non binding, limitations of military activity in the CEE (no nuclear arms, no large foreign troops or military facilities).

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Russia tries to control the transport routes of its own products itself

By Yrjö Myllylä

After the independence of the southern oil producing countries once belonging to the Soviet Union, Russia has become a more northern country seen from the energy producing point of view.

As a result of this change the importance of Ukraine, Byelorussia and Estonia is emphasized in the export of energy from Russia. This is due to the fact that in Russia the increasingly important oil and gas producing areas in West Siberia are connected with pipelines which go through these countries to Western Europe.

In southern Russia on the Black Sea only a hundred kilometres of coastline is left which the country can use for its energy transport and control itself. In oil transport through the Black Sea there is the risk of heavy traffic in the Bosporus Straits in Turkey.

The countries of the EU form by far the most important buyers of Russian oil and gas products. The growth of the world economy, among other things as a result of the growth of the economy in China, as well as the unstable situation in the Middle East, raise the prices of oil and gas. These factors also increase the possibility of conflicts and accelerate the development of new transport routes for the needs of European buying countries.

Russia is trying to avoid economical and political risks in the export of energy by developing competitive, lucrative alternative transportation routes. Conflicts caused by the increased price of oil and gas pose risks to Russia. These conflicts are seen for example in disputes in transit payments when trying to adapt to market prices.

Russia has the right and obligation, for example along with the possible WTO membership, to avoid subventions and move to market based pricing in different products. Oil and the gas products get subventions in Russia. The country has sold gas and oil to the countries of the former Soviet Union clearly below the world market price.

However, Russia cannot avoid transit through Ukraine, Belarus or the Baltic States, as the oil and gas lines built during the Soviet regime form the central transit routes to Europe.

The Russian government decided in May 2005 on an approved traffic strategy to emphasize such transport routes, which the country could control itself and thus avoid economical and political risks influencing its economy.

The same pattern of development could be seen when Russia developed new oil pipeline and transportation infrastructure. As a manifestation of this trend can be seen the harbour of Primorsk (Koivisto) becoming the most important individual oil export harbour and the planned gas pipeline between the Finnish Gulf and Germany.

In connection with the Bronze soldier statue dispute in Estonia, Russia announced moving of [the oil transportation away from Estonian railways. This is also connected to the logistical change now taking place in Russia.

The logistical change in Russia is understandable, when studying the map. The country is the largest in the world measured by area. It is also a continent, so the transportation distances are long. North West Russia is an important gateway to world markets.

Russia has in North West Russia in practice two logistical points, which it can control. One is the innermost part of the Gulf of Finland and the other is the Murmansk Area. The role of the Gulf of Finland is the [most] more important in trade with Europe and already more than one third of Russian oil is exported through the Gulf of Finland. Ocean going tankers cannot come in through the shallow Gulf of Finland. The Murmansk direction is important especially in the overseas transportation as this is the only open sea harbour in North West Russia which is ice free round the year. Also restrictions in the traffic in the Baltic Sea may produce emphasis on Murmansk.

The European Union has a historical opportunity to influence development in Russia, because Russia is economically dependent on countries in the EU. As Russia's commercial relations with Asian countries grow stronger along with the new infrastructure, Europe's influence on Russia may decrease.

The EU must recognize Russia´s rights to act on the terms of the market economy when it develops lucrative logistical routes. The political and economical risks are for Russia actual costs, which have to be taken into consideration. There should be a possibility to influence these costs through the Union in order to avoid problems, which arise for example during the transition period of energy prices.

Preventing of the threat of an oil disaster forms one of the areas for co-operation. Russia should be influenced in the direction that it fulfils the stipulations. At the same time it ought to be possible to contribute to that any agreement already made cannot be changed by one part for money or for example based on the political situation; corruption and along with this the impossibility to predict the situation is one of the biggest problem in Russia.

In my opinion, the most important task of EU is to integrate Russia in the Union using agreements. At this moment Russia strives to make energy delivery and investment related agreements directly with the largest European nations, such as Germany and France. The agreements do not necessarily take the interests of the small coastal states of the Baltic Sea into consideration. Due to this, it would be in the interest of the small nations to create a common will in the EU in respect to Russia and especially to energy co-operation with Russia. The historical task of the whole Union has in the past been to avoid energy disputes in the form of the earlier founded Steel and Coal Union.

Finland, as well as the other Northern European countries, has to take into consideration change in the geopolitical situation in Russia, which has increased the significance of the neighbouring areas to Finland and the area of the Baltic Sea in Russia´s energy transportation.

In addition to preventing environmental threats, Russia´s efforts to ensure vital transportation should be taken into consideration. From Finland's point of view, the most important is a policy, which increases the stability of Northern Europe. Disputes and threats related to energy transportation should be prevented in advance.

A practical way of creating a common sense of will between Russia and the countries belonging to EU in energy politics, is by using such methods in future research, where participation, analysis of results of interest groups and common learning of the future actors taking part in the research, is emphasised. One such method is the feedback-Delphi model created in my dissertation.

Yrjö Myllylä

An expert on regional foresight

Oy Aluekehitys RD

The author has carried out research on the future of North West Russia, especially the Murmansk Area, in this project financed by the Academy of Finland and led by Prof. Markku Tykkyläinen at the University of Joensuu during 2004-2007

Baltic Europe 2050 challenges of the future, heritage of the past

By Antoni Kukliński

The Finnish Ministry of Foreign Affairs and the Finnish Institute in Rome have organized a Conference and have published a charming and path breaking book – Europe 2050 – Challenges of the Future – Heritage of the Past.

The conference and the book should be seen as an inspiration to discover a new perspective to analyze in a philosophical and holistic way the experiences and prospects of Baltic Europe. The most valuable contributions published in the Baltic Rim Economies are following the title of publication formulated inside a broad and yet restricted disciplinary field of economic and institutional sciences.

Maybe *hinc* et *nunc* it is possible to enter a transdisciplinary field inspired by philosophy, history and futurology.

In this context I would like to propose to organize a Conference and publication: Baltic Europe 2050 – Challenges of the Future – Heritage of the Past. The proposed Conference and Publication would have four features:

1) It will be a follow up of the book Europe 2050 with a specific orientation towards Baltic Europe.
2) It will be a creative laboratory of transdisciplinary thinking integrating the historical and prospective approaches.

This creative laboratory will incorporate:

- *primo* – the dynamic diagnosis of the transformation of Baltic Europe at the turn of the XX and XXI century,
- *secundo* – the visions of Baltic Europe as an element of the global scene of the 2050,
- *tertio* – the scenarios of the development of Baltic Europe in the years 2010-2050.

3) It will face the challenges to compare two civilizations – The Mediterranean and the Baltic Civilization.

For quite a long time I was trying to say that the experiences of Baltic Europe should be seen as a civilization analyzed in Braudelian perspectives. Maybe the proposed Conference could be organized by the Finnish Institute in Rome (Villa Lante). I am expecting that the comparative reflection related to the Baltic and Mediterranean Civilizations will create a new bridge in the interpretation of the European Past and the European Future.

4) It will be an input into the grand debate "Europe 2050" which is emerging on the global horizon

This grand debate has not yet gained a strong intellectual and institutional take off. The European Union is still not ready to look into the mirror of the global scene of 2050.

This is not a deficiency of knowledge or even imagination. It is a deficiency of intellectual courage to discover the expected and unexpected faces of the future. The proposed Conference Baltic Europe 2050 could provide a demonstration effect promoting a pluralistic stream of thinking related to the Future of Europe *in toto*.

I am convinced that the brilliant Finnish diplomacy, science and culture will see in this suggestion an inspiration for our knowledge and imagination to see Baltic Europe in a new transdisciplinary brainstorming perspective. Especially important in this proposal is the comparative reflection related to the holistic vision of the past and the future of the Mediterranean Civilization and the Baltic Civilization.

The proposed Conference is not outside the open minded interpretation of the experiences of the Baltic RIM Economies. It is only a proposal to see these economies in a holistic transdisciplinary perspective of philosophy, history and futurology.

This preliminary outline should be seen as a starting point in the process of creative thinking related to the Conference – Baltic Europe 2050. The next stage in this process is the preparation of a Feasibility Study which is naturally outside the scope of this short note.

Antoni Kukliński

Professor

Poland

Management challenges - what is in the air?

By Pirjo Vuokko

What kind of management is needed today and tomorrow? This question is present all the time in my job. Our unit TSE exe designs and produces development programmes, e.g. the executive MBA programme for private and public sector organisations, and the participants in our courses are middle to top level managers. When developing these managers and through it their organisations, we have to consider what is needed today and what is needed in the future.

There are, in fact, a lot of different issues in the air. I have selected here five of them, i.e. communication and decision-making skills, tolerance and the power of diversity, innovativeness, future-orientation and visionary skills, as well as self- leadership. Each of these five are analysed below.

The three c's of management are said to be communication, communication - and communication. Furthermore, it is stated that in the future the rhetoric skills will be highly emphasized as the essential features of a manager. Good rhetorics are needed especially in relationships between both internal and external stakeholders. Last year there was in the Harvard Business Review an article titled 'Five messages leaders must manage'. These five messages are the following: organisational chart, its changes and their impact on employees' work; organisational culture and its elements; financial results and the connections between the results and employees' behaviour; the leader's sense of his/her role as an asker of right questions and not as an "answer man"; time not as a threat but as a resource among others; and corporate culture that encourages performance. In addition, the decision-making skills are emphasised more and more. A manager has the power to make decisions but also the responsibility for the decisions made. This responsibility means the ability and motivation to communicate and implement the decisions. A good decision executed quickly beats a brilliant decision implemented slowly.

Secondly, tolerance is important. Richard Florida, the person who has talked a lot about the creative class and its importance to national success, states that the essential conditions for success are our capacity to employ technologies, the importance of and support for highly skilled people, and tolerance. Nowadays, we already face the challenge of tolerance when working in multicultural or virtual teams that might include people with highly different ways of saying and doing things. And, in the future, the challenge for us is, for example, how we accept elderly people or immigrants as our equal colleagues or even as the vitally important resource in our organisations. Diversity can be regarded as a threat or as an opportunity. It is the manager's job to regard it as an opportunity and make his/her own staff to see it in the same way. The trust between people does not necessarily mean that they are alike each another. It means that they understand each another.

Innovativeness is perhaps the most often mentioned element of a successful organisation. But usually we mean by it in this connection the function of R&D, i.e. innovativeness that helps to create new products, services or ways of producing these. In addition to these, management innovations are important: how to create new ways to organize, lead, coordinate, or motivate. And to combine these two; how to create an organisational climate that supports and nurtures innovativeness, questioning, and ability and motivation to see far from where we are now?

This brings us to the fourth issue: future-orientation and visionary skills. Jack Welsh, former president of General Electric, says in a recent interview that the most difficult feature of and a challenge for a manager is the competence to see the future. This presupposes an ability to listen with highly responsive ears and to smell with a sensitive nose. But it also presupposes that the organisation accepts that there are different scenarios and is ready to make its own future.

Finally, what I wish to present here is the importance of leadership and self-leadership as its one essential element. Knowing yourself helps you to understand others. What do you see in the mirror? In our programmes, for example, we use both peer mentoring and senior mentoring as methods to develop people's leadership skills through developing their self-leadership skills.

In fact, management today or in the future has the same elements. That is so because management is about getting things done. This is the eternal challenge. But the world changes and we face new situations all the time; that brings us to the challenge of flexibility. Are you sensitive toward each individual situation and do you have in your tool kit more than just a tool. A good manager needs a rich tool kit and, in addition, a motivation, ability and opportunity to selects and use them all depending on the situation, problem and challenge faced.

Pirjo Vuokko

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Finland

Baltic Sea region - at the head of the reform process

By Günter Verheugen

The Baltic Sea region is one of the most dynamic parts of Europe. It is a region of high growth rates and an example of economic dynamism and reform. The Baltic Sea countries have demonstrated their capacity to adapt to the accelerated pace of globalization and stiffer international competition, defying their peripheral position and sparse population and achieving high and sustained levels of growth. They built their success on stable institutions, well developed infrastructure and highly skilled labour. The region is a good example of how European integration and globalization can benefit individual countries and wider regions.

According to the latest European Innovation Scoreboard (EIS) published in 2007, the Baltic Sea region includes two types of countries, namely those which are among innovation top-performers in Europe and those which are catching up.

The EIS statistical analysis confirms that in the Nordic countries there is a well-balanced high performance across practically all innovation indicators. This is an interesting observation revealing a rather solid basis of the innovation system in these countries and a promising trend for their innovation performance in the coming years. This rather constant Nordic countries' high performance but also the promising efforts in the other Baltic Sea countries will be vital for further accelerating the pace of innovation in the whole region in the close future.

The National Reform Programmes (NRPs) prepared in the context of the re-launched Lisbon process in 2005 show a high level of ambition and reflect the different challenges facing the various countries in the region, which, despite high growth in the Eastern countries, is still characterized by large heterogeneity. It is therefore appropriate that every country reform programme reflects its own reality rather than merely transposing measures from neighbours.

On the backdrop of the overall positive assessment of the progress of reforms in 2006, the Commission noted that particular attention should be paid to the level of competition in services. Similarly, a study for the Baltic Development Forum noted that high price levels are likely to originate in weak competition, which can be a deterrent for investors and has already contributed to a decrease in foreign direct investment flows.

Boosting innovation through regional clusters

Industrial clusters are an efficient way of developing core regional capabilities and help companies based in the region to exploit new market opportunities. Clusters assemble a critical mass and build linkages in areas where countries, regions or companies would otherwise find it difficult to develop a competitive position. Moreover, interactions within clusters result in increased innovation of the whole group, thus further increasing the region's competitive advantage.

Cluster development efforts have a positive history in the Baltic Sea Regions and especially in the Nordic countries such as Denmark, Finland, Sweden and Norway. We noted with pleasure that the Baltic Sea countries remain conscious of the synergies that can be gained from building an attractive region through a coordinated cross-border approach. Examples of successful clusters in the region abound. For example, ScanBalt and Cruise Baltic are two cross-border clustering initiatives established in the sectors of medicine and tourism, respectively. Both clusters have more than 20 members from almost all Baltic rim countries.

At policy level, the on-going EU-funded Baltic Sea Region (BSR) Network project brings together policy authorities from all countries of the region in order to identify concrete areas for cooperation in the field of clusters and to design cluster policies over national borders. The BSR Network is considered as a strategic project for initiating cross-boarder innovation programmes in the Baltic Sea Region.

To further promote cluster development in Europe, the Commission has recently launched the European Cluster Observatory that tries to identify clusters and assess their evolution over time in EU27 as well as in Iceland, Israel, Norway, Switzerland, and Turkey. Moreover, the Commission supports the trans-national cooperation between public authorities as well as between clusters as a way to assist clusters to develop international relationships, share information, mutually exchange technical competences, share research infrastructure and production facilities and develop joint business strategies and strong partnerships in the same or in different business sectors. In the period 2007-2013, the Community CIP programme and its foreseen actions will be instrumental for defining and implementing in close association with the Member States a European cluster strategy and providing the appropriate tools. Furthermore, the two European networks, namely the Innovation Relay Centres Network and the Euro Info Centres Network, that have recently jointed their forces into one network funded under the CIP, will further boost innovation culture in Europe and strengthen the innovation capability of firms in all European regions including the Baltic Sea Region. Besides this, one should keep in mind the numerous possibilities for public authorities, private firms and research organisations to participate in international projects under the INTERREG and 7th Framework Programmes and further increase cooperation with neighbour non EU countries such as Russia, which is an eligible partner in these programmes.

Future challenges and opportunities

Another common point observed in the national reform programmes is the emphasis on sustainable development as a prominent source of future growth. The Commission strongly supports efforts in this area. Whilst European entrepreneurs and investors must take the leading role in exploiting the growing opportunities offered by the growth of environmental markets, policy makers should contribute by creating conducive market conditions that stimulate the successful commercialisation and early deployment of new environmental technologies. Europe needs to develop lead markets for environmental technologies, products and services.

At the beginning of the re-launched Lisbon strategy in 2005, the Commission President called the Baltic region "a beacon for the rest of Europe". It is essential that the appropriate measures to upgrade the business environment continue to stimulate local enterprises and attract foreign investors. A policy framework conducive to investors and a dynamic business environment offer the best opportunity for sustainable development and further income convergence between the eastern and western rim of the Baltic Sea.

Günter Verheugen

Vice-President of the European Commission
and Commissioner for Enterprise and Industry

European solidarity is the best investment into the future

By Petras Vaitiekūnas

Twenty years ago the idea of restoring the independence of the three Baltic States - Lithuania, Latvia and Estonia - was still considered a risky political project. However, with the support and solidarity of the Western democracies, we not only rebuilt our statehood, but also established competitive and fast-growing free market economies.

Our road to success was built on democratic values, economic pragmatism, the culture of social and political dialogue, and a firm perspective of European and transatlantic integration.

Today the three Baltic States represent a successful political and economic 'trademark'. And the cooperation between the Nordic countries and the Baltic States, which also includes Germany, Poland and Russia, has changed geopolitics of the Baltic Sea region.

Our geographic location on the frontier of the European Union is a big advantage; but it also poses new challenges. One of them is to bring the European Union and Russia closer to each other. The more Russia will become integrated with the European values and economic cooperation, the more will we exploit the potential of the Baltic Sea region.

Unfortunately, the EU border infrastructure in our region today hardly corresponds to the growing needs of businessmen and investors. We need to address this challenge together. Through cooperation and integration we can transform our region into one of the most progressive and competitive regions in Europe.

Ambitious projects of Rail Baltica and Via Baltica are already underway. However, the energy security issues still need further progress. The Baltic States continue to exist as 'an energy island' having access to mainly one energy supplier – Russia.

Lithuania has taken first steps towards increasing of our energy independence. We focus on two strategic projects: development of a new nuclear power plant and connection of our energy grids with those in the EU.

We are grateful to our Northern neighbours, first of all, Finland and Sweden, for their continuous assistance to the security of the old Ignalina Nuclear Power Plant, which is due to be closed in 2009. But we also look forward to learning from the Nordic experience and expertise, especially in the environmental field, as we proceed with the construction of a new nuclear site.

During the years of the EU membership Lithuania established close economic business cooperation and investments links with the Nordic countries. More than a quarter of Lithuanian exports today go to the Nordic markets. Sweden, Denmark and Finland are among the largest foreign investors in Lithuania. Therefore, it is natural that common EU energy infrastructure is essential to guaranteeing stable economic and social development of the region. I am certain that our success, as well as the successful realization of energy projects, will only strengthen the economic potential of the whole Baltic Sea region and stimulate its future growth.

It is worth remembering that the present-day European Union also takes roots in energy. 50 years ago the European Coal and Steal Community and EURATOM offered a unique way of overcoming disputes among the European nations, which later was established in the European acquis.

In 21st century coal and steel is replaced by oil and gas. However, supranational structure to govern the supply and demand for those resources is not yet established. We have a common EU trade policy, but we do not speak in one voice, when we have to deal with energy issue. Competition among the Member States regarding energy recourses has no clear rules.

So why the EU supports, politically and financially, the development of the EU transport infrastructure in the new Member States, but the development of energy infrastructure is left to the discretion of individual countries?

I believe that suppliers also suffer from this situation as they lack incentives to invest more in new fields and technologies. Monopolistic presence in the region prevents from creative thinking.

As a result, the name "Responsible Energy for Responsible Partners" chosen for Vilnius Energy Security Conference, which is held on 10-11 October, is not accidental.

We trust that this forum, to which representatives are coming from the countries of Northern and Southern, Eastern and Western Europe, Central Asia, the Caspian Sea and the Black Sea regions and from the USA, strengthens transatlantic energy dialogue and helps to create a constant high-level consultation mechanism, and an open cooperation among the countries, which have energy resources at their disposition, transit countries and consumers.

While the dependency of the European Union on the external countries is constantly increasing, it is high time to tackle the EU energy issues in solidarity not just inside the EU, but also to speak in the solid EU voice with its external partners. The EU energy partners not only talk loudly about their policy interests, but also implement their energy policy actively. In the meantime, the EU countries still function mostly on the bilateral basis and speak, I would say, tentatively with Georgia, Azerbaijan and Central Asian countries. But do we have an efficient strategy of relations with these countries, and, even more so, a strategy coordinated with the USA, our most important partner on the American continent?

The European Union has to take a rational opportunity to avoid the situation, when even in Europe democratic countries compete between themselves and fall prey to their own egotism and failure to agree. Moreover, can Europe shut eyes to the fact that the oil dollars and oil euros increase not the welfare of the common people, but the wish to use power politics in the dialogue with partners, and manage business affairs in this way?

The European Union does not threaten anyone to become an energy policy dictator. I think that Europe does not need this, because it is not within our interests to impose our will on other countries of the world. The strength of the EU is our firm foundation of values, solidarity and strong transatlantic relation, as well as the open dialogue with all of our partners. We should learn to use this potential to guarantee secure and prosperous future of European people, while the countries, which are rich in energy resources, should invest their income into reforms promoting social progress.

Petras Vaitiekūnas

Minister of Foreign Affairs

Lithuania

Iceland and her companies in the Baltic Sea region

By Ingibjörg Sólrún Gísladóttir

As a Nordic country, Iceland has close links with the Baltic Sea region, both politically and economically. This fact may be best illustrated today by the active interest that Icelandic companies and investors have shown in the region.

I am delighted to contribute an article that gives me a platform to highlight the deep and growing ties between Icelandic companies and the Baltic Sea region, in particular the three Baltic States.

It is no secret that the Baltic rim is one of the fastest growing and business friendly regions in Europe. This fact was reconfirmed by the World Bank's recently published Doing Business 2008 report, where all three Baltic States ranked in the top 30 economies in terms of their business friendliness. Icelandic companies and investors were quick to realize the advantages of these conditions. In the past 15 years, their presence has grown both in terms of volume and value, expanding into diverse and non-traditional sectors that would have been unimaginable just a decade ago. Icelandic economic participation reflects above all the huge potential of this region.

The dynamism in our economic cooperation is impressive. Since 2001, trade in manufactured goods between Iceland and the Baltic States of Estonia, Latvia, Lithuania and Poland has increased by almost 350%, to 330 million USD in 2006 (Global Trade Atlas). And this does not take into account the tremendous growth in services and foreign direct investment, the establisment of local presence.

Icelandic companies: investing in the region

Icelandic companies and investors entered the region immediately after Baltic independence in 1991. Among the first Icelandic companies to enter the region was Byko, a construction and do-it-yourself store, and Hnit Baltic, an engineering consulting firm. These companies were soon followed by others, attracted by the potential of a region teeming with creativity and innovation. Indeed, the latent energy and spirit of the Baltic Sea region was fully unleashed after independence.

Icelandic business interests are diverse and dispersed throughout the region. Their success has been facilitated and encouraged by factors of globalization and structural changes in the Icelandic economy itself. Both have obviated geographic distance and expanded the potential sectors for cooperation and integration. The following overview is by no means exhaustive but does paint a revealing picture of Icelandic business investments in the area.

In the retail sector, Smaratorg ehf. operates a growing number of furniture outlets under the name Jysk, with plans for more in the pipeline.

The clothing and fashion house 66° North manufactures all of its goods in Saldus and Aizetje, two cities just outside of Riga. In Lithuania, Icelandic investors bought and renovated one of Europe's largest shirt factories in a small city outside of Vilnius. The factory now produces over 900.000 shirts a year under leading brand names.

In the fishing and seafood sector, Hampidjan Ltd, which is one of the largest suppliers to the fishing industry, moved all its production of rope and netting to a new 20 thousand square meters factory in Lithuania in 2004.

In the shipping and transport sector, companies like Eimskip, Samskip and a company under Byko's ownership are active throughout the region, supplying Baltic goods to Iceland, Europe and beyond.

In the banking sector, Norvik Bank and MP Investment Bank have established a sizeable presence in the region. MP Investment Bank is the only Icelandic company listed on the Tallinn, Riga and Vilnius Stock Exchanges, and on 11 October 2007, it will host a conference to introduce an innovative pension fund in the region. The presence of Icelandic banks and investment partners in the region, which have created many business opportunities in the past 3 years, augurs well for future ventures.

In the technology and services sectors, Hnit Baltic provides general engineering consulting services, ranging from engineering services to software development. Icelandic architectural firms like Arso, which is jointly owned by Arkis and Hnit Baltic, have also established a presence in the region.

In the aviation sector, Icelandair Group recently purchased Latcharter, a Latvian charter airline which operates flights to destinations worldwide from its hub in Riga. The Group sees the Baltic region as a small but important market with a high potential for growth.

Icelandic companies have also made their mark in the pharmaceutical sector. Lyfja established a presence in Lithuania in the mid 1990s and now operates around 45 pharmacies under the well known Farma name. Actavis, a leading player in the generic pharmaceuticals market, has operated in the region since 1999.

Natural partners

It should come as no surprise that Icelandic companies and investors are active in the region. Indeed, Iceland and the Baltic States are natural partners. We share many of the same economic values and characteristics such as open and vibrant markets, dynamic and well-educated labour forces and the desire to meet proactively the challenges and opportunities of the 21st Century. Increased Icelandic investments in this region did not come about as a result of any coordinated effort or intervention from the official level, but simply from the huge economic potential of this region.

However, commercial and economic success does not emerge in a vacuum. The fact that Icelandic companies and investors are able to benefit from, and contribute to, the economic success of the region is closely related to the broader context, in particular the special relationship Iceland shares with the Baltic States. The decision of the Government of Iceland to recognize the independence of the Baltic States in August 1991, the first foreign government to do so, signalled our long term commitment and solidarity with the region.

The presence of Icelandic companies and investors in the region is also facilitated by the institutional framework of the European Economic Area. Standardized rules and regulations of the single market have created a more transparent and predictable business environment. Indeed, the Baltic process of accession to the European Union contributed to making the regional market complementary, significantly mitigating any problems of economies of scale and attracting foreign investment directed towards the larger European market.

Outlook

The potential for further commercial and economic cooperation has by no means been exhausted. There are still many possible areas that remain underdeveloped, including the travel and tourism sector. There are many opportunities to increase commercial traffic between Iceland and the Baltic region, whether through direct flights or through hubs in the Nordic States. Such traffic from Iceland to the region has already increased significantly and the interest is there. For example, Icelandic companies are increasingly chartering direct flights to destinations in the Baltic States for corporate seminars.

The Baltic rim has managed to blend social responsibility with entrepreneurial innovation, and the results speak for themselves. In the past fifteen years, this region has once again emerged as an economic power house. In fact, with such a diverse membership this region has every possibility of being among the most exciting growth areas in the global economy in the years to come.

Ingibjörg Sólrún Gísladóttir

Minister for Foreign Affairs

Iceland

Estonia protects the Baltic Sea along with its neighbours

By Jaanus Tamkivi

Estonia is one of the nine countries on the coast of the Baltic Sea. As the Baltic has been declared a particularly sensitive - marine area, we need to work together to preserve what there is to preserve and to improve what we need and are able to improve.

Much of the responsibility for protecting the Baltic Sea falls to HELCOM. In 2005 the convention adopted a new approach to reducing pollution in the Baltic and dealing with damage caused to the marine environment. The necessary measures and operations have been brought together in the Baltic Sea Action Plan, for which Estonia has made its own proposals. Estonia also plans to develop a maritime strategy, which will in turn require changes to be made to its maritime legislation.

Maritime operations require a permit for the special use of water

Human activity on the coastal and open sea in Estonia is regulated by permits for the special use of water, which the Ministry of the Environment issues around 60 of to private citizens and businesses alike each year. These permits are required for such activities and operations as dredging; dumping; loading and unloading of dangerous substances and solid bulk goods that are volatile in windy conditions; ship repairs; and fish farming in open sea pens. The permits are also needed for any activity which may lead to changes in the biological or chemical quality status of the water or the physical characteristics of the waterbody. The permits set out the requirements and restrictions such activities and operations must observe, as well as monitoring obligations.

Local requirements are perhaps more stringent than elsewhere

One of the most important objectives of protecting the Baltic Sea is to limit the pollution load from point and diffuse sources of pollution. Markedly more stringent requirements have been set in Estonia than in many other member states on effluent directed into receiving bodies of water in order to minimise the pollution load from urban wastewater. Additionally, Estonia has adopted measures to reduce industrial pollution. Although we have few industries, we advocate the use of the best possible technology and the least possible influence on the environment.

Estonia has made significant investments designed to prevent environmental pollution. Between 2000 and 2006 we directed more than 2 billion kroons (128 million euros) into the restructuring of our wastewater systems. A large number of wastewater treatment plants have also been modernised, and new ones constructed. 89% of the population in wastewater collection areas with a p.e. of more than 2000 are connected to the public sewerage system. Since Estonia as a whole is characterised as a low density area, this makes the national coverage 72%. Further major investments in the updating of wastewater systems are planned for the 2007-2013 programme period.

Accession to international conventions

Estonia has joined or is in the process of joining the majority of International Maritime Organisation conventions on the marine environment. For example, the International Convention on the Control of Harmful Anti-Fouling Systems for ships (the AFS Convention) is currently being prepared for ratification. Accession is also pending to the Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea (the HNS convention) and the 2003 protocol to the 1992 international convention on the founding of the International Fund for the Compensation of Oil Pollution Damage, which saw the establishment of an international Supplementary Fund for compensation of such damage.

Within the next few years we also plan to prepare to join the 2004 International Convention for the Control and Management of Ships' Ballast Water and Sediments, which has not yet entered force internationally, and the 1972 London Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter.

But it is not enough to simply sign on to the conventions if we are to fulfil the obligations and requirements they set. More important is to ensure that the conventions are able to be implemented and that their requirements are observed at the national level.

Preparedness for pollution controls

As a result of the increase in the environmental requirements placed on ships and of the larger volumes of oil and chemical transport in both Estonian and neighbouring waters, it is vital to ensure the administrative capacity needed to detect pollution from ships, to check the ships themselves and to apply sanctions in the event of infringements. It is important that those who breach requirements be handed sufficiently severe penalties so as to avoid situations in which it is cheaper for the owners of vessels to pay fines than it is to meet their obligations. In connection with the adoption of European Union directive 2005/35/EU (dealing with maritime pollution caused by ships and determining penalties for infringements involving such pollution), Estonia has already bolstered its sanctions against ships dumping pollutants at sea. In the short term we also plan to review pollution by ships with other substances and the penalties imposed for such offences.

In order to reduce damage from ship pollution in the generation phase, the polluter's obligation to avoid or where necessary deal with environmental damage must be implemented in Estonia, as the polluter's obligations are currently limited to compensating for any damage that has already been caused.

Hazardous substances

The bioindication method is used in Estonia to determine the presence of hazardous substances in organisms. The method measures the hazardous substance content of the Baltic herring, tellin and aquatic sow bugs in Estonia's coastal waters. The concentrations of heavy metals (cadmium, mercury, lead, copper and zinc) and organic pollutants (polychlorinated biphenyls and chlororganic pesticides) in the organisms are ascertained. The content of chlororganic compounds is also measured, as a rule, in the fishes' muscles.

The concentrations of copper, cadmium and zinc in the organisms in Estonia's coastal waters are relatively even and comparable to the average values for the Baltic Sea as a whole. The content of cadmium, zinc and organic pollutants (HCH, DDT and PCB) is lower in the open sea than in the Gulfs of Riga and Finland. It can therefore be concluded that the content of hazardous substances in organisms in Estonia's coastal waters is not in contravention of the quality objective set out in EU water protection norms that the content of hazardous substances must not increase significantly over time.

Monitoring provide us with an overview

Estonia's monitoring programme is based on the traditional HELCOM programme. Between 1994 and 2006 the sub-programmes "Phytobenthos monitoring," "Operational monitoring or Automatic measurements performed from ferries" and "Intensive monitoring or monitoring with increased frequency of measuring in Tallinn, Pärnu and Narva Bays" were added to the main programme. "Monitoring of fish colonies in coastal waters," launched in 1995, was incorporated into fish stock monitoring in 1997.

In addition to eutrophication monitoring, hazardous substances monitoring is also carried out, primarily to determine the presence of heavy metals, oil products and persistent organic pollutants (the latter of which are measured in fish and molluscs). Added to the coastal waters monitoring programme in 2005 was remote monitoring, which requires high levels of operativeness.

The results of the monitoring play an important role in the evaluation of the state of the sea, in the protection of the Baltic as a sensitive ecosystem, in determining the pollution load and in planning economic activities.

Jaanus Tamkivi

Minister of the Environment

Estonia

A Baltic Sea Strategy - acting regionally, thinking globally

By Ojārs Kalniņš

At the 14th Ministerial Session of the Council of Baltic Sea States in June 2007, Carl Bildt proposed the development of a new Baltic Sea Strategy which would promote the Baltic Sea Region as a priority area for the European Union. Since 2001, Uffe Ellemann-Jensen has led the Baltic Development Forum in exploring the possibilities of another strategy for the Baltic Sea Region: branding it as a coherent region with a distinct profile that can compete more effectively in the global marketplace. Both have emphasised the region's place at the "top of Europe" not only geographically, but also in terms of economic growth, educational levels, innovation, research and development.

Time magazine seems to agree. In its May 2007 issue, Latvia's capital of Rīga was described as "one of string of economic miracles" in Europe's "Sea of Plenty". Time's glowing report of a booming region where eight of nine countries are growing faster than the EU average reads like a Baltic Sea Region public relations man's dream.

For Latvia, which has taken over the presidency of the Council of Baltic Sea States, this emphasis on the Baltic Sea region as a potential political, economic and marketing powerhouse couldn't have come at a better time. From the moment we restored our independence in 1991, many of us in Latvia's foreign policy establishment were convinced that the rebirth of our own country was organically linked to the rebirth of the Baltic Sea Region as a whole. What was good for us, was good for the region, and vice versa.

As the Iron Curtain that once divided the Baltic Sea sunk into the oblivion of Davey Jone's locker, many shared this vision of a region reborn. Images of a phoenix-like New Hanseatic League emerging from the ashes of the Cold War even shaped the Clinton Administration's Baltic policy in the 90's. State Department strategists Strobe Talbott and Ron Asmus were strong supporters of Baltic Sea regional cooperation and worked closely with Carl Bildt and the Baltic countries in developing Clinton's 'Northern Initiative'. The creation of the Council of Baltic Sea States in 1992 was enthusiastically received in the White House. The Americans liked it so much they wanted to join, but for obvious geographic reasons, had to eventually settle for observer status.

As Latvia's Ambassador to the United States at that time, I welcomed this initiative and even took an early stab at 'branding' this newly reconstituted Baltic Sea region by proposing that it be called 'The Amber Gateway'. As a former advertising and marketing professional, I couldn't resist thinking about the packaging, even though the product had barely come into existence. I was encouraged in part by Darrel Delamaide's book "The New Superregions of Europe". Published in 1994, the book called the region 'The Baltic League' and described it as one of the most dynamic of all new superregions:

" …it already has one of the strongest identities. Its diffuse structure of overlapping networks makes it one of the most advanced superregions. Above all, there is a widespread awareness of the regional dimension, and an understanding of the role and functioning of a superregion."

Like my 'Amber Gateway' marketing slogan, Delamaide's optimism may have been a bit premature. At the outset, awareness of the Baltic Sea's regional dimension was far from widespread, and its function as a 'superregion' was neither totally understood nor fully appreciated. But over the last 13 years, his predictions of booming regional economic growth and development have withstood the test of time.

The recent CBSS proposal for a Baltic Sea Strategy envisions the directing of EU funds to sectors such as infrastructure, energy, environment, education and research. But any strengthening and development of the region itself through cross-border cooperation and collaboration must be accompanied by a coordinated external dimension. While a common foreign policy may be a task for the European Union, this doesn't replace a need for the countries of the Baltic Sea Region to develop a common branding policy.

As Uffe Ellemann-Jensen rightly points out, the Baltic Sea Region needs to create more awareness and develop a more distinct profile "so it can stand out in an increasingly competitive global environment." The European Parliament's proposal for a Baltic Sea Strategy aspires to "systematically create a brand for the region as one of the most attractive and competitive areas in the world."

For those who recoil at the crass commercial connotations of the word 'branding', Simon Anholt (the originator of the concept of nation branding) offers a more precise phrase – 'competitive identity'. In Anholt's view, you increase the competitive identity of a city, country or region, not through advertising a brand, but by building on strengths that enhance its reputation. This falls in line with the June 2007 Declaration of the CBSS in Malmo, which talks about 'enhancing the competitiveness of the region'.

Whether you call it branding, marketing or reputation building, it seems clear that a truly comprehensive Baltic Sea Strategy must include an agreement between all stakeholders that, a) the Baltic Sea Region is a coherent and viable entity, b) promotion of the region as such adds value to the promotion of each country individually, and c) any attempt to build positive awareness of the region must be unified and coordinated.

Is this possible? The experts will say this is an uphill struggle for, until now, no region has ever tried to establish itself as a global brand. In the countries that surround the Baltic Sea, diversity may overshadow commonality. And yet, organizations, institutions, concepts, strategies and conferences based on 'the Baltic Sea Region' continue to proliferate.

If the yea-sayers in favour a Baltic Sea brand hope to win against the nay-sayers, several steps need to be taken. First, we need to come to an agreement on what we want to call the region. 'Scandinavia' and 'Nordic' already enjoy some brand recognition around the world, but they are no longer sufficient to cover the much broader, post-Cold War liberated 'Baltic Sea Region'. "The Top of Europe", "Amber Gateway", "New Hanseatic League" and other creatively catchy designations have a limited utility for promotional materials, special events or projects, but are hardly recognizable outside the region.

Some Scandinavians are wary of building an identity around the word 'Baltic' because to many, it simply refers to the Baltic countries of Latvia, Lithuania and Estonia. And yet, if we build an identity around the sea that unites us, in English at least, the word 'Baltic' is inescapable.

In addition, we need to identify and empower some institution in the Baltic Sea Region that would take on the responsibility of researching, developing and implementing a regional strategy. Henry Kissinger once asked who he should call when he wanted to speak to Europe. Who are we going to appoint to man the Baltic Sea hotline?

By default this responsibility has fallen upon the shoulders of the Council of Baltic Sea States. The CBSS has been tasked to reform itself, in order to be "better equipped to focus on priority actions, including the capacity to develop regionally important and strategic projects." The CBSS is also undertaking the development of a Baltic Sea Strategy.

Perhaps one of the tasks that CBSS could undertake is to begin some serious market research on the strengths, weakness and identity of the Baltic Sea Region in the global marketplace. In this spirit, the Latvian presidency of CBSS has initiated a 'Balticness' campaign, to promote the idea of shared cultural identity and common values in the region. If there are shared values, they can and should be exploited to the common advantage.

Like the weather, everyone is talking about the Baltic Sea brand, but until now, no one has done anything about it. Here I would fully agree with Uffe Ellemann-Jensen. It's time to just do it.

Ojārs Kalniņš

Director, The Latvian Institute

Latvia

What Europe has done for competition

By Jerzy Samborski

President Sarkozy's question which he asked at the EU Summit in June this year "Competition as an ideology, as a dogma, what has it done for Europe?" was part of his explanation on why he had wanted the replacement of the phrase "an internal market where competition is free and undistorted" with the words "a single market" in the new proposed EU Treaty .

The question since has been seen by some analysers as a provocation whereas others have been treating it rather as an invitation to the fundamental debate explaining the economic success of Europe and its possible future development for the benefit of the European citizens.

According to the former, competition is what made Europe successful and prosperous for such a long period of time. Johnny Munkhammar, for instance, believes that to a very large extent, it made Europe what it is – not only in the economic sense. Free and competing artists created a massive cultural heritage. Free and competing scientists paved the way for knowledge. Free and competing explorers discovered the world. And the very idea of being free to compete is to a very large extent European, developed in theory and practice in our continent.

Others, like Peter Jungen, would add that "the Bourgeoisie had produced more economic wealth since industrialisation than all generations of mankind before (…) And the combination of the values of the bourgeoisie and of capitalism, based on the best ideas Europe ever brought about - the Scottish Enlightenment and the Austrian School of Economics, have kicked off industrialisation and made Europe rich. At the heart of this economic dynamic process lies innovation created by unfettered competition. The American Revolution started only after these ideas and thoughts, and their connected values of the bourgeois had been exported from Europe to America and to many other parts of the world.

All these what have happened and, consequently, made us successful is that Europeans have invented and implemented competition.

But recently, at a time when we can watch the world adopting competition to the high extent the old member states of the EU become reluctant to make it flourish in Europe.

So, at this point, whereas agreeing to these elucidations what competition has given to Europe, one might naturally wonder "And what has Europe done for competition?" The answer to this question is just as compelling as to President Sarkozy original one as indeed, the history of this continent is brimming with excellent examples of European attempts to resist competition. Historically, in Europe, competition had sometimes been confused with confrontation, and aggressive political and economic foreign policies did much damage to the notion of fair and well regulated competition.

From this perspective, the Industrial Revolution played a definitive role in challenging the forces that suppressed the freedom to compete (for the revolution does, in essence, challenge the status quo). The Industrial Revolution liberated the people's desire to embrace innovation and provided them with increased opportunities to implement their ideas into practice. Industrial expansion curbed state interventionism and ensured that Europe became the economic leader of the world.

Nonetheless, in truth, the subsequent establishment of the Common Market or the EEC, with six and later fifteen member states, has significantly reduced competition in Europe. The tendency to safeguard a particular state's economy by means of interventionism and over-regulation, as well as an outdated belief that European superiority is to last forever, has led to economic stagnation and compromised the people's very desire to compete. Believing themselves to be the natural champions in the world, the Europeans had lost their competitive drive and began to expect to win the economic race without actually trying. This stance has proved to be extremely dangerous in the era of globalisation which saw the sleeping tigers of the East rise and successfully compete with Europe, using our own innovative tools and borrowing European methods, which had been already borrowed and improved by our brothers and friends from the United States of America.

Competition is not just an abstract ideology or a dogma: first and foremost it is a part of human nature. The affluent, relaxed Europeans devoted themselves to different, more spectacular competitions, leaving economic aspects of competition to others. The Europeans have embraced sport, especially football, as well as other mass social and cultural contests, sublimating their natural competitive spirit in these distractions. The results are evident: at present, largest European nations battle over trophies in the soccer championships, while their economies are deep in stagnation.

The Europeans eventually renounced this sort of denial of the economic reality, but not as a result of external pressures. It was their fellow Europeans, recently invited to join the European Union that opened their eyes. The new members came from ten ex-communist countries, bringing with them enormous competitive drive, which they had been quietly accruing for dozens of years. This ardent desire for innovation, a desire to achieve ensured that Polish plumbers, Czech dentists, Lithuanian nurses have arrived at their neighbours' doorstep, offering services and goods at a competitive price, sometimes many times lower than that of their western European business counterparts. Most of the established EU members have prudently closed their own markets against intruders, in visible and more often, invisible ways. Some, like UK and Ireland, were brave enough to welcome internal competition. We did not have to wait too long for the results: the UK and Irish economies are booming now, whereas those of other member states are still facing an uncertain future, as their leaders hold on to the bygone days of European economic supremacy.

Let us hope that President Sarkozy's question about competition is just an invitation to the discussion and not the attempt to pull out France and EU from globalization process.

Jerzy Samborski

Executive Director

European Enterprise Institute, Belgium

Islands are part of the main

By Urve Tiidus

No island is an island, entire of itself, every island is a piece of a continent, a part of the main. These words can describe any island in the world. The Baltic Sea washes the shores of hundreds of islands. Out of the ten biggest ones in the Baltic, three are located in the western part of Estonia. The biggest of them is Saaremaa.

Comparing the population of islands to that of the whole Estonia, islanders make just a fraction. Still, it does not mean that the importance of the cultural, economic and political aspects of islands fall in the same category. Questions often asked by the people responsible for the local development are: how flexible are islands in the quickly changing world and do islands have any advantages or only disadvantages in a regional competition? There are emotional answers to these questions.

Being flooded by waves and flown by winds makes one always aware of the threat of losing one's identity and intuitively fight against it. On the other hand, the sea and winds make people strong and persistent. On Saaremaa historical findings prove four thousand years of human activity. In the 11th-13th centuries, wealth based on agriculture and trade, high density of population and a good location made the Saaremaa islanders a considerable power. The number of inhabitants has decreased during the last century. 12 people per square kilometre is almost nothing compared to the places of the densest settlements in the world, like Honkong with 6,352 people per square kilometre. Islands reflect in their own way the urbanisation process of the recent decades. Also on islands people move from villages to towns or leave islands for new homes on the mainland. Kuressaare, the capital of Saaremaa has attracted a number of people from neighbouring municipalities and even mainland as a place for living, but for the future it is vital to attract more people.

Actually, the existence of human settlement on islands depends on the quality and choice of transport. The ports connecting Saaremaa County and the mainland are passed by 1.3 million people every year. From 2001 to 2006, the increase in the number of vehicles crossing the Suur Strait was about 10 % a year. The predicted increase in traffic until the year 2010 is 5.5% a year. However, a significant traffic increase of 25-28%, is predicted in case of the possible opening of a fixed link in the year 2014.

Slower pace of time has been one of the characteristics of islands. Things have changed considerably. Ten years ago people were patiently waiting for hours to get on the ferry for a 30-minute crossing. A kilometres long line of cars in the ports during the biggest summer event, Midsummer Day, used to be like a ritual dance. But it is not acceptable any further. Time has become the most precious resource for everyone. Everybody, be it local inhabitants, business people or tourists, lose from logistics of yesterday, that prevents travelling to islands.

Preparations for establishing a fixed link between the biggest island of Estonia and the mainland were started 10 years ago. An economic and environmental analysis carried out in cooperation with foreign experts, determined that the fixed link is justified both technically and economically. Further assessment of the strategic environmental impact and socio-economic aspects has been launched, the results are expected next year. The possible fixed link brings about different opinions. Some fear the loss of an insular character, some deny it. One of the most sensible opinions has been expressed by a Danish diplomat who stressed that one should never forget the figurative positive meaning of bridges. Bridges unite people and improve communication both directly and indirectly. Indeed, a well functioning communication is an essential development advantage for islands. To be more specific, Saaremaa is lucky to have a contemporary deep water port. Air-connections to Tallinn, Riga and Stockholm and airport infrastructure improvement underway give the island an advantage in this highly competitive world.

There are issues on islands, that can most efficiently be dealt in cooperation. Since 1989, seven Baltic islands are involved in B7 cooperation network. The objective of this network is to facilitate the development and keep the islands an attractive living environment with a developing and diverse economy and wealthier, more educated and happier people. From the point of view of Kuressaare, this objective is not too idealistic and is in good harmony with the development plan of the biggest municipality on the island. Kuressaare is really proud of good cooperation with higher educational institutions both in Estonia (Tallinn University of Technology and Tartu University) and in Finland (Turku University). Despite that one of the challenges remains to attract and keep educated people on the island.

For Kuressaare the city development plan has set an objective to increase the number of tourists for several times during the coming seven years. A healthy weekend in one of the wellness-spas, a bike tour in the pure and clean nature, a unique golf-course to be opened next summer, a retreat from stressful city life, these are just a few reasons to travel to Kuressaare and Saaremaa. Small and medium businesses have invested in tourism enterprises hundreds and hundreds of million krones. For the local decision makers it is quite a task to keep the balance between tourism and production oriented economy.

When speaking of the uniqueness of islands, we can not skip the special culture of islands that is dialects, patterns, traditions and skills passed from fathers to sons and mothers to daughters. In these, the features brought along from far off countries got blended with local customs. Next year, the Estonian Ministry of Culture is launching a new programme focusing on the research and retaining the traditional culture of islands. Distinctiveness and individuality, clearly appearing in the cultural heritage of islands, are gaining more importance in the world often too fond of mainstream.

Saaremaa holds a similar to many other inhabited small islands position in the global competition. Resources are limited, transportation connections are time and resource consuming, the natural environment is more demanding. These issues can be considered disadvantages. But an island that is home for 38,000 people and hosts less than 400,000 annually has several advantages. A very long experience of living on an island, openness to new ideas, cooperation ability at every level and the wish of the Estonian government to reduce the regional differences on islands – this is not bad at all.

A thought from another island in a different end of the world would draw the conclusion: depart with a brave heart, if you have to leave the islands. Live with a firm belief, if you have to remain. This belief has also lived on the biggest island of West-Estonia.

Urve Tiidus

Mayor of Kuressaare

Estonia

The Baltic Sea - threats and expectations

By Eeva-Liisa Poutanen

The Baltic Sea has always provided a livelihood and gateway to the outside world for the coastal countries and the 85 million people living on its drainage basin. It has given a transport route for both people and goods and a living for fishermen. At the same time it also offers us the opportunity to enjoy its natural beauty.

The Baltic Sea ecosystem is extremely fragile. Since the Baltic is a product of the last glacial period, many of its characteristics are quite unusual. The Baltic Sea is a semi-enclosed, shallow, cold and brackish water body. Its water is a mixture of salt water from the ocean and fresh water supplied by numerous rivers. It hosts a community where both marine and freshwater organisms live side by side with a number of living relict species. The Baltic Sea is poor in terms of species diversity when compared to oceans or lakes.

The Baltic Sea is an ecosystem under extreme stress. The four main threats are eutrophication from excessive inputs of nutrients from human activity, contaminant loading from industry, overexploitation of living marine resources, and invasive species, mainly introduced through ballast water. In addition, the consequences of climate change and accident risks arising from ever-increasing oil transportation are concerns that require special attention.

The Baltic Sea is subject to considerable amounts of pollution from the countries bordering it, and the pressure generated by human activity is intense. Pollution has persisted for so long that even if discharges were reduced, the Baltic Sea would only recover slowly.

According to the Helsinki Commission, the majority (more than 50%) of losses and discharges of total nitrogen and total phosphorus originate from diffuse sources. Agriculture is the main contributor of diffuse losses in all countries around the Baltic Sea, but scattered dwellings and storm water overflows can also play an important role. In Russia and Poland point sources are also important contributors to the total load. To combat eutrophication problems, joint and coordinated nutrient reduction measures should be implemented for the entire Baltic Sea drainage basin. The impact of agriculture should receive particular attention. Whilst several decisions and attempts to reduce the nutrient load in the Baltic Sea have already been made, further action will still be needed.

Intense algal blooms, which currently occur every summer, are a result of heavy nutrient loading. In addition to algal blooms, slime accumulation on shores and in fishing nets are visible signs of eutrophication. The ecological impacts of eutrophication are even more severe than the visual nuisance. Dead benthos, increases in internal loading and changes in species composition and predominance are examples of eutrophication effects in the Baltic Sea.

Persistent harmful substances are among the most urgent challenges. Reductions in DDT, PCB and lead concentrations are commonly used as positive examples of the success of remedial actions taken. But, this does not mean that we no longer have to worry about harmful substances. There are still high concentrations of mercury as well as dioxins, which are formed as by-products of impurities in several different industrial processes as well as during most combustion processes. Dioxins are only one example; there are a great number of other persistent harmful substances, and we do not have enough information about their sources, concentrations or effects. Cyanobacteria blooms are also known to produce liver toxins that are able to accumulate in the liver of flounders, for example. This is yet another effect of eutrophication.

The safety of maritime traffic in the Baltic Sea - and oil transportation in particular - is among our current challenges. A common fear is that an oil tanker accident will take place somewhere in the Baltic Sea. In recent years there has been a heavy increase in maritime traffic. In 2006 the volume of oil transported via the Baltic rose to about 150 million tonnes. Estimates for the future predict annual volumes as high as 250 million tonnes by 2015.

The increase in the amount of oil transportation also means more ballast water discharges in Baltic harbours. Therefore the introduction of invasive species from the ballast water tanks of ships is among the most serious environmental issues of the Baltic Sea. The risk of non-indigenous species invasion is not merely hypothetical. On a monitoring expedition in August 2007, scientists aboard the Finnish research vessel Aranda found large colonies of comb jelly *Mnemiopis* in the deeps of the Åland Sea and the Bothnian Sea. In some locations, their population density was as high as 600 individuals per square metre. *Mnemiopis* has been found to be extremely adaptable and can reproduce in the northern Baltic Sea in colder conditions than previously observed. It does not rise to the surface layer but rather seems to thrive in the halocline or below it at a depth of approximately 80-110 metres. *Mnemiopis* appears to have adapted to Baltic conditions by becoming smaller than it is in other habitats - a common phenomenon among flora and fauna.

In the early 1980s, this comb jelly was accidentally introduced to the Black Sea through the ballast water of ships. It had a catastrophic effect on the entire ecosystem. Later it invaded the Azov, Marmara and Aegean Seas and recently also the Caspian Sea. Its effects on the Baltic Sea ecosystem remain to be seen.

At the global scale the International Maritime Organization (IMO) adopted the Ballast Water Convention in 2004 in order to prevent, minimize and ultimately eliminate the transfer of harmful aquatic organisms and pathogens through the control and management of ships' ballast water and sediments. All Baltic Sea riparian countries have signed the convention, but unfortunately none of them have ratified it yet.

Communities and decision-makers around the Baltic Sea are becoming increasingly concerned about the state of the marine environment and its very slow recovery. Discussion about major polluters and insufficient implementation of prevention measures starts every summer as soon as the massive algal blooms appear yet again. Ordinary citizens are becoming very worried about the future of the Baltic Sea, and the pressure on politicians for additional measures increases. Nevertheless, the steps taken remain rather small.

The Helsinki Commission is elaborating new provisions of the ambitious HELCOM strategy - The Baltic Sea Action Plan - with the aim of drastically reducing pollution in the Baltic Sea and restoring its good ecological status by 2021. This plan is already widely seen as a pilot project for the European seas under the EU Marine Strategy and a model to be followed by other regional marine conventions around Europe. These new steps taken are important, but new strategies alone will not help. What is urgently needed is implementation.

Eeva-Liisa Poutanen

Director General

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How can we find the motivation required to protect the Baltic Sea?

By Pauliina Kainulainen

There is a massive amount of knowledge about environmental problems available, which raises the questions: Why is so little being done to improve the environment? Why does that knowledge not result in a change of attitudes and action that leads to concrete political decisions? We all know about the tragic state of the Baltic Sea and we probably also share the view that the ecological state of the Baltic is crucial for the well-being of all people and their economies in the Baltic region. In addition, other challenging problems, such as accelerating climate change, also affect peoples' lives and economies in every part of the world, including our region.

In the following I shall briefly present an overview of the deep cultural levels of Western thinking i.e. philosophy and theology, upon which our attitudes and concepts of reality have been based. There are age-old models of thinking that draw upon these sources, models that still influence our relationship towards those parts of the natural world that are not human.

More holistic thinking is necessary

Since the industrial revolution in the 17th and 18th centuries the dominant Western concept of reality has been mechanistic. Even nature is seen as a machine without a soul that obeys strict mathematical laws. Human beings were expected to reveal the secrets of nature and develop new technologies in order to use all possible natural resources.

Such thinking has indeed created much well-being for humankind. However, in our era more and more people are asking if something has gone too far, if well-being is turning into being ill. The excessive fragmentation of nature and human knowledge are damaging the ecological balance of the earth and the spiritual integrity of many human beings.

What could be an alternative to mechanistic thinking? Many philosophers, feminists, and ecologists are turning their gaze towards an older way of understanding nature. The old model can be called a holistic or organic model as it uses the image of an organism, a living body where all parts are interdependent. In this case the whole is more than the sum of the parts. Knowledge is integrated and brings together reason and emotion, the body and respect for mystery. If updated to meet today's challenges, this kind of thinking may prove to be a strong basis for a relationship between humankind and non-human nature that is more sensitive to the needs of the natural world.

I claim that in the Baltic Sea region a new kind of integrated thinking is needed in order to save the sea from complete ecological disaster.

The role of religion

Christianity is the main religion in the Baltic Sea region. During recent decades, Christianity has been accused of having accelerated humankind's destructive domination of nature. It is true that the biblical ideas of human beings' hierarchical right to dominate the earth have for too long been used in a way that does not convey the original biblical message of humankind being responsible caretakers for all life.

Christian communities have – finally – awoken to the massive challenge that is posed by the environmental crisis. A new kind of theological thinking is surging forward in many parts of the world and the countries that share the shores of the Baltic Sea. This kind of theology is often called ecotheology. It radically re-interprets many old traditions, but at the same time it finds important but neglected elements from the tradition itself. For example, the Orthodox tradition has always maintained a remarkably holistic view of nature and resisted some Western nature-hostile philosophies.

Symbols powerful enough: the Baltic Sea is sacred

The Lutheran ecotheologian Larry Rasmussen has said that now we need symbols powerful enough to awaken us, to help us to transform our knowledge into action. I suggest that one powerful symbol could be that the sea is sacred. All the earth is sacred and carries the presence of the Holy Mystery. Thus, the Baltic Sea is sacred. Recognising this sacredness has concrete implications: It leads us to the need to restrict some economic endeavours in the short term in order to heal the sea and enjoy its riches in the long term.

The strongest sources of motivation for the protection of the Baltic are not found in a sense of responsibility or guilt. The deepest sources are found in a feeling of interdependence, of communion with all living things, in respect and love. Do these ideas sound strange when combined with issues of ecological and economic well-being? If so, that tells us much about the way in which Western culture has tended to keep different areas of life very separate. However I am delighted to notice that even in the world of economy a new kind of interest in the theme of integrating knowledge is dawning.

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HSE expanding operations in the Eastern Baltic Sea Region

By Eero O. Kasanen

The Baltic Sea Region economic area has been reintegrating ever since the fall of the Iron Curtain. The era of globalization accelerates the pace of change. As a result, in business, many Finnish firms have expanded their home market to cover the entire Baltic Sea region with special focus on the Baltic States. In politics and administration, various kinds of pan-Baltic Sea networks and organizations have been formed. Also universities are following the development and actively form inter-regional networks. In addition, it seems increasingly important to integrate the pan-Baltic Sea networks into the wider European academic community. Helsinki School of Economics (HSE) has been actively responding to the new needs stemming from the business community in its education, research and management training strategies. Doing so, we are active members in various business school associations built in the former Eastern Europe (such as CEEMAN, BMDA and RABE) with the aim to link the Baltic Sea Strategy with our memberships in high-quality European Communities such as the CEMS.

The HSE has decades of experience in research, education, student exchange and management training in the Baltic Sea region. The collapse of the Soviet Union and the clearing trade clearly pointed to new needs arising from the business community towards the university. While the bilateral clearing trade was mainly conducted by large companies, the opening up of the markets in Russia and the Baltic States rapidly attracted also small firms. Simultaneously, there was increasing need to train the local managers. As the result, the HSE Small Business Center established a subsidiary in St Petersburg already in 1993 to provide expert training, information and support services for Finnish and Russian SMEs. A related subsidiary was established in Tallinn in 2004. HSE also participated in a pan-Nordic management training program NORLET (Nordic-Russian Leadership Executive Training) conducted in cooperation with St. Petersburg State University and a consortium of large Nordic companies to educate Russian managers in western business theory and practice. This five-year program was continued on a bilateral basis between Finland and Russia in the form of JIPROFIN management training program in 2000-2004 financed by the Ministry for Foreign Affairs of Finland. In Poland, management training took the form of tailored executive MBA education in Poznan.

The new challenges were tackled also in Master's education, and a multidisciplinary study track specializing in Russia and Eastern Europe was established under the Area Studies program. At the end of the 1990s, the HSE established the Center for Markets in Transition (CEMAT) to coordinate and develop the university's operations related to Eastern Europe. CEMAT soon managed to build up long-term research and training projects both with Finnish partners as well as with Russian and Baltic partners. A good illustration is the Economic Monitoring of North-West Russia (www.economicmonitoring.com) project that has been conducted in cooperation with Finnish and six Russian partners since 2000.

In the 1990s, the transfer of knowledge in the Baltic Sea region was largely one-sided, i.e. from West to East, not only in business operations but also in the cooperation of universities. The East European universities made radical changes to their curricula in order to correspond to the needs of the market economy. Often, this was supported by help from Western universities and EU financing. HSE's experience of curricula development at the St Petersburg State University School of Management aimed at developing the expertise and mentoring the academic staff via student exchange, academic exchange and development of teaching materials. Today, both student exchange and academic exchange of scholars continues with various partners in the Baltic Sea region.

In all its operation, HSE seeks to integrate high academic quality with relevance to the business community. Here, the well-established cooperation with administration of the Helsinki metropolitan area and our partners in business is pivotal. This is reflected in the nature of research carried out by the departments and centers of the HSE, where the share of outside funding has skyrocketed. Within the Baltic Sea region, this has facilitated our aims to rapidly increase true research cooperation with our local partners. It has been a delight to document the fast accumulation of learning of the Baltic Sea partners. HSE hosts annually young researchers from the Baltic Sea region and their capabilities seem to be improving. The knowledge transfer is no longer predominantly one-sided, but rather an increasingly two-way process as it should be.

Eero O. Kasanen

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Connecting competitiveness and regional sustainable development

By Paula Lindroos

On 13th September, 2007, a high level meeting of the Council of the Baltic Sea States (CBSS) was held in Riga under the auspices of the Latvian Presidency. The main objectives of the meeting focused on the role and possible contribution of higher education and science in the promotion of sustainable development and competitiveness in the Baltic Sea Region.

In the discussions representatives from the Ministries of Education and Science from the Member States of the CBSS; Denmark, Estonia, Finland, Germany, Latvia, Lithuania, Norway, Poland, Russia and Sweden reflected on the best ongoing practices as well as current and future challenges in the field of higher education and science. Moreover, the meeting agreed that education is an area for concerted action and improvement if the Baltic Sea region wants to meet the challenges and use the opportunities of globalization, thus promoting the implementation of the Lisbon Strategy goals.

In cooperation with the CBSS, the Baltic 21, or the Agenda 21 for the Baltic Sea Region, is advancing sustainable development in the region. The Baltic 21 Education sector was launched in 2002 together with a strategy for education for sustainable development (ESD). The Education sector has enhanced the work with national strategies, action plans and curriculum development on ESD.

Based on a recommendation from the Johannesburg Summit in 2002, the UN General Assembly proclaimed a consensus in December 2002 a UN Decade for Education for Sustainable Development (DESD) 2005-2014, with UNESCO as the lead agency to promote the Decade. In his follow-up report on Agenda 21 in 2002, the UN Secretary-General Kofi Annan writes: "..Education should provide students with the skills, perspectives, values, and knowledge to live sustainably in their communities. It should be interdisciplinary, integrating concepts and analytical tools from a variety of disciplines. Few successful working models of education programmes for sustainable development currently exist."

The UN's ECE Strategy on Education for Sustainable Development, a DESD for Europe, was adopted in March 2005 in Vilnius, Lithuania. This European DESD has been "constructed" along the lines of the strategy for ESD adopted by the countries participating in the Baltic 21 – the regional agenda 21 process for the BSR.

The Finnish vision and strategic lines for ESD in the education system are based on national education policy documents, the Baltic 21E programme, the ESD strategy of the United Nations Economic Commission for Europe (UNECE), and the University Charters for Sustainable Development. It is no exaggeration to say that the promotion of sustainable development is an integral part of the objectives of Finland's education policy.

The CBSS high level meeting also expressed support to the activities of the Baltic University Programme as a focal point in the region for higher education on sustainable development. The Programme has made valuable contributions through courses and projects since 1991 when the first satellite mediated course was produced. The Programme has developed into on of the largest university networks and which focuses on regional aspects of sustainability, with the Baltic Sea region in the forefront. National centres in all BSR countries coordinate the activities and participate in the development of the Programme together with the coordinating secretariat at Uppsala University. Over the years the centres have developed considerable expertise in sustainable development. Strengthening of these centres in each country would be an important task in order to increase impact and visibility of ESD in higher education. Finland has – as a forerunner - supported the centre with project funding since 2004.

UNESCO does not offer a ready-made, universally applicable plan of action for the implementation of the DESD, as sustainable development is intricately tied to local social, cultural, economic and ecological circumstances. One can generally say that in order to learn about sustainable development, one must be acquainted with several different branches of science. Learning about sustainable development is guided by a principle of organizing science and at the same time focusing on the problem solving capabilities of the students. Sustainability science is often defined as a systems study, where the system to be studied is the nature-society system. Therefore education needs to emphasize a systems understanding, in parallel with management skills, handling of conflicting interests and ethics.

According to the traditional division in academic institutions, however, research which is multi- or interdisciplinary becomes even more problematic than multi- or interdisciplinary education. The first problem is the divide between the cultures of different disciplines. This cultural gap is wider the longer the distance between the academic disciplines is. The second gap is between research and application, where traditions and systems for cooperation with the surrounding society often are lacking.

Easy to agree on is the fact that the most central position in the education strategy for sustainable development is the improvement of the human capital and that this is a prerequisite for all other sustainable development strategies.

The CBSS high level meeting in Riga considered the role of higher education most important in the sectors of resource, energy and demand management, sustainable production and development, all subjects which are essential to meet the global challenges. At the same time higher education institutions should also increase their role and responsibility towards sustainable development and act as models of sustainable development by implementing and promoting principles of sustainable development.

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The new law on special economic zones (SEZ): a better catalyst for the region of Kaliningrad?

By Horst Brezinski

The Kaliningrad region which was lagging behind the Russian economic development in the mid 1990s seemed to do much better when its status of a Free Economic Zone was transformed into a Special Economic Zone (SEZ) in 1996. The scenario for Kaliningrad was aiming at becoming a pilot region of EU-Russia co-operation. The SEZ of 1996 can be regarded as a kind of free trade area, because the foreign goods imported in this region were exempted from customs duties and taxes and so were the goods exported from Kaliningrad to other regions of Russia if the commodity classification code had changed at the level of any of the first four digits and the share of the value added amounted at least to 30%. Thus, since the beginning of this decade the growth rates of Kaliningrad's GRP was all years 4 to 5 % higher than that of Russia. Industrial growth was in most years at the two digit level. The rate of unemployment level went continuously down to a moderate 5.9% in 2006. Exports and imports went up since 2000 by more than 400%. Wages increased by 3.3 times and the inflation rate went down to the one digit level. Why to bother about the results of the economic strategy of opening up and leading the region to a sustainable development which no longer seemed to lag behind that of Russia?

A second look revealed that this economic boom was artificial. The enterprises benefited from boom due to the tariff and tax exemptions. Only few industrial goods such as TV sets, vacuum cleaners and cars were produced, or these products were just assembled. Consequently, no production networks were created. Due to the enormous tariffs on these industrial goods being imported from other countries to Russia, the business was flourishing, but it had no profound impact on the overall economic situation in the Kaliningrad region. In addition, we have to keep in mind that in 1996 the Kaliningrad region started from a very low level. The volume of industrial production in 1996 was only 27% of the level of 1990 compared with 46% of the Russian Federation. The average wages were even in 2006 more than 12% lower than in Russia and more than 30% below that of the St. Petersburg. There was a net migration flow from the Kaliningrad region. The innovation potential was seen at the 60th place out of the 88 Russian regions in 2006. 75% of the normal exports consisted of oil and oil products. The inflow of real direct investment amounted in 2006 to only about 20% of the Russian per capita level. Foreign investors were not satisfied with the institutional environment and the economic development. The corruption perception index of Transparency International listed Russia in 2007 only at rank 143 (out of 179 countries) after rank 79 in 2001. There were inconsistencies in the legal framework, a large amount of bureaucracy, the administration intervened into entrepreneurial activities and infrastructure development was lagging behind when looking at the neighbour states. In a nutshell, there was an artificial development which was driven by rising fuel prices on the export side and an increasing demand for relatively cheap consumer goods in the Russian market.

The New SEZ from 2006 did not cancel the privileges of the previous investors and enterprises. The privileges will last until the end of March 2016. Under the new law firms starting a capital investment of at least 150 million RUR (about 6 million US $) in the region over more than 3 years may use tax benefits. These foresee a reduction of the corporate income tax and property tax to 0 % for the first 6 years following that investment and a 50% reduction from tax for the years 7-12 after the investment. The law will be in force until the end of March 2031. Moreover, measures are foreseen for the promotion of an ecological and sustainable tourism and for establishing a gaming centre.

This new law will have some profound changes on the economic structure. The new investors, which can be already seen concentrate on the traditional exports that is on the oil and mining business and on industries which sell their products and services in the regions such as construction materials and the construction business. Moreover, the Association of Russian Car Manufacturers has intervened at the prime minister in asking him to revoke the duty free region because the increased production of cheap Chinese cars in Kaliningrad has upset the traditional Russian producers. Consequently, the new law as well as the lobbying of Russian manufacturers may lead to an economic structure that will not create internationally competitive industries and enterprises. This may lead in the future to a slow down in the economic development and also have negative impacts on the demographic and social situation. This can already be seen at present. The percentage of population in the working age is decreasing from 65% in 2005 to 60,2 in 2015 and the number of pensioners is increasing to 23,1 in 2015. The number of students in vocational education is going down and quite often the well educated population lacks namely business competences. Are there perspectives to change that path of development?

From the above mentioned deficiencies we can conclude that the Kaliningrad region needs investment in professional training and the retraining of specialists in order to offer to potential investors skilled labour and to meet the requirements of a modern knowledge-based economy. Further on, a concept has to be set up, how to promote the innovation and technology transfer from research institutions to the enterprises. Only then the region could participate to a larger extent in the national and international value chain and offer competitive products to the Russian as well as to the international market. Moreover, the enterprises in the region will be able to increase wages and to stop the brain drain from the Kaliningrad region. The cross-border relations which are extremely important for a small region can only develop when the barriers to travel are very low. This would increase the inflow of tourists. Thus, Russia and the EU have to improve the current status of relations and will have to work out a more flexible solution for cross-border relations for the Kaliningrad region. Without such an improved solution there will be no emergence of the tourism, because the major part of foreign tourists are coming from the EU.

The new SEZ concept does not cover these points which are relevant for the economic emergence of the Kaliningrad region. The SEZ concept will bring only some short-term benefits. In the long run it will not contribute to a real sustainable development.

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China's 'Go-abroad' strategy and the case of Baltic Sea region

By Matti Nojonen

China's 'red' capital is reshaping the global economic architecture. China's central government has become increasingly active in utilising its massive $1.3-trillion foreign exchange reserves. This strategy shift will be the most dramatic macro-economic shake-up of global economy in the near future. The central government has begun an active 'Go-abroad' investment strategy (*zouchu qu zhanlüe*) that is supported by various governmental institutions. We can identify three different patterns of Chinese foreign investment strategies in the Baltic Sea region countries; resource, market and know-how based investment strategies. Most recently, we have witnessed a strategic shift in Finland where China has for first time established a policy driven industrial organization, lobbying bureau for Chinese chemical industry, in EU.

Institutional backing

The powerful National Development and Reform Commission (NDRC) of China has announced number of policies and instruments for Chinese companies and industry sectors to realize the 'Go-abroad' strategy. In spring 2007 the NDRC published the third edition of an industrial directory for investing abroad. The purpose of the directory is to provide information about countries, regions and industrial sectors for Chinese companies going abroad. Naturally, this directory also reflects the policy and strategic interests of the central regime of China. This directory should be subjected to detailed analysis[30].

The actual powerhouse of China's foreign direct investments is the China Investment Corporation (CIC) that has a fixed capital of $200 billion. The importance of CIC's role in world economy and in China's political system has been paid very little attention to. The management of this fund has created a race between different ministers and other government agencies. The hardliners are willing to use the money to build up the strategic reserves of China; others demand China to purchase shares in foreign high-tech companies or to acquire foreign high-tech companies to develop China faster. Yet, there are some influential scholars close to the top who openly demand China to use the money for stabilizing and developing the poor and remote areas of China. The investment portfolio and practices of CIC has been under strict secrecy. It is assumed that the 17th National Congress of Communist Party, in October 2007, will shed some light on the CIC's strategies.

Four investment strategies

By studying Chinese domestic and international reports we can identify three different investment patterns that are used in the Baltic Sea Region.

The resource based investments strategy aims at securing the increasing demand of energy consumption of China's growing economy. At the same time China is gradually building up its strategic reserves. Naturally, Russia plays a key role in this respect and is the fourth biggest source of energy to China.

China has launched a sustained diplomatic campaign in recent years aimed at increasing supplies of oil and natural gas from Russia. These efforts have culminated in promises of building two natural gas pipelines from Siberia to China, which eventually will be finished by 2011. The Chinese have also shown active interest in purchasing shares and rights in Russia oil and gas-fields and companies. However, the Russian's have been very reluctant to sell to the Chinese any strategic parts of their national reserves, like in the case of resent Rosneft's IPO. Beside of economic issues, Russia and China share common strategic issues, like fight against terrorism in Central Asia and the need to create a multipolar world system. This political strategic relationship has also been manifested in arms-sales to China, joint-conferences between finance specialists and in actual business deals.

The emerging strategic partnership between the countries is also visible at the Russian Baltic Sea shores where Chinese investors are building a $1.5 billion office, shopping and residential apartment complex, the Baltic Pearl. The Chinese construction company is also building $1 billion tunnel under the River Neva. It is claimed that both projects are good-will gestures on the Chinese side and can be seen as strategy to tie-up Russia closer to China. Even more investments are taking place. In June 2007 Chinese companies signed up contracts worth of $2 billion in the northwestern Russia.

In market based investment strategy Chinese companies establish their presence at the local markets and seek various market based benefits. There exist a small number of Chinese companies that have established greenfield operations in the Baltic Sea region. The household appliance producer TCL Ltd., the biggest TV maker in the world, runs its plant in Poland from where it sales to EU market. The Chinese car producer Chery has a factory in Kaliningrad and sell cars first in Russia, but naturally aims at EU market. The Chinese companies enter into local markets also by acquiring existing local companies. For instance, in 2003 Huapeng Trading, purchased a German pressurized container producer, Welz Gas Cylinder, in order to be able to produce faster customer tailored containers.

In the Baltic Sea market we have not yet seen Chinese acquiring factories and then moving them back to China, like was the case with the traditional British crown jewelry MG car factory. In the case of machine tool producer Schisess, the new Chinese owners moved only parts of the high-end German engineering knowledge back to their own factories in China while it continues part of the production in Europe.

In the know-how based investment strategy Chinese acquire local technologically advanced companies. Within this investment pattern we can see two different practices. Chinese investors identify Western high-tech companies that are in financial problems, acquire them and keep running the business within EU; like TCL bought the bankrupt German Schneider Electronics in 2002; the Shenyang Machine Tool Group bought the German machine tool maker Schiess in 2004. The Chinese are also acquiring healthy high-tech companies that provide them access to technology, patents and educated specialists. So far, Sweden, Denmark and Germany have been active in attracting Chinese investments in ICT, renewable energy and life sciences sectors. As these sectors are also at the top of the Chinese governments 'wish-to-develop' list, it is likely that these countries will get important advantages over other countries in this region.

A new strategic opening in China's foreign trade and investment

In October 2007 China opened a new front in its 'Go-abroad' policy, which has a central strategic importance in Baltic Sea region. The China Chamber of Commerce of Metals Minerals & Chemicals Importers & Exporters (CCCMC), a semi-private industrial interest representative organization that has 4000

[30] The directory was not accessible on the NDRC Chinese or English language homepages for a closer analysis.

members, established its office in Helsinki. The reason for this move was strategic and got the blessing of Chinese government. The function of CCCMC is to follow closely the work of EU's Chemical office in Helsinki. The aim of CCCMC is to inform and help its members to invest and do trade with EU. Another objective of the organization is to enhance the interests of Chinese chemical industry in EU, in other words, do lobbying in Helsinki and EU. This is the first Chinese industrial interest office abroad and therefore we need to follow closely the modes and patterns of its work.

China is truly reshaping the global economic architecture. However, it is evident that within China's elite there is strong tug-of-war what to do with the $ 1.3 trillion national reserves. The 'Go-abroad' strategy is still mantled in secrecy. At the moment we do not know what the actual importance of Baltic Sea region has in China's global chess-game – at the moment we can only identify different patterns of Chinese investment strategies and the establishment of first Chinese industrial lobbying office in Helsinki. This all indicates that the Chinese 'game' has begun on this sea that unites Russia and EU countries.

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High export duties for roundwood in Russia?

By Matti Palo

Increasing export duties of roundwood during 2007-2011 in Russia and its consequenses have been the most frequently commented business news in Finland during 2007. About 16 million cubic metres or one fifth of the utilization of wood by the Finnish forest industries in Finland has lately originated from Russia. According to a common view the duties will become fully reflected in increasing demand for roundwood in Finaland. Consequently, the respective increase in domestic supply should take place.

The timber prices in Finland have already during 2007 increased in real terms more than in 17 years. If the demand for timber in Finland would increase by the amount of the imports from Russia, it would be possible to bye this large amount only at further increased prices. The price increases would not be only restricted on the additional demand but on the total domestic demand, which definately would make this operation non-profitable.

Therefore, the Finnish companies are considering alternative options to react on this change. The independent sawmills have only a limited number of such options. One option is to change technology to be able to saw also pulpwood-diameter logs. The four large integrated companies, especially the globalized companies, Stora Enso and UPM, have, however, more options available.

Socialistic forestry is practiced in Russia, because all forests are owned by the state. The stumpage prices (prices of standing timber) are administratively set remarkably below the market prices. These prices have recently been 4-5 euros per cubuc metre, which is a tiny faction of the respective prices in Finland. The logging contractors have hence been able to operate profitably, when at the border they have been able to sell the timber at high Finnish prices. In the official statistics, however, lately losses have been reported, which indicates low productivity in logging systems or biased reporting.

Low stumpage prices have also been a main source for huge corruption in forestry in Russia. Transparency International has assessed Corruption Perceiption Index in Russia as 2.5, while Finland scores 9.6. Russias rank among 163 assessed countries is 121 as counted from the least corrupted end (Finland, Iceland, New Zealand). It is one possibility that the new export duties will not be fully included in export prices but payments for corruption or profits could be somewhat decreased. In this alternative the imports of roundwood to Finland would not be totally stopped.

The rise of duties of birch pulpwood will take place not before 2011. Therefore, a change of policy may appear by the follower of President Vladimir Putin. Stora Enso and UPM are the two largest importers of roundwood fron Russia to Finland. Both of them operate globally, which also have invested in fast growing tree plantations in The South. If the import prices from Russia will increase too much, the companies have two major options available.

The companies can close down some low productive mills in Finland and thus decrease the demand for domestic wood. This strategy would increase the global profitability, if the remaining mills would have higher productivity. Furthermore, the companies could avoid bying more high-priced wood in Finland, which also would improve their profitability. Both giants have already tested this strategy in Finland with highly critical public opinion due to increased unemployment. Now the increased export duties in Russia would be a reliable excuse to continue on this line.

Botnia company has this year already imported four giant shiploads of Eucalyptus chips from Uruguai to its pulp mill in Kaskinen western Finland. This outlet will be closed down still in 2007, when the 1 million ton new pulp mill by the same company will start production. However, roundwood, chips and pulp are supplied at competitive prices in a number of other countries in the South.

The export duty in Russia is ordered by a presidential act. Therefore, it most likely that Mr Putin himself will not cancel it. If it will become fully implemented during 2009-2011, it will total to 50 euros. It is an outcome of strong lobbying by the Russian forest industries, against global efforts to liberalize international trade. If true, the markets will adjust the the future of the Finnish forest industries in various ways.

Mr Jouko Karvinen, the CEO of Stora Enso, declared last July that “The export duties are an issue of life or death for the Finnish forest industries”. This view seems to be more lobbying the Finnish government than anything else. The government should not due to this publicity rumba change the tax system of forestry as suggested lately by a forest economist. The present system is clear and operational. As a policy analyst I am doubtful, if even any other instruments to support domestic wood supply will be needed.

Socialistic forestry is the predominant regime in the world, when 84 % of global forests remain owned by states. No socialistic forestry country has proven by facts its way towards Sustainable Forest Management, not even Canada. In corrupted Russia sustainable forestry is even less likely option. A first step had been to raise the stumpage prices instedt of export duties. In this way the basic source of corruption within forestry had been eliminated. Neither the Russian forest industries nor the politicians wanted this effective policy instument.

Increasing the stumpage prices had produced the same additional income to the government as the export duties. Simultaneously, it had improved the profitability of investments by the forest owner (state) in forest management intensification. Under such intensified of silviculture logging could be immediately expanded profitably within the best economic-geographic locations.

The higher stumpage prices would make logging unprofitable in the old-growth natural forests of Siberia and elsewhere in the periphery. The financial accessibility of forests for logging could even be shrinked due to rising stumpage prices. Consequently, under higher stumpage prices and values of Russian forests the markets could even be supportive for more forest conservation.

Higher stumpage prices and consequent lower corruption would also decrease the country risk for major foreign direct investments in pulp and paper in Russia. Under the present situation there exist a few announced investments from Finland in this front but the increased export duty will not decrease the country risk. Major increases in stumpage prices with its benefits are most unlikely under the prevailing socialistic forestry regime.

Ad hoc privatization or decentralization of Russian forests under heavy corruption would lead to the worse. This is the Gordion knot of Russian forestry behind the curtains of the export duties.

Russia has about 40 times the volume of the standing timber in Finland. Russia can annually log only three times more than Finland. In both countries the forests are to a large extent located in similar ecological conditions. Finland is relying primarily on the private ownership and the market system of forestry, Russia on socialistic forestry.

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Increasing traffic in the Gulf of Finland presents challenges for winter navigation

By Atso Uusiaho

Many factors have shown that the traffic in the Gulf of Finland is increasing at a notably rapid rate. The majority of the discourse surrounding this issue concerns the increase in oil tanker traffic to Russia, and the accompanying risks of possible oil spills. I would, however, like to point out that the volume of commercial and passenger traffic has also increased. The overall increase in traffic correspondingly increases the risk of accidents, not just because of the traffic frequency, but also because of the varying condition of the vessels and the varied expertise of their crews. Furthermore, every vessel, whether it be a container vessel transporting dry cargo or a luxury cruiser, carries tens to hundreds of tonnes of oil on board as fuel.

The pressures to ensure smoother and safer traffic connections are intense, but the characteristics of this particular sea region also present their own difficulties. For instance, winter navigation in the Gulf of Finland, with its shallow and rocky coastlines, is very challenging. This is particularly true for seafarers who are not accustomed to travelling on icy seas. The ability to safely manoeuvre through icy waters requires knowledge, expertise and extensive experience.

The Gulf of Finland freezes practically every year. The thickness of the ice and the permanence of the ice cover depends upon the number of days when the temperature is below zero. In the east, at the bottom of the Gulf of Finland, the sea may be covered with ice for up to 120 days, whereas, to the west, off the shore of Hanko, for example, the number of icy days is around 30. During a harsh winter, the Gulf of Finland can completely freeze over. The thickness of the ice at the bottom of the Gulf of Finland is generally about a half metre, but the drifting pack ice can rise up to several metres above the ice and under the water.

The frozen sea does not restrict navigation, since it is facilitated by icebreaking services available to vessel traffic. The task of simply opening the fairways for vessels is not, however, necessarily enough to guarantee safe winter navigation. It is easy to assume that the ship's passage through the channel forged by the icebreaker or that the process of following behind the icebreaker is simple and straightforward. This is not the case. In icy seas, the ship's officers must be able to predict how the channel opened by the icebreaker might move or change as a result of heavy winds or refreezing, in addition to being able to prepare to deal with pack ice. Passing through the channel also requires experience, for example in overtaking or head-to-head situations. Co-operation with an assisting icebreaker or tugboat is not without its dilemmas either, if the ship's officers are inexperienced or unskilled in ice navigation.

A high percentage of oil transports and goods traffic is primarily handled by modern ships that are in good condition. The development in this area has been good, but the reverse side of this coin is that the size of the ships has also grown. The increased size of the vessels also presents challenges for winter navigation since the icebreaker's channel is approximately 25 metres wide, but the largest tankers are 40 metres wide or more.

The direction of the development has been clear for some time already, and, at the same time, measures have been planned and taken into use to further secure navigation at sea. The coastal states of the Baltic Sea region are working together more than ever before. One example of this is the GOFREP (Gulf Of Finland Reporting) system that was introduced in 2004 and requires all vessels with a gross tonnage of more than 300 GT to make notification of their location.

A risk analysis concerning traffic in the Gulf of Finland was ordered by the Finnish Maritime Administration, and on the basis of the analysis, the GOFREP system would reduce the likelihood of ship collisions by up to 80 per cent. Technical equipment and monitoring systems do not, however, eliminate the risk completely, since there remains the possibility of accidents caused by human error, equipment malfunction or difficult conditions.

One additional method for reducing dangerous situations is to ensure that there is an experienced professional on the bridge who is familiar with local waters and conditions. Last year, the Finnish State Pilotage Enterprise, Finnpilot, and the Shipping Enterprise, Finstaship, jointly established Ice Advisors Ltd, a company providing ice advisory services to shipping companies operating in the Baltic Sea.

The ice advisory service is a tool which helps shipping companies to increase the efficiency of their transports by improving, among other things, the predictability and reliability of transport schedules, but which also oversees the safety of the vessels, their crews and the environment. While ice guidance is also an important part of the job of local pilots along their own specified routes, an ice advisory expert is free to operate within the entire sea region. The service is also very important in a social and cross-border sense.

The experts at Ice Advisors are experienced pilots and masters of icebreakers that work for Finnpilot and Finstaship. They and the organisations behind the company have decades of experience in winter navigation and the special conditions related to ice fields. The ice advisor also has access to real-time information on weather and forecasts, and on the ice conditions in the Gulf of Finland.

The task of the ice advisor is to guide and assist the officers of the vessel in selecting the safest route, and to ensure that the vessel stays in motion and on the proper fairway. The ice advisory service has, thus, a significant environmental value since there is a great risk of accidents involved with inexperienced navigation through ice.

As I mentioned above, the ability to travel through ice requires highly specialised expertise. The officers of the ship must be able to co-operate with the assisting service and to predict other traffic obstacles. When travelling on their own, the officers of the vessel must also be able to properly interpret the conditions around them, such as rapid changes in the weather and the movement of ice fields, since ice can cause significant problems or damage for the vessel. The vessel might, for example, end up stuck in pack ice, and might sustain damage or drift with the ice into shallow waters. Furthermore, there is always the risk of an accident resulting in damage that will require long-term efforts to correct.

The service does not provide a guarantee or remove the risk of accidents, but it is one means of reducing these risks.

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Safe seaway connections are our life blood

By Bo Österlund

We are used to regular seaway connections and regard them as self-evident. In the good times, goods are sufficient to fill the shop shelves, the raw materials and components of industry are in the right place at the right time, and industry is run by means of either domestically produced or imported energy. We are used to our country's prosperity and the export income which fundamentally affects our standard of living, and also regard them as self-evident, since already over 50% of our national product is generated beyond the borders of our country. However, even a small disturbance in our seaway connections could change these circumstances in a decisive manner.

A logistics chain in which the components and spare parts are under the control of the manufacturer and the user has the goods requiring manufacture for a limited time only achieves even substantial savings. The expected outcome is that the prices of commodities will fall. This "just in time" system increases, however, dependency on the smoothness of deliveries as well as, most significantly, the vulnerability of logistics. This requires an already continuous, functional and safeguarded transport chain to the production facilities.

The freight traffic of the Baltic Sea's entire area of influence comprised, according to the statistics of 2003, 1,788 million tonnes in total. The share of export was 1,044 million tonnes and share of import was 744 million tonnes. The proportion of marine traffic is about 50% of all transport. The Baltic Sea is too wide from the perspective of overall supervision, but it is nevertheless highly sensitive to disturbances at the same time, owing to its limited scope.

Globalisation not only increases possibilities, but requirements as well, to rapidly deliver goods, services, information and other commodities round the world. The Baltic Sea is almost entirely surrounded by EU countries, but at the same time highly central to Russia's foreign trade, which is growing from year to year. This year, as much as 40% of Russia's foreign trade proceeds by container via this inland sea. Oil shipments make up the largest part of this sea transport.

Calculated from the year 2000, EU export to Russia has tripled and, at the same time, EU import from Russia has doubled. Europe will still be dependent for quite some time on Russia's fossil energy, though it is attempting to improve its self-sufficiency and establish new import routes via Southeast Europe.

Some alarming statistics figures

According to last year's statistical data, ship traffic on the Baltic Sea consisted of over 60,000 vessels either entering the area or leaving it. Each moment round the clock and throughout the year, over 1,350 merchant ships ply the Baltic Sea. This "movable storage system" conveys over 730 million tonnes of cargo—which is over 15% of the world's deliveries of goods. The traffic level of about 900 vessels at the turn of the new millennium has grown approximately 50% to the present day. At the same time, 150 – 200 rather large tankers carrying oil are resting at about 20 ports in the area.

On the basis of Russia's economic growth in particular but also that of Poland and the Baltic countries, the growth prognosis for marine traffic on the Baltic looks quite significant. This belief for the future looks set to bring new ship orders as well as increasing the number of expansion projects at ports. The Vuosaari Island Port Construction Project to the east of Helsinki is currently the Baltic's largest.

Russia shows some of the area's largest economic growth figures. The handling of containers at the base of the Gulf of Finland, the Port of St Petersburg, has increased over 20% during the last two years, and oil exports from Primorsk Port have simultaneously grown over 15%. Russia is currently strongly dependent on its exports of oil and gas. Together with the metal field and still operational timber exports, these fields correspond to over 80% of Russia's overall exports. Russia's oil proceeds make up to over 40% of the country's gross national product. In 2006 as in the previous year, oil exports from Russia reached at least 250 million tonnes, 66 million tonnes of which were conveyed via Koivisto. The capacity of the Port of Koivisto is set to grow to over 100 million tonnes within a few years.

The Port of St Petersburg handled over 54 million tonnes of goods last year, a new oil/chemical port is being planned, and its capacity is assessed to be approximately five million tonnes. Deepening the entrance route to 13 meters is also under planning. The capacity of the Port of St Petersburg currently acts as a bottleneck in the logistics chain. At present, the waiting periods for ships to enter the port may stretch to up to ten days.

The East Laukaanlahti Bay Port Project on the south shores of the base of the Gulf of Finland close to the Estonian border is progressing and is expected to be ready this year, at which point the port will comprise a coal and motor vehicle terminal as well as a dry cargo terminal. In connection with the expansion of the Port of Vysotsk towards the farthest reaches of the Gulf of Finland, its cargo-handling capacity will grow from 11 million tonnes to 15 million. The capacities of the ports of Varandey and Batareinaya are almost doubling.

Russia has stated that its intentions are to reduce the *transito* transport occurring via the Baltic ports which, together with the transit traffic directed via Finland, currently reaches over 80 million tonnes annually (the figure corresponds to almost the entire volume of goods respective to Finland's marine traffic) and that it will transfer this share to its own ports and oil- and gas lines. At the end of May, the Russian government decided to build a new oil line extending to the shores of Koivisto. The volume of oil to be conveyed via Koivisto with the completion of the new pipeline will almost double. At the same time, the number of oil tankers will double in the Gulf of Finland. As a result of the completion of the new pipeline, the 'friendship' line proceeding to Western Europe will become redundant. As the Port of Koivisto has been expanded, Russia has already terminated oil shipments to Latvia's Ventspils and Lithuania's Butinge earlier this year. These oil deliveries have also been transferred to the Gulf of Finland. A safety zone with a width of 200 metres on each side—whose project managers say "shall be enforced"—is to be established along the North Stream gas line, which is 1,200-kilometre long, 1.2 metres in diameter and designed to proceed across the Baltic Sea on the bottom of the base of the Gulf of Finland. This will also on its part affect maritime use. The compressor station planned for construction in the area of Sweden's Gotland will be the only structure extending above the surface.

The Baltic nations' ports handled a total of over 138 million tonnes of goods last year. During the last ten years, the cargo quantities at the Port of Tallinn have grown about 300% to 41 million tonnes. The share of *transito* transport is no less than 34 million tonnes. According to the announcement issued in mid-July by Sergei Lavrov, Russia's Minister of Foreign Affairs, Russia will halve the transit oil transport going on via Estonia. This 25-million tonnes export consignment will also switch to the Gulf of Finland for delivery. In Estonia, plans are being made to raise China's

container traffic and to simultaneously reduce the handling of mineral oil products.

In the strategy approved a few years ago a few years ago by Russia's government, attention is being given to transport routes which Russia can control itself and thereby avert the economic as well as the political risks thereby caused. Russia has two logistics centres within its region which it can control itself. One is the base of the Gulf of Finland, where the oil port of Koivisto has become Russia's most important individual oil export port, and the other logistics centre is situated in the Murmansk area.

Of Finland's foreign trade, about 85% proceeds by sea and, amongst the countries of the Baltic, we are the most dependent on maritime transport. We are in a position close to the status of an "island state". Marine traffic comprises of roughly 95 million tonnes of cargo quantities. On the basis of this cargo quantity and the number of visits by vessels, we come to an average of 2,300 tonnes for the cargo ship size. These sorts of average ships arrive in or leave Finland at a rate of 114 per day throughout the year, summers and winters. The cargo quantity of these vessels is equivalent to 11,400 train cars or 34,200 full-trailer combination lorries of goods. About half of the ship traffic heads to the east or west side of Åland to the ports of the Gulf of Bothnia, and about half to those of the Gulf of Finland. We are dependent on this sort of uninterrupted activity in the flow of goods. Even so, the goods travel in ever greater quantities by foreign keel.

According to the statistics from the 1960s, about half the foreign traffic in terms of the flow of goods was transported by Finnish vessels. Of the transport from 1990, domestic tonnage remained responsible for only 35% of this share. Last year, the proportion of domestic tonnage already declined to below 30% (27.7%). Abroad, Finnish vessels transported only under 17% of cargo deliveries, with slightly over 35% of domestic tonnage dedicated to import. Supply and operational reliability using foreign tonnage are, under emergency conditions, surely not on the same level with Finnish ships sailing under the Finnish blue and white flag. We are also relinquishing our commercial fleet with respect to the nationality requirements of captains. According to the change in legislation under preparation, the master of a merchant vessel sailing under the Finnish flag will no longer be required to be a Finnish national. A more important factor than the nationality of the shipmaster, however, is the ownership status of the vessel. On domestic ships, the status of command remains under national control. Our transport by sea is vulnerable to interruptions.

Baltic cargo transport is expected to grow faster than other areas and, by the year 2020, as much as 64%. The flow of goods is thus going to grow by almost 500 million tonnes. The ports of Germany, Poland and the Gulf of Finland are anticipated to gain the most benefit from this growth in traffic. The sizes of vessels—particularly in container traffic—also appear to be growing in order to achieve the desired cost effectiveness. Oil transport is increasing faster than other types of transport. The Baltic nations now bring 64 million tonnes from Russia and 86 million more tonnes from other European countries. It is calculated that by 2010 oil transport in the Gulf of Finland will grow to slightly less than 200 million tonnes, which means an increase of six thousand (6,000) approximately 32,000-tonne container ships per year. This means about 16 tankers per day will be travelling east or west. According to the assessments of the State Technical Research Centre, the risk of oil disasters in the Gulf of Finland has dramatically increased. It is assessed that by 2015 this risk will further double from that of the current level. With the growth in ship size, it is anticipated that the size of ports practising foreign trade will also grow. The number of ports engaged in foreign traffic appears as a consequence should decline, since it is not possible to make large ports out of all of them. Far-sighted subsidiary traffic by wheel and rail will probably be developed on the basis of these development trends.

Safe seaway connections represent the life-blood of our society's survival as well as in our global trade and international collaboration. As a result of this dependency, we may of course ask: which sort of threat scenario with our vital marine traffic as its object could there be?

In dealing with a threatening scenario, it is also of course necessary to evaluate the likelihood of a possible threat. This point of view is fundamental, but it is virtually impossible to answer the question. During the period of the Cold War, assessment was made even more difficult because those interests which could truly pose a threat attempted at the time to conceal their intentions as long as possible. These days, the matter must also be examined from the opposite side: Do those who now publicly and via the media pose a threat really have the capacity to implement their intentions?

Selecting terrorism as a modus operandi requires, as operational resources, not only money, individuals eager for action and a strong motivational ideal, but also some sort of operating concept. Many international specialists assert that terrorism and crime have warmed up to each other. This cohesion has opened up financing channels to terrorism as well. Terrorists have utilised ships for transporting both their materials and personnel. Transportation of explosives by means of other modes of transport may be problematic.

Fortunately, to our knowledge there are no situations these days in which vessels carrying dangerous loads would be used in the manner of 'suicide bombers' at ports with vigorous traffic. On the other hand, ships have been selected as targets. In October 2000, an American destroyer at the Port of Aden was attacked. The offensive was realised with a small boat loaded with 250 kg of explosives. The attack killed 17 Americans and the economic losses were reckoned at 250 million dollars.

In October 2002, the *Limburg,* an oil tanker, became the object of an assault by a boat carrying explosive agents. The consignment burst into flame and one of the crew members lost his life. The consignment, totalling 75,000 cubic metres, discharged 15,000 cubic metres of oil into the sea. Between May and June, three Saudis were arrested in Morocco. They had plans to use boats with explosives to attack American and British warships in the Strait of Gibraltar. This plan remained unfulfilled. Tips have also been obtained concerning suspicious characters who have sought diver training, at least in the Netherlands at the end of 2002. This reference does provide reason to also examine the underwater threat to ships. A few years ago, a rather major ship-owner with 200 vessels that sailed the world's seas was asked about the effects of this sort of underwater threat. He stated that greater detriment would be achieved by closing strategically important maritime passages. A mine in the Strait of Malaka or at the front of the port city of Aden would mean that we could not enter the port. According to this ship-owner, navigation would come to a halt in 1 – 2 weeks and the interruption would immediately be felt in the global economy. Many of the clients of this shipping company, too, have only enough reserves to allow operations for less than a week. Their reserves as well are also transported by sea.

The capture of the Danish vessel *Donica White* at the fore of the coast of Somalia at the outset of June was the most recent incident of an attempt to disrupt or prevent international trade and interfere with the freedom of the seas.

NATO has reacted to the possibility of this kind of threat, and has implemented, among other things, the 'Active Endeavour' operation on the Mediterranean Sea to make the area safe for marine traffic. Through area supervision, escorts of merchant vessels and mine searches and eradication, marine traffic routes have been kept safe. Port

security has been increased and through traffic is the object of special supervision and inspection. The same sort of activity has been practised on the Indian Ocean. A corresponding threat in, e.g., the Denmark Strait would immediately impact the marine traffic on the Baltic Sea. With a trade embargo, it would also be possible to prevent shipping through some marine area or prevent access to a port.

It is particularly important to protect the traffic routes and the ships plying them at Baltic marine traffic nodal and passage points and in areas in which traffic is restricted to certain routes as well as in the archipelagos.

The point of emphasis in our naval defence has become the protection of seaway connections. This task represents both the military protection of our country and the safeguarding of the nucleus of vital functions on the sea and along the coasts. Juhani Kaskeala, Chief of Defence of the Finnish Defence Forces, declared in his editorial in *Rannikon Puolustaja* [Defender of the Coast] (1/2007) that the safeguarding of seaway connections has always been part of the task of our naval forces. It is only that at times its emphasis has been rather minimal.

The protection of seaway connections is multidimensional and requires the collaboration of all maritime authorities and actors. The naval forces are responsible for the whole and harmonise the measures. Maritime situation awareness creates the need to do something or provide the rationales for conscious non-intervention in events: without reliable situation awareness, this sort of requirement is not established.

The naval forces compose and maintain the required situation awareness required as the foundation for marine activities as a whole and distribute it to the authorities that need it for the evaluation of the situation and as the basis for decision-making. The maritime situation awareness composed in collaboration between Finland and Sweden expands the possibility of decision-making far into the Baltic. Mikael Odenberg, Sweden's Minister of Defence, reported during the Defence Ministers' Conference in Sandham, Sweden between May and June that Finland and Sweden are offering other Nordic nations the opportunity to join as observers in their cooperation involving the supervision of the Baltic Sea. Sweden is also engaging in discussions with Denmark about assembling combined maritime situation awareness.

The formation of situation awareness to accompany the safeguarding of our seaway connections requires the supervision and regulations of marine traffic, protection of seaway connections, close and remote protection of ships against the threat of air, surface and underwater threats. Ensuring routes that are important to us, rescue services, inspection of vessels and the maintenance of port accessibility are also important tasks to acknowledge.

Preparedness for various circumstances challenges the community to develop, together with other actors, multilateral performance competence to safeguard vital functions in our society in the manner required by the government's basic programme from November of last year. Naval defence ensures our vital seaway connections which keep the wheels turning also under emergency conditions.

The time has not run out. Yet!

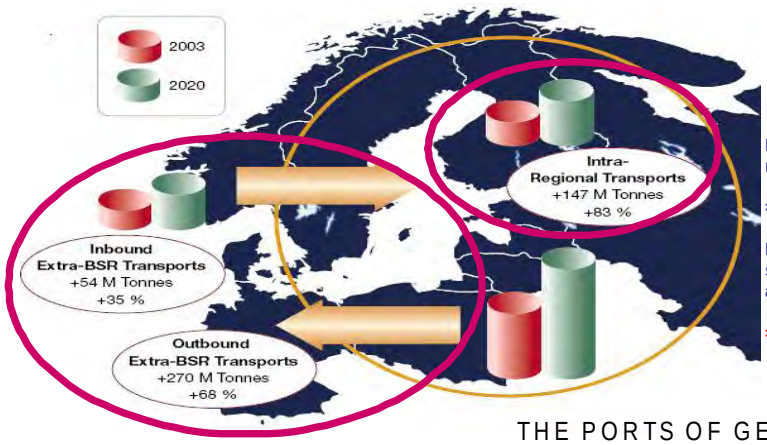
"TEMPORA MUTANTUR NOS ET MUTAMUR IN ILLIS"

Bo Österlund

Commodore

Finland

BALTIC SEA: DEVELOPMENT PROSPECTS FOR FREIGHT TRAFFIC



Internal market Baltic Sea transport represented 24% of total freight volume in 2003.

=178 million tonnes.

In the inspection period extending to the year 2020, sea transport is expected to grow

=147 million tonnes, 83% growth from year 2003 level

In the external traffic of the Baltic Sea transport represented 76% of the entire traffic in 2003

=553 million tonnes.

In the inspection period extending to the year 2020, sea transport is expected to grow on the part of import and export by a total of

=324 million tonnes, 58% growth from year 2003 level

THE PORTS OF GERMANY, POLAND AND THE GULF OF FINLAND ARE EXPECTED TO BENEFIT THE MOST FROM THIS GROWTH

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The European Union's role in protecting the environment of the Black Sea region

by Stavros Dimas

Almost 600 kilometres of the Black Sea coastline became part of European Union territory when Bulgaria and Romania joined the EU on 1 January this year. With a surface area greater than that of our two newest member states, and collecting its waters from a catchment area six times larger than its own surface, the Black Sea is one of the world's great seas. But in being virtually cut off from other oceans and accessible only through a narrow, shallow channel – the Bosphorous – it is particularly vulnerable to the effects of pollution.

Almost one third of the entire land area of continental Europe drains into the Black Sea. Waters from as far away as Germany and Poland can bring a host of environmental problems. Nitrogen and phosphorous originating from agricultural fertilizers, livestock manure and untreated sewage pose one of the main threats. These nutrients are over-fertilizing the natural ecosystem and choking its oxygen supply. This has led to radical changes over the last 40 years that are threatening the sea's biological diversity – its natural wealth of plant and animal species - and economic activities such as fishing and tourism.

Although the Black Sea ecosystem has shown signs of recovery since nearly collapsing from pollution in the 1980s, it remains fragile. More than ever before, the prosperity, stability and security of our Black Sea neighbours are of concern to the EU. It is no secret that environmental problems bring regional tensions. The Black Sea's widespread environmental problems can only be tackled through regional cooperation. A recent Communication from the European Commission, and backed by the EU Member States, has put Black Sea cooperation firmly back on the political agenda and flagged environment as one of the main areas for cooperation.

At first glance it may seem that new regional processes for cooperation need to be created. But for the environment such mechanisms already exist. It is implementation that is lagging behind. The EU has been working with the region for many years and its new status as an EU coastal zone offers an opportunity to redouble our efforts. We will focus on implementation and improving how existing institutions work. The EU is making available financial support for environmental protection by Black Sea countries, ranging from structural funds for EU member states to assistance instruments like the European Neighbourhood and Partnership Instrument (ENPI) for those outside the EU.

The European Commission recognised the need to address marine environment problems at regional level in our 2005 EU Marine Strategy and our proposal for a Marine Strategy Directive, which will require member states to cooperate with neighbouring counties. They will be encouraged to use regional seas conventions, including the Convention on the Protection of the Black Sea against pollution, to reach this goal. With Bulgaria and Romania now EU member states, accession of the European Community to this important convention becomes a priority.

The most important river flowing into the Black Sea is the Danube, and in recognition of this link the Commission in 2001 launched the Danube-Black Sea initiative, or DABLAS as it has become known. DABLAS aims to support implementation of the two regional conventions dealing with the Danube and the Black Sea and to improve coordination between them. A key activity has been to get a range of infrastructure projects off the drawing board with the involvement of the international institutions - such as the European Investment Bank and the European Bank for Reconstruction and Development – to address the regional environmental hotspots identified in the work of the two conventions. Consequently new projects have been implemented on the ground that is both environmentally significant and financially 'bankable'. This has been seen as a success in the water sector and spreading this approach to other sectors is now being considered.

The Commission will also work with the countries of the region to combat climate change. We attach particular importance to making use of the Kyoto Protocol's two market-based mechanisms to promote emission-saving projects in third countries, the Clean Development Mechanism and Joint Implementation. This year the EU is launching a €5 million technical assistance project on climate change in the region.

As well as taking action at regional level, we also have distinct relations with each of the non-EU countries bordering the Black Sea. Turkey, as a candidate for EU membership, is in the process of aligning itself with our requirements. Financial support is available to help it build the sewage treatment plants and other environmental infrastructure needed to comply with these demanding environmental standards. Other countries are covered by the EU's European Neighbourhood Policy, with cooperation guided by the jointly agreed national action plans and priorities that underpin this policy. Cooperation with Russia takes place under a partnership and cooperation agreement.

The new political landscape gives us the opportunity to strengthen our work in the region. We owe it not just to our newest EU citizens in Bulgaria and Romania but to all people living in the region to redouble our efforts to ensure a brighter future for the Black Sea.

Stavros Dimas

European Commissioner for the Environment

Latvia - transit land and destination

by Ainārs Šlesers

Latvia is a transit land. Our geographical position - a crossroad for international transit flows has created number of opportunities to become an important partner in trade relations between East and West, North and South. There are two major transit channels going via Latvia: the North-South, connecting Finland to Germany, and the East-West, connecting Moscow to the Port of Ventspils and beyond. Being centrally located in Northern Europe it is also the first and last EU border with Russia (except for Estonia and Finland), making it ideal for East-West trade.

Riga, largest Baltic city, is located in the middle of region in less than two hours' flight from the population of half a billion people.

This determines our strategic aim: to secure stable growth in cargo transport, attracting new cargo flows, to ensure increase in cargo value-added processing, to develop Latvia as international logistics and distribution platform and advantageous transit corridor. Upon my initiative, a governmental working group has been established in order to facilitate transit and logistics sector development by putting particular emphasis on ports' development and integration of ports, railway, and roads network into a single logistic network.

Our transport system with a high density of roads and well-developed transport infrastructure for maritime and pipeline transport serves the transit needs and opportunities. Latvian transport system has become an integral part of the Trans-European Transportation Network TEN-T, and we are actively accommodating the EU funds for the further modernization of transport infrastructure.

Without doubts, our main asset is three non-freezing international ports (Riga, Ventspils, and Liepaja) well linked into the country's infrastructure by rail, road and pipeline. Being practically ice-free even during the most severe winters is a great advantage over the neighbouring ports in North.

Latvian Railway is the main link in the Latvian transit chain. While integrating our railway infrastructure in the common EU transport system, our rail system shares the same gauge standards (1520 mm) and has common information systems with Russia and the CIS countries. It provides an infrastructure base to facilitate the growing trade flows between the EU and Russia/CIS, and eventually China and other countries in Far East.

While the main cargo types processed by the Latvian Railways are oil products, coal, mineral fertilizers, metals, and wood - containers are seen as perspective trend in cargo transportation. An example - a regular container train *Baltica-Transit* is operating from Riga to Kazakhstan with the perspective plans to extend the route further to China.

As a new impetus for the *Rail Baltica* project, a decision on reconstruction and modernisation of the existing railway infrastructure connecting Estonia, Latvia, and Lithuania was agreed by the Transport Ministers of all three Baltic States as a first step towards the initial project of building a European standard fast-speed railway line. The Memorandums of Understanding have been signed with the respective Ministers agreeing on next steps to be taken in *Rail Baltica* development course, such as, coordinated project proposals for the EU TEN-T program, further feasibility studies required for European gauge line, harmonization of technical and operational parameters, etc.

One of Latvia's main challenges in the transport sector remains improvement of the quality of roads. At present, 65 % of the excise tax on petrol is devoted to road infrastructure. According to Latvian legislation, this share will gradually increase up to 80%, but currently the Ministry of Transport has submitted a proposal to increase the share up to 95%. The road reconstruction program for the years 2007-2013 will be implemented with the financial support from the EU structural funds; several public-private partnership projects are foreseen for constructing new highways along the main transit axis.

Another pressing issue is long queues of trucks on the Latvian/EU-Russian border. These queues, regularly reaching records of over 42 kilometres and 1500 trucks in the direction to Russia, are endangering the road safety situation and creating major inconveniences for both truck drivers and local population.

As Latvia, of course, is not in a position to solve it on its own, we are in active dialogue with authorities of Russia and other countries experiencing similar problems (like Finland and Estonia). We are also insisting on keeping this matter on agenda of the European Commission.

Number of actions is envisaged to improve the situation: modernisation and expansion of the border control points, construction of terminals or truck parking sites next to them, road construction projects in the West – East direction. At the same time, given the trends and potential for the growth of cargo flows between the EU and markets of Russia and CIS countries, a construction of the highway *Riga-Moscow* is needed urgently for which we need support from both Russia and European Commission.

After signing the border agreement in spring, our relations with Russia have improved. In July, the Latvian-Russian intergovernmental commission (IGC) has finally met and adopted a work program. Furthermore, a comprehensive debate of government officials and transport business representatives was organized and a Transport working group was established within the IGC. It serves as a good basis for further cooperation.

In June, *TransContainer*, a subsidiary of Russian Railways company, opened a representation office in Riga with a perspective plan to increase container freight turnover between Latvian ports and Russia up to 1 million containers by 2010.

Development of the transport infrastructure facilitates also the increase of passenger transportation, both for business and tourism purposes.

The International Riga Airport continues its impressive growth rate. In 2006 the airport served 2.5 million passengers, which is an increase of 33% compared to 2005. In the first half of 2007 passenger numbers have already increased by 25.6% and we are expecting a 2-millionth passenger to arrive in Riga at the second half of August. 1 million passengers have been carried by the national carrier *airBaltic*, the second largest market player is *Ryanair.*

Currently Riga is linked with direct flights to more than 50 destinations in Europe, America, Asia, and Africa. We are the closest point in the EU to the East, so, in next years there will be more flights to Asian countries.

Our policy of cancelling the duty for passenger departure and reducing charges for aero navigation and services of the airport, making them lowest in the region, has clearly paid off. It increased competition, significantly reduced ticket prices and made travelling by air affordable to practically everybody. And our goal of having a 10 million passenger airport in nearest future is no longer a dream, it will be a reality soon. In order to accommodate such an expansion, new airport development plan has been elaborated (currently the airport has almost reached the limits of its capacity). We are

constructing a practically new terminal and extending the existing runway. Construction of the second runway is foreseen for later on.

Development of infrastructure at the regional airports in Liepaja, Ventspils, and Daugavpils will contribute to the growth of tourism and business in the western and eastern regions of Latvia.

Liepaja airport is already operating commercially and in June 2007 it became a second international airport. Now *airBaltic* performs not only regular flights two times a day on route Riga – Liepaja, but also daily flights on routes Liepaja - Copenhagen (Denmark) and Liepaja - Hamburg (Germany). Flights from Riga to Ventspils are foreseen for the next year. The necessary developments are being studied for perspectives in Daugavpils, the largest industrial city and transport hub in eastern Latvia.

The civil aviation sector gives a valuable contribution to the development of tourism industry, which continues to boom in Latvia – according to statistics the number of foreign visitors has increased by 13% during the first quarter of 2007; 25% of longer-term visitors were in Latvia for the first time. Visitors spent 72 million EUR during that period which is an increase by 20% compared to the same period in 2006.

It proves that Latvia is increasingly becoming an attractive destination for tourists and for business.

Ainārs Šlesers,

Minister of Transport of the Republic of Latvia

May the Baltic way be the European way

by Piia-Noora Kauppi

The Baltic area is fast becoming a text book example of a dynamic business environment. European Union membership of the three Baltic States and Poland has made the area into one big market. Healthy tax competition has increased trade and investment flows. The prospects for the four core freedoms of the EU - people, capital, goods and services - look strong in the Baltic.

But the Baltic is already a significant actor. According to World Bank figures, with $33,56 billion in foreign direct investment flows in 2005, the Baltic region (excluding Germany), with only a fraction of the population, was not far behind China, the world's largest single recipient of FDI.

The economies of the Baltic rim are complementary, contrary to the Mediterranean for example. Labour markets are flexible and the population is well-educated. They have demonstrated a capacity and a willingness to move around the region, not only between Sweden, Denmark and Finland, but also the Baltic States. Witness the ground-breaking labour dispute in Waxholm involving the Latvian construction company Laval. Despite the ruling by the European Court of Justice upholding Swedish collective wage agreements, the ice is broken and it will be a reference point for future EU labour movements. The structural dynamism of the Baltic area is unrivalled in Europe. It is the EU's most competitive region and it will only increase its attractiveness for foreign investors.

In OMX, the joint stock exchange operator, the region possesses one of the most promising capital markets in Europe. The bid from NASDAQ and the rumoured rival bid from Dubai's stock exchange testify to its potential. OMX offers a single platform for companies to raise cash, giving rise to more liquid and more transparent securities markets. The infrastructure for clearing and settlement of OMX trades is also one of the most efficient cross- border mechanisms in Europe.

There are also problematic policy areas confronting the Baltic. Firstly energy policy, which indeed seems to cause problems for the whole union. Russia's interest is to deal not with the union as a whole, but bilaterally with individual member states. EU common interests have successfully been split as a consequence. The new Baltic pipeline Nord Stream is a vivid example. For Russia it is as much about politics as about energy. The previous German government should have anticipated the ire of the Baltic States. It could have made a stronger case for their suggestion to build the pipeline on land, through the Baltics and Poland. It would probably be less expensive, better for the environment and bring benefits for the energy management of these countries and would thereby not be a project just between Russia and Germany.

The EU needs a common energy policy. Dependence on Russia is problematic, both because its capacity to keep the oil and gas flowing is questionable due to chronic underinvestment, and because of its habit of shutting the valves for political purposes. Bilateral agreements should be avoided and a common European ground should be established. The Baltic area can lead the way in this debate.

Secondly, the union is still lacking solidarity and a robust common defence to back it up. The crisis provoked by the Soviet war memorial in Tallinn was a stark illustration. We cannot let any of our Member States be left on their own in a case of crisis - even a diplomatic one. What is the point of the union, its values and common policies, if in reality they are not enforced and guarded?

The Baltic is a strategically important region. We all, the Finns and the Baltics in particular, have a specific interest in maintaining balanced and secure relations with our eastern neighbour. Sometimes it is forgotten in Brussels how long our common border with Russia actually is. A united Baltic area could show the way towards a united EU policy on Russia. A united foreign policy is what we need if we dream of ever being a powerful actor in world politics.

Thirdly, our common concern is also the environment and the fragile Baltic Sea. It has been estimated, that the Baltic Sea is the most polluted sea in the world. Cooperation with Russia is once again vital. More than anything, the countries surrounding the Baltic Sea have to convey to our European friends that the Baltic Sea is not just their business anymore. It is Europe's new Mare Nostrum, which makes it our common concern. The Baltic Sea could be in a pilot project for solving our common environmental threats with the necessary supranational action.

In spite of all the problems yet to be solved, the Baltic area is clearly a frontrunner is several sectors. It has vigorously implemented the four freedoms of European Union, to the envy of other Member States. It has shown that we can build a successful common home market area and rapidly adjust and improve our economies. There is a lot to learn here for the rest of the EU. In the future, the Baltic area can play an important role in tackling Europe's new common challenges.

Mrs. Piia-Noora Kauppi

Member of the European Parliament (EPP-ED Group)

I regard myself as a son of the Baltic Sea

by Antti Peltomäki

I was born in Helsinki and spent my childhood in Kotka. After a spell inland during my school years, I returned to the Baltic Sea, first to Turku to do my military service and then to Helsinki to study, to talk politics and to work. Although I have nothing particular against Riihimäki and Brussels, I really feel at home only when I see, smell and taste the sea.

For a little boy the Kotka harbour was the most exciting place in the world. In the Finland of the 1960's there was no other place you could experience the international atmosphere as vividly as in Kotka. The crews of the ships that were taking on cargo in the harbour or waiting to dock monopolised the roads, pubs and football pitches – maybe even the girls – for several weeks at a time.

However, as a little boy I never travelled very far on the Baltic Sea. The furthest I got was Kaunissaari – that is as far as the janitor's boat took us. At that time I knew nothing about Suursaari, which had been ceded to the Soviet Union. The southern coast of the Baltic Sea seemed to lie further away than the islands in the South Sea, which I dreamt of sailing to when I grew up. I still haven't made it to the South Sea, but I did make several boat trips to Sweden and once even all the way to Denmark and Germany with my parents.

At the end of the 1970's, when I came back to the coast after my school years spent inland, the sea of adventures of my childhood had become a very political sea. During my time as a politically active student, the East-West confrontation was ever present and we Finns were very keen to ease the tension. I remember having participated in some kind of a Peace Cruise myself on a ship called Konstantin Simonov. We travelled all the way to Tallinn and Riga, but I suppose that, instead of bringing about love and peace, we just managed to get a massive headache.

In the late 70's and early 80's, I travelled to Poland on the Pomerania a couple of times on my way to continental Europe. Those trips opened my eyes and ears even more. In those days Poland was already different, and it was not just a question of courageous protest by the Solidarity movement. Having met ordinary young people from Poland and East-Germany, I started for the first time to believe that change was possible.

When the Estonian activists started to visit the secretary of international affairs and many other colleagues of mine in the offices of the National Coalition Party almost on a weekly basis, I knew that a historic day was about to dawn. The southern coast of the Baltic Sea could become closer to us than the South Sea islands – or not. Although official Finland was very careful in its comments, many Finns were very enthusiastic about the possibility of following and sharing the historic moments on Estonia's, Latvia's and Lithuania's road to independence. I was one of those Finns, too.

The biggest watersheds in the history of Europe were undoubtedly the fall of the Berlin Wall and the disintegration of the Soviet Union. These events created a completely new political situation in Europe, but in the Baltic region their effects could even be compared to the Big Bang. They did create a certain amount of political instability, but above all they generated a huge amount of economic and human dynamics in the area of the Baltic Sea, Russia included.

Now that Poland and the Baltic countries have joined NATO and the European Union, the political, military and economic situation differs radically from that of my childhood's Kotka. The little boy's sea which ended in Kaunissaari is now the whole Baltic Sea, from coast to coast.

I still have not had the opportunity to take a boat to Suursaari. Nevertheless, I am more than happy when I stand on the deck of my friend's sailing boat on our way from Kotka to Tallinn and see all the ships plying back and forth between Finland and Estonia. I even cannot seem to be worried about the oil tankers heading west from the Koivisto harbour or about the cargo ships arriving at Kotka harbour from Germany with luxury cars on board for wealthy Russians. Although I do understand the various concerns about gas pipelines and electrical cables going under the Baltic Sea and maybe even a tunnel between Helsinki and Tallinn in the future, I like these projects – simply because they bring together countries, businesses and people in the Baltic Sea region.

When we look at the economic development of the Baltic region during the last decade, we have to conclude that there are tangible results to be seen and that there is an enormous amount of potential still to be exploited. The Nordic countries are at the top of the class in implementing the EU's Lisbon Strategy, each in their own way. The economic development in the Baltic countries has been extremely rapid, and the investments the Nordic businesses have made in the Baltic countries and in Poland have increased the economic integration in the Baltic Sea region notably.

The giants of the Baltic Sea, i.e. Germany and Russia, have tended to overlook the Baltic Sea, failing to see the possibilities it can offer, but I am sure that they will follow the smaller countries when they learn to look closely enough and to see clearly enough. Even if Moscow and Berlin do not always understand the significance of the Baltic Sea, it is enough for us to see that St Petersburg, Hamburg and Rostock are aware of its potential.

This is what a little boy from Kotka wants to say!

Antti Peltomäki

Deputy Director-General

Information Society and Media DG

European Commission

Kaliningrad is the city to invest in

by Yury Savenko

Kaliningrad is the administrative centre of the westernmost region of Russia, which is separated from the mainland Russia by hundreds of kilometers and by the borders of two sovereign states.

The unique geopolitical location predetermines ample perspectives and provides plenty of opportunities for cooperation. There is no other region in Russia which has enjoyed the status of the Special Economic Zone for such a long period of time. This regime allowed to create new industries such as car assemblage, production of the complex household appliances and electronics, furniture, laminated wood structures, poultry processing industries and some others.

The Federal Law "On the Special Economic Zone in the Kaliningrad region" came into force from the 1st of April, 2006. It aims at the promotion of the establishment of the high – tech competitive industries. Within this period of time 17 Kaliningrad enterprises with the total volume of more than 8 billion rubles have been registered as the new residents of the Zone. The project aimed at building of the 2nd line of enterprises processing vegetable oils has been launched. The production of automatic gearboxes for the Russian automobile complex and erection of the factory manufacturing the ceramic bricks has been set up. Several smaller projects on electric appliances assemblage and wood processing are being implemented.

In 2006 the total volume of investments into the stock capital of the large and medium sized enterprises constituted 15, 3 billion rubles. According to the data for the beginning of the year of 2006 the accumulated foreign capital amounted up to 136, 5 million dollars. During the year 66 million dollars of foreign investments were received. There are 2, 3 thousand organizations with foreign capital.

Kaliningrad is a favorable area to invest the capital in building. During 2006, 109 industrial and community facilities were built i.e. 1,5 times more than during the previous year. The total area of these objects constituted 281 thousand square meters i.e. 48 thousand square meters more than in 2005. In the sphere of commercial real estate several large-scale investment projects are being implemented: multifunctional complexes "Europe – centre" and "Clover – house", trade and ethnography centre "Fishing village", hotel complex at the Verkhneye Lake.

In order to assist in the building of dwelling houses the municipal authorities have elaborated the necessary project and regulatory documentation. Among them are the programs aimed at the construction of houses, development of communal infrastructure, gasification and power industry, etc. In 2006, 369 thousand square meters of dwelling houses were put into operation, i.e. twice more than in 2005. This is an exceptional record in the history of our region.

The authorities aim at providing sustainable urban development, making the city comfortable for citizens and at implementing business operations. The General Plan of Kaliningrad for the period till 2015 is adopted. One of the most important tasks is to bring the numerous objects of the city's infrastructure up to the new and modern level. During the last 5 years the corresponding city budget lines were increased by almost 2,5 times. The Public Private Partnership is used as one of the tools for achieving the strategic goals to the city development. The preparation to the concession of the municipal unitary enterprise "Kaliningrad "Teploset" is being performed.

There is a close cooperation with the Federal agencies and the Ministries of Russia on the financing of the city's infrastructure objects in relation to the Federal target and investment programs. The sewerage pumping plant, coast-protecting structures erected on the right embankment of the Pregel river are among them. The construction works at some other objects are being performed.

The construction of the second elevated bridge over the Pregel river, which is the largest project, (the cost is more than 3,4 billion rubles), has been launched in 2006.

The policy aimed at the formation of favorable image of Kaliningrad, creation of the conditions for effective operation of business and attracting investments is carried out. This work is open for the public. All adopted municipal regulatory documents and other decisions are covered by mass media and presented on the City Hall website. The most updated information useful for would-be investors and entrepreneurs is presented there as well. Administrative assistance is rendered to the investment projects implementation. The investors are advised on the economic, law and organizational issues of business arrangement.

The Kaliningrad City Hall maintains close relations with the Regional Industrialists and Entrepreneurs Union, Foreign Investors Association, business unions, Chamber of Commerce and Industry, Exhibition Centre "Baltic Expo".

Being the member of different Unions of the Russian cities, Kaliningrad hosts and takes parts in various seminars, conferences, exhibitions and other undertakings contributing to the development of interregional economic cooperation.

International cooperation is among the priorities of the Kaliningrad City Hall activities. At present Kaliningrad has 27 foreign partner cities and cooperates with them throughout the whole scope of local self – government activities. Kaliningrad is the member of the Union of the Baltic Cities. In 2006 the city joined the world-wide organization "United Cities and Local Authorities". Kaliningrad actively participates in the projects funded by the European Union, governments of Sweden, Denmark, Germany and other countries. The opportunities contributing to the development of the economic links are widely used. Within their framework the joint undertakings, business missions exchanges are regularly carried out. In 2007 the representatives of the local authorities and business took part in the presentation held in Lithuania and Poland. The delegation of the city participated in the 18th international exhibition of the investment projects "MIPIM – 2007" which was held in Cannes (France).

It is pleasant that Kaliningrad is marked and highly appreciated by the Council of Europe. In 1999, the city was awarded the Flag of Honour for the achievements in the international activities, in 2003 – the Plaque of Honour, in 2005 – the highest reward – the Prize of the Council of Europe. Currently Kaliningrad is the only Russian city awarded such a prize. In 2006 the city was awarded the Flag of Concord by the Fund "Concordia" of the Lithuanian Republic for the consolidation of friendship, peace and concord between different nations.

Yury Savenko

Head of the City of Kaliningrad, Mayor of the City

The Baltic Sea in the new strategic context

by Raimo Väyrynen

In recent years, two issues have dominated the agenda of the Baltic Sea politics; the protection of its marine environment and the emphasis on economic transformation and cooperation. In both respects, progress has been made. Even if the state of the Baltic Sea environment has not noticeably improved, public consciousness of its dismal condition is more widely spread than ever before. We know, for instance, that one half of all phosphorus entering the Baltic Sea originates from Poland. It seems that the environmental conditions for its entry to the European Union, as well as their implementation, have been too lax.

The economic progress of all Baltic republics, and especially of Estonia, has been impressive. Their economies have also become quickly more international, although in a somewhat lopsided manner. Multinational corporations from Nordic countries, especially from Finland and Sweden, have invested heavily in the Baltic republics. Many of them have developed active corporate strategies to capture their share of the growing markets. The downside of this development is that the Baltic countries themselves have not invested enough in the production capacity and productivity which neglect is largely due to their neoliberal economic policies.

The positive tendencies are obviously welcome as they hint to the emergence of a security community in the region and, ultimately, of a mare pacificum. It can no longer be argued, as the Soviet Union tried during the cold war, that the Baltic Sea is a mare nostrum. Yet, the strategic significance of the Baltic Sea has not entirely faded away. To the contrary, it appears that new games of competition are emerging in the region.

Economic competition is a natural concomitant of the spread of the market in the Baltic Sea Rim. However, such a competition is seldom only commercial in nature. With the presence of major or medium powers in the region – such as Russia, Germany, Poland, and Sweden, - economic strategies have also political elements. Especially in Russia, the state agency combines economic objectives with political goals.

One element of such competition concerns the construction of ports, mostly for foreign trade purposes. Russia is investing heavily in the construction of commercial ports both for the export of oil, of which the port of Primorsk is the prime example. East of St. Petersburg, Russia is planning an export port of Ust Luga that may be ready in about ten years when it is expected to handle annually 35 million tons of coal and other bulk commodities.

It is well known that Russian authorities and companies have been using pressure tactics against ports of Baltic Sea countries to play them against each other and derive various benefits from them. For instance, Russian exports through Latvia have been occasionally restricted in an effort to gain a stronger control over the port of Ventspils. The new Helsinki port of Vuosaari and the Tallinn port of Muuga are also becoming active participants in the commercial rivalry in the Baltic Sea area.

The German-Russian, or the Putin-Schröder plan to construct of a gas pipeline (North Stream) from the Russian part of the Gulf of Finland to Germany (from Vyborg to Greifswald), crossing the economic zones of coastal countries, is also loaded with politics and potential strategic consequences. North Stream is controlled 51 per cent by Gazprom, while E-E-ON and Wintershall of BASF Group are the minority shareholders.

Poland and the Baltic countries fear that Moscow aims to create a transportation route that it is able to control fully and play them, as well as the consumer countries, against each other. In Sweden, there have been somewhat overblown fears that the control and maintenance station near the island of Gotland could be used by Russia also for military purposes. Yet, it is an undeniable fact that a main purpose of the expanding Russian Baltic navy would be to protect the new pipeline (against whom the question remains).

The Baltic Sea region is witnessing even more serious military tensions as a result of the U.S. plans to deploy a radar system in the Czech Republic and some ten antiballistic missiles in Poland to counter the potential threat from emerging nuclear-weapon powers, especially North Korea and Iran. These plans have been very controversial not only in the Czech and Polish public opinion, but also among most NATO members. Thus, there is a pretty strong opinion against incorporating Europe in the strategic defense plans of the United States.

The criticism against the deployment plans has been especially pronounced in Russia which has issued a threat not only to target the new systems by its own missiles but also deploy new short-range missiles (Iskander-M or SS-36 Stone) in Kaliningrad. These missiles are tactical only in terms of their short range as they can reach much of Northern and Western Europe. If the deployment of these missiles in Kaliningrad, as suggested by the first Deputy Prime Minister, Sergei Ivanov, is realized, the military tensions in the Baltic Sea region will assume a new dimension.

If Russia, furthermore, will decide to withdraw, as mentioned in Moscow, from the Intermediate-Range Nuclear Forces (INF) Treaty, the situation will become even more serious. After all, the conclusion of the INF Treaty in 1987 was a turning point in the cold war and the decision to backtrack from that accomplishment would be a turn to the worse. Promising trends in the Baltic Sea cooperation would be badly undermined by the new missile rand naval race in the region.

Professor Raimo Väyrynen

Director of the Finnish Institute of International Affairs

The Baltic Sea Region as an arena for income level convergence

by Paavo Okko

The eastern enlargement of the EU created a union with large income differences. The Baltic Sea Region is now a good laboratory to see how income differences are narrowing via integration. Factor price equalisation is the ultimate measure of integration and the income level convergence has been the basic trend in the EU. So it will be in the case of the Baltic Rim, too. Low income countries have a potential for to catch up the rich ones. Also the average growth rate of the EU will be higher when large income differences do exist and low income countries are capable to narrow those differences.

There is a large literature on growth and income convergence. It is mainly in favour of per capita income level convergence via growth, but the catching-up and convergence are possible only under certain circumstances. The countries with sufficient human capital, infrastructure and institutional settings are capable to adopt and use new technologies successfully. Investment in physical capital is a necessary but not a sufficient condition for convergence. The new EU members of the Baltic area belong to the common single market. They have no technical restrictions to adopt same technologies but their capacity to absorb may be different. That is why there is no ultimate guarantee for convergence.

According to a convergence measurement about the EU14 (Luxemburg excluded) the speed of convergence has not been constant but income levels have been converting in the past. The speed of catching-up in 1961-98 was on average 2.05 % per year. It was slowest in the 1980`s (0.83 %) and fastest in the 1990`s (3.59 %). When different types of countries have an access to the same technology and to the single market, their long run income levels are near to each other but actual levels are far from each other. The crucial issue is how soon these differences will be narrowing in the large EU.

The basic expectation is that income gaps will be narrowing but it will be an issue of the long run. E.g., the gap in the per capita GDP between Estonia and Finland was about 60 % when Estonia became the member of the EU. If the convergence rate would be only 2 % per year, the difference would be still about 15 % after 70 years! Comparing Finland and Estonia gives an example on the convergence phenomenon in the Baltic Sea Region.

The average growth rate of Estonia in 1995-2006 was 6.6 % and of Finland 3.8 %. The per capita income level difference between the countries was roughly 60 % in 2004. If Estonia would keep the same growth rate until 2015 its income level will be doubled. If Finland is capable to grow by 3.8 % per year up to 2015 its income level will be 50 % higher than in 2004, but anyway, the income level difference between Finland and Estonia will be larger than in 2004 (about 70 %)! This means that if growth rates are coming to be at the current level, there will be so called beta-convergence but not sigma-convergence between these two countries. The first one means that low income countries have higher growth rates. If growth rate differences are high enough – or the original gaps low enough - to push the original income level differences smaller, we have a stronger form of convergence called sigma-convergence. In the case of Finland and Estonia we would have also sigma-convergence if the growth rate of Finland would be, e.g., 2.5 % and of Estonia the previous 6.6 %. By these rates the income difference between Finland and Estonia would be narrowing being still 44 % in the year 2015.

Convergence calculations are interesting, but their results depend heavily on assumptions made. In an optimistic case it will take about 25 years from the ten Central and Eastern European new member countries to catch up to the level of 70 % of the EU25. The variation is large. A comparison to the EU15 shows that, it will take 30 years to come to the level of 70 % of the EU15. Even if the tendency of convergence is in existence, income differences will remain forever in practice.

Anyway, there is now a large potential to catch-up. Catching-up economies must be capable to create innovations but they must have also capacity to learn from others – using the main strategy to learn new things. A special way for that is offered by foreign direct investments (FDI). FDIs mean an effective way of absorbing knowledge capital into a low income country. It is not only the question of comparative advantages of a country but also competitive edges of firms located in a country. According some simulations the speed of convergence is faster if FDI flows between members are larger. We can see evidence of this in the Baltic Sea Region. It is understandable that also Russia is willing to get FDIs, but FDIs are sensitive to institutional setup. EU members are in a better position in this respect.

Even if the real convergence is going on, the nominal convergence criteria of the EMU process may be difficult to fulfil. We have seen that higher growth rates tend to mean higher inflation rates. The single currency may mean problems to fast growing low-income countries showing real convergence but having problems with nominal convergence. The EMU was established actually for a final stage of a very deep integration. Some new EU members seem to be willing to enter into the Euro area perhaps too early. It is lucky enough that there is also a tendency that the membership of the Euro area makes a country to develop faster into the direction, which makes it to be more suitable for a currency area. Experiences of Finland from the Euro period offer a good example of restructuring in this way.

A status of equal factor prices is like the absolute zero point in low-temperature physics: it will be never reached exactly! Income differences are fuel of economic growth, and an integration process has not yet come to the end as long as differences still exist. A crucial condition is that the new members invest enough both in physical and human capital. FDI is a good way of mutual adjustment. A successful catching-up process of the new members means possibilities for the old members, too. The high income level member countries must be capable in increasing their productivity in accordance with their cost level. A restructuring in which the old members are loosing some production to new areas within the union is their possibility to allocate more into more productive sectors. Capacity to transform is required both from the old and the new members. This is also the crucial issue for Europe as a whole. It may seem paradoxical that an internal restructuring problem can help Europe in solving a simultaneous external problem of adjustment for the global competition. But that is a real option for Europe and the Baltic Sea Region is an important source of economic dynamics in order to get a more effective Europe.

Paavo Okko

Professor of Economics
Turku School of Economics

Nordea plans for growth in the Baltic Rim markets

by Hans Dalborg

Nordea has ambitious growth plans in the Baltic Rim markets. We expect to open around 200 branches in these markets over the next three years. It could even be more because Nordea has identified Poland, Lithuania, Latvia, Estonia and Russia as the geographical markets in focus for growth.

For the financial services industry, Northern Europe means opportunities.

This region – the Nordic and Baltic Rim markets – is one of the fastest growing areas of Europe. The Nordic countries have enjoyed higher growth rates than the EU average over the last 10 years and are seen as some of the most competitive markets in the world. The Baltic Rim countries are expected to grow about three times as fast as the European average in the years to come and banking is likely to grow twice as fast as that in these markets.

As the largest bank in Northern Europe, Nordea already plays an important role in the integration of the Nordic and Baltic Rim economies. The bank is positioned to benefit from the growth of this region - but also to contribute to it.

Proven growth record

The creation of Nordea started 10 years ago. In a "merger for growth" in 1997 between Merita of Finland and Nordbanken of Sweden, a strategy to form the leading bank in the Nordic and Baltic area was laid out. Uni Bank of Denmark and Christiania Bank of Norway soon joined the group. Activities in Poland, the Baltic Countries and Russia started to grow.

The philosophy was straightforward. In the Nordic countries, we are similar enough to work well together, different enough to have a lot to learn from each other and many enough to provide a solid home market. The Baltic Rim Countries are our closest neighbours with longstanding historical ties. Trade, investments and tourism between our markets develop rapidly.

With more than 10 million customers the over all strategy now is to increase our services for existing customers – our "share of wallet". In the Baltic Rim markets too, organic growth is preferred. It is a safety first strategy in an environment that we need to learn better and markets that can learn from Nordic banking practices.

In the last five years Nordea has achieved income growth of 26% and cost decreases of 2 per cent. Return on Equity has been stable around 20 per cent. Our record of modest acquisitions and strong organic growth in the Baltic Rim countries is part of this success story. We can not rule out bad surprises in these markets (either) but at least we have proven able to avoid them so far.

Recently, Nordea won the category for "Best Regional Bank in the Nordic and Baltic regions" in Euromoney's Awards for Excellence 2007. In addition Nordea won best bank in Denmark, Sweden and Finland. Euromoney's panel of judges has taken into account volume of business transacted, innovation and leadership, credit ratings, quality of assets and earnings and efficiency ratios and key performance indicators.

Baltic Rim – a priority area

Now we have adopted a reinforced organic growth strategy with the financial target to double the risk adjusted profit in seven years, which implies 10 per cent average annual growth. The strategy is to improve profitability through organic growth in Nordic home markets and "near abroad emerging markets" – corporate lingo for the Baltic Rim markets.

Today's starting point for this growth strategy is as follows. Nordea is number one in the market in Finland (and among Nordic customers in Private Banking in Luxemburg), number two in Denmark and Norway and holds a number two-three position in Sweden. In Estonia, Latvia, Lithuania and Poland our market ranks are 3, 4, 6 and about 18 respectively. In Russia we are among the top 50.

In Poland we have over one million customers (including life insurance), two per cent of the retail banking market and roughly 50 percent of the market for Nordic corporations operating there. With at present close to 50 branches, our goal is to have a network of 200 branches in Poland within three years.

In the Baltic countries we have around 10 per cent of both the retail and the corporate market.

In Lithuania we have about 35.000 customers and 10 branches. In Latvia we have 40.000 customers served by 17 branches. In Estonia 17 branches serve more than 50.000 customers.

In the next few years we aim to have at least 100 branches in the three Baltic countries.

Overly optimistic? No. Last year revenue was up 40 per cent and total lending up 50 per cent in Poland and the Baltic States. Profit almost doubled.

In Russia, Nordea now is the majority owner of Orgres Bank with 20.000 customers and 35 branches in Russia's centres for growth: S:t Petersburg and Moscow. Intensive efforts have been initiated to upgrade these branches and to expand the branch network.

The Russian market is expected to grow steadily and our focus initially will be on Russian corporate customers, Nordic corporate customers and personal customers in the high end segment.

Shared values to support growth

We strongly believe all this is doable with Nordea's leading position. Furthermore, our strong profit orientation – focus, speed and performance – is now complemented with three additional values to underpin sharing of best practice in the whole group. They are: "Great customer experience", "It's all about people" and "One Nordea Team" – values for organic growth.

When our first Finnish-Swedish merger was announced and we invited leading banks in Denmark and Norway to join, quite a few eye brows were raised. But after our strong over all performance in the past five year period few question the seriousness of Nordea's ambitions to be the leader in Northern Europe or our ability to deliver on plans.

I am personally confident that in five years Nordea will have grown substantially and that a considerable part of that growth will be attributed to our success in the Baltic Rim Economies.

Hans Dalborg

Chairman
Nordea

Stockmann has succeeded in internationalisation of its department store operation

by Hannu Penttilä

Baltic countries and Russia have offered a good market for not so often seen successful "green field"-investments

"Department stores do not travel well" has been during many decades a well known phrase within the international department store community. The explanation of this sentence is based of the fact that traditional department store companies have globally done very modest attempts to internationalize their business and in cases they have done that, most attempts have proved to be big failures. For some reason department store business has stayed a very local business.

Of all the international companies maybe the most well known French department store company Galeries Lafayette has made the most attempts for internationalisation. The company however closed very soon their store in New York and withdrew its operations from Far East and even from Moscow, where they had a small operation in GUM department store in the 1990es. The only city outside France, where Galeries Lafayette has today an own department store operation is Berlin, where the store had its 10th anniversary last autumn. According to available information, last year was the first year when that store was able to make a break even result of its operation. The latest internationalisation attempt in Galeries Lafayette will be made this year when the French will together with a local partner open a franchising store in Dubai.

Maybe the most successful internationalisation in traditional department store business, in addition to Stockmann's operations, has been made by the German Galerie Kaufhof, which some years ago bought a 15-stores Innovation chain in Belgium and converted it to Galerie Inno, according to their own Kaufhof-concept. The Spanish giant, El Corte Ingles, who has almost a monopoly position in their home market, has recently opened two stores in Portugal.

Stockmann is a-145-year old public company with estimated sales 2007 of above 1.6 billion euros, 11 000 employees and three business units. Department store business is the core business of the company, but the company is actively expanding also its other divisions, fashion store chain Seppälä (127 stores in Finland, 29 stores in all three Baltic countries and 21 stores in Russia) and its mail order and internet company Hobby Hall, which operates in the same markets, starting Russia in the end of this year.

The small Finnish market and the limited expansion potential of all its businesses in the home market has already long time ago forced Stockmann to search for new markets in the neighbouring countries. Stockmann was the first western retailer in the former Soviet Union and opened its first small stores in Moscow already in 1989. The entry to the Estonian market happened 1993, Latvia 2003 and Lithuania (Seppälä) 2005. The department store business has today, beside the seven stores in Finland, four full scale department stores in Moscow, fifth opening 2008, a large shopping mall and department store complex under construction in down town St. Petersburg and full scale department stores in Tallinn and Riga. Stockmann does not yet operate with a department store in Lithuania, but it is very clear that the store will be opened as soon as a suitable location has been found.

The success of all our stores has been good from the very beginning and all the stores have achieved or exceeded their targets. Opening a full scale department store is a heavy investment, and therefore, a normal rule of thumb is that the first full year is heavily loss making, the second year you halve your losses and the third year you will make a break even result or a small plus. Our Baltic stores however, have formed a pleasant exception of that rule. The Tallinn store reached a positive result already during its first full year of operation and the store was expanded very soon after its opening. The second expansion is at the moment on the drawing board.

Our store in Riga was also very well received by the customers and the store made a positive result during the second full year of the operation. At the moment we are also planning an expansion and a new parking garage for our customers.

Even if our department store business is running well in as well Estonia and Latvia, where the economy has been booming in the last years, there were considerable differences in entering those markets. Entering Estonian market was very easy and bureaucracy did not set up unreasonable obstacles. The situation was considerably more difficult in Latvia, where we during several years investigated many projects, before the entry could be made. Generally speaking one can say that everything that can be done to deregulate and to beat bureaucracy, protectionism and corruption, will improve the international competitiveness of the Baltic region.

Maybe the largest problem for a retailer in all our market areas, but especially in the Baltic countries, is the labour availability. When the wage level in these countries increases strongly annually, the turnover of staff causes problems. Of course you can say that this is a pleasant problem for the society as it, because of the competition, increases the level of earnings and appreciation of retail business. The net emigration makes the labour shortage worse, and it in deed is a big problem for retailers.

Despite problems Stockmann has against old beliefs been able to internationalise its department store business in a successful way. The customers have accepted us. If I look pictures taken at the same time last spring during "Crazy Days" - campaign in our stores in Finland, Russia, Estonia and Latvia, I could not tell the difference between the pictures. A lot of happy customers.

Hannu Penttilä

CEO of Stockmann group

President of the International Association of Department Stores

Safety on the Baltic Sea and protection of the marine environment - risk anticipation

by Paavo Wihuri

In the last ten years, a lot of work has been done for the safety and environmental protection of the Baltic Sea. All measures have been proactive. The Helsinki Convention, or HELCOM, formed by the Baltic rim states plays a crucial role in protecting the marine environment.

In the maritime safety and security efforts and protection of the marine environment, however, the most crucial body is the International Maritime Organisation. Due to the global nature of the IMO, there is a delay in the enforcement of decisions, which to many outsides seems painful and unnecessary. After the 9/11 strikes, however, the IMO showed its ability to react fast by creating the International Ship and Port Security Code in the space of a few years. The wide-ranging obligations of this Code were implemented over a short period of time in administrations and ports as well as onboard ships.

In the EU, community legislation has invested the Commission with a strong role as a co-ordinator of the safety and security efforts. The co-ordination work of the Commission has shown to the member states that co-operation is power, and this has also been taken onboard by the governments of the member states. The co-ordination meetings have set out to seek a strong European consensus through compromises. Unfortunately, the coin also has its other side. A compromise made in the Commission's co-ordination meeting often waters down the original national proposal. The adoption of compromises based on watered-down proposals may often be difficult in the IMO, and sometimes it may even happen that elements of the original national proposal are reintroduced in the adulterated proposal by nations outside Europe. Each European proposal rejected in the IMO reduces our authority as pioneers of safe shipping and environmental protection. I find this situation worrying for Europe; Europeans cannot see that depending on the method of calculation, European shipping and influence in the IMO only represents 27-28% of the global total. If we include tonnage owned by Europeans but flagged outside Europe, the share of Europe is some 34% of the world shipping. It therefore follows that we cannot dictate the course of action to the rest of the word. Someone should analyse the situation and then decide on a European strategy and tactics in the matters of maritime safety and security and protection of the marine environment. It seems pointless to set goals if the mechanism for achieving them is not working, or at the very best it is not running on all cylinders.

On the protection of the marine environment

The spread of non-indigenous species via ballast water is a serious threat to the sensitive environment of the Baltic Sea. The entry into force of the IMO's International Ballast Water Convention would be necessary in order to stop invasions and maintain the biological integrity of our sea. The ratification of the Convention poses quite a challenge in the Baltic Sea area, however. Due to the small size of the Sea, ballast water exchange meeting the requirements of the Convention cannot be performed within the Baltic. Some methods of ballast water treatment may also be inappropriate in the Baltic because of the low salinity and the seasonally low temperatures. In addition, surveys and inspections of compliance with the provisions of the Convention may prove to be impossible, since reliable and practical methods are still to be developed. As has unfortunately been experienced in many parts of the world, the spread of non-indigenous species has the potential to cause serious, irreversible consequences to both the environment and the economy. In order to prevent such disasters in our unique sea, it is therefore imperative to rise to these challenges before it is too late. The designation of specific ballast water exchange areas should be one step further along the way. This must be done in co-operation with the North Sea countries. The other challenges will require dedication on part of governments, researchers, shipbuilders, seafarers and other stakeholders.

On the subject of ballast water, no voices have been raised in Europe about the problem caused by the ballast waters of inland waterways traffic. Inland waterway vessels travel along canals from Black Sea harbours to ports in the Baltic and the Nordic Sea and vice versa. I cannot believe that organisms carried in ballast water to another area only are a problem when transported through the sea.

While ships are sailing within SOx emission control areas (SECAs), they have to use either fuel oil, the sulphur content of which does not exceed 1.5% m/m, or an exhaust gas cleaning system to reduce the total emissions of sulphur oxides from a ship to 6.0 g /SOx/kWh or less. Waste streams from the use of such equipment may not be discharged into enclosed ports, harbours and estuaries unless it can be demonstrated that such waste streams do not have an adverse impact on the ecosystems of such enclosed areas, based upon criteria communicated by the authorities of the port State to the Organization. IMO MEPC 55 established a correspondence group to develop criteria for wash water discharges from exhaust gas SOx cleaning systems. Most members of the correspondence group agree that the two key parameters are pH values in the outlet water and oil concentration. Some members consider that also other hazardous substances like Ni, Pb, Hg, Cd and some PAH compounds should be regulated.

Paavo Wihuri

Director of Maritime Safety and Security
Finnish Maritime Administration

Trends and challenges for ports in the Baltic Sea region

by Christian Ramberg

New investments are needed in ports and in infrastructure, but investments cannot alone guarantee the balanced development of the maritime transport sector of the Baltic Sea region

The maritime transport volumes in the Baltic Sea region have grown considerably during the last ten years and will continue to do so according to recent forecasts. The growth of trade is expected to be proportionally highest in the eastern parts of the region and the analysis indicates further that the total transport operations will double within 20 years. This will of course mean that considerable investments are needed in ports and the transport infrastructure in the region. Baltic Sea routes, port facilities and hinterland connections have to be efficient, but investments alone will not be enough. In order to enhance productivity or to attract other foreign investments infrastructural costs, taxes and legislation should also be harmonized. Transport industry must moreover cooperate in a different way than before.

The growth in maritime transports in the Baltic is well known to most of us and new investments in a number of ports along the Baltic coastline are also a fact, but other things i.e. maritime policies and instruments needed to secure the sound development of the industry are perhaps not so known.

From the ports viewpoint, the key issues will be; how to maintain productivity, ensure port capacity and protect our common environment by making decisions based on the sustainable development.

At present, a broader EU Maritime Policy is being prepared in the Commission followed by a new EU Port Policy. Hopefully both will help the maritime regions as a whole.

As one member port in both Finnish Port Association and in AMRIE Port of Turku have had a chance to follow the policy work in progress for some time. According to the Commission, the Green Paper should combine the competitiveness and employment objectives of the Lisbon agenda with improving the health of the marine environment. The Green Paper puts forward several areas for discussion; sustainable maritime development, quality of life in coastal regions, ocean management tools, maritime governance and European maritime heritage and identity.

European Seaport Organization ESPO sees that seaports feature prominently in the Green Paper and are identified as key-elements in the logistics chain as well as business locations, but equally providing residential space and tourist facilities. The Green Paper further acknowledges that the growth in trade and shipping is dependent on having adequate port capacity and recognises that this need is under competition from environmental objectives.

If we look at the new Port policy paper one can easily share the view ESPO have; that sustainable development of port capacity and adequate hinterland connections is the most urgent issue that needs to be addressed. Environmental guidelines for the application of environmental legislation to port development would be a first important step to provide more legal certainty.

The Commission has also announced that it will publish a working paper on Motorways of the Sea. This document will describe the state of play for the Sea Motorways and provide an outlook for their implementation. The document will prepare the first call for project proposals which will open in December this year.

Another policy paper was also prepared in October 2005. Union of the Baltic Cities UBC Logistic Task Force presented a document with general recommendations and some practical ideas. In the UBC policy paper cities, in dealing with issues concerning maritime logistics cities should promote the harmonisation of maritime transport infrastructure and standardisation of cargo equipment to facilitate intermodal transports (e.g. standardisation of containers, port-ferry interface and ramps). Ports should support the development of port-hinterland connections and encourage public private partnerships in investments in port and port-hinterland infrastructure. And also promote the harmonisation of infrastructure costs for different kinds of transport modes and for different users in the BSR countries and promote a common approach to maritime fees and dues to create compatible operating environments. And furthermore support the enlargement and strengthening of the EU transport networks and promote cooperation and coordination between different regions in planning and developing transport infrastructure and more specifically transport corridors including new priority projects such as Motorways of the Sea.

Many of the above mentioned recommendations are evident and there should not be too many problems to make changes, but one of the problems is that things are not changing fast enough.

The Baltic Sea is an important transport corridor, but as we know, dense traffic can also generate problems. The marine environment is very sensitive and there is a growing concern about the rapidly increasing oil shipments.

But what can Ports do in order to contribute to the conservation of nature?

Ports can contribute to the development of a sustainable logistics chain, as ports are key elements of the Trans-European Network. Ports can encourage wide consultation, dialogue and cooperation between port administrations and the relevant stakeholders at local level. Ports can also generate new knowledge and technology and develop sustainable techniques which combine environmental effectiveness and cost efficiency. Furthermore ports can enhance cooperation between port administrations and facilitate the exchange of experiences and implementation of best practices to avoid unnecessary duplication and enable port administrations to share the costs of environmental solutions. This is very important, because earlier ports did not share too much information with each other.

Cooperation is also important on all levels. The market in which ports and shipping lines are operating has been substantially changed during the last two decades. To be competitive today, ports and other players in the logistic chain must cooperate and meet the demands on cost and performance by the users in a new way. Ports, Shipping lines and operators in the transport chain must work in a closer partnership relation than before to improve Cost efficiency and overall productivity. Here the port product (services offered by the logistics companies in the logistic chain together with the port) is in itself a chain of consecutive links, while the port as a whole is likewise a link in the global logistics chain. We can see this development happen in Port of Turku and in many other Baltic ports as well.

To summarise, ports like Turku and other organizations can contribute to the development of the Baltic Sea region in many ways. Just to give some examples. The City of Turku and the Port of Turku have both been active on EU level in the consultation of the EU Maritime Policy Green Paper. Furthermore, the City and Port of Turku took also part in the preparation of UBC Maritime Logistic policy. At present Port of Turku is involved in the preparation of a Motorway of the

Seas project together with the ports of Hamburg, Rostock, Stockholm, Kristiansand and Naantali. The Nordic Triangle Sea Motorway NTSM project proposal, www.ntsm.org is a good example of a successful cooperation in the logistic chain.

The concept Motorways of the Seas can in fact be a fundamental element in the great picture discussed here and at the same time a method to deal with many of the questions we are trying answer, because as a practical project NTSM covers many important things such as infrastructure investments, sustainability, intermodal transports and cooperation.

Christian Ramberg

Managing Director
Port of Turku

The changing role of the trade association

by Harry Piela

The Finnish-Lithuanian Trade Association, SuLi, has been highly active for over ten years.

In the 1990s the role of SuLi was fairly clear and there was a lot to do. Doors were opened, new channels created, enterprises were assisted and authorities "bashed". Countless seminars and round-table discussions, both in Finland and in Lithuania, were efficient instruments of change. Many company representatives received valuable help in running their business. On the other hand, members of the SuLi Executive Committee had a ringside seat at the relations between our countries, and public administration was (and is) much appreciated.

Today, everything is different. Lithuania is a member of the EU. Most of the major companies have their own offices in Vilnius or have established other channels of their own. Even tourism is on the increase. The trade association is forced to renew itself and rethink its raison d'être. Of course, some things have remained unchanged. The trade between our countries is small in comparison with, say, the trade between Finland and Estonia.

Is there a need for a trade association? If yes, why? What will be the role of SuLi?

We have discussed these issues and asked for the opinion of the members.

We compared our activities with associations which have been active for decades. Part of them has clearly focused on pleasant social events, part on influencing politics and part on consultation.

However, the members sent a clear message that the trade association is needed but that it must concentrate on promoting business. This was a good signal, and it was further emphasized by the fact that SMEs are beginning to participate more actively. Members range from private persons to Finnish subsidiaries of the world's biggest corporations. Accordingly, needs do vary.

We decided to focus on the following: assisting SMEs, creating relations with high-level decision-makers and promoting project activity. Project activity will surely soon give good results. As an example we might mention the development of collaboration between centres of excellence. The "Sunrise Valley" in Lithuania is a project which needs foreign expertise to develop. In Finland we have that expertise. What we need now is to help these parties to find each other and get things going. Even here SuLi has taken an active role in bringing the parties together.

Trade is always a two-way business; so the trade association also helps Lithuanian companies to cooperate with Finnish organizations. However, the jesting remark of a representative at a meeting – "We haven't seen many representatives of Lithuanian companies in reindeer herding areas" – reflects the need to promote business operations.

We believe that the trade relations between our countries will develop favourably. We also believe that SuLi has a place and a function in this development. Welcome along!

Harry Piela

Member of the Executive Committee
Finnish-Lithuanian Trade Association

A new mesostructure for Russian mining industry

by Veikko Kärnä

The Soviet Union collapsed in 1991, and was divided into 15 sovereign states. This event, which has been described by President Putin the biggest geopolitical tragedy of the 20th century, also changed the mesostructures of Russian Industry branches; in other words the overall governing structure of enterprises. My focus in this article is on the Russian Mining Industry, RMI, and the individual mines, which according to my research faced three transitional phases from 1990 till 2006: autonomy phase, privatization phase and consolidation phase.

The autonomy phase of transition took place from 1990 until about 1995. Starting already in Gorbachev era and continuing during Yeltsin's liberalization period the Soviet mining ministries were abolished. This era is characterized by the weak and passive ownership of the Russian state through Regional property committees. During this time the mines, who already earlier in the end of Soviet Era were working according to "khozraschet" (financial autonomy) principle received for instance the possibility to independently buy materials and equipment abroad. The policymakers expected that the mines would take the initiative into their own hands. But they didn't do that; they reacted passively, and remained faithful to the old Soviet traditions. They did not seem to use the freedom; they had received as a result of the liberalization policy of Yeltsin government. They seemed to follow a "no-change" strategy. This empirical observation was peculiar, because at the same time the Russian mines had very poor productivity compared to their peers in the West. It was apparent that they needed investments to buy modern equipment and structural changes to improve their organizations.

The privatization phase, which took place right after the autonomy phase, is the period during which the RMI's enterprises were sold by the state to its private owners. The new owners during this phase of transition could have been the management, the so called "red managers", sometimes together with the personnel, or it might have been private businessmen or privatization funds or other outside owners of the industry. As a result the government did not own the whole mining industry as it did during Soviet period, although some strategically important mining enterprises remained in governmental ownership; Alrosa diamond company and Tvel uranium company to name a few.

The third phase of transition, which can be identified as the process of consolidation, has been going on since the end of 1990s. The owners of the industry have started to advance their assets by purchasing new mining enterprises and consolidating them into their group's mining houses. As a result, the once sporadic spread of hundreds of gold, diamond, precious stones, iron ore, and coal mines in the mining sector has been consolidated and is now dominated by a dozen giant holdings, which have taken the role of previous mining ministries in the mesostructure of Russian Mining Industry.

It seems that only as a result of consolidation, a new phase in the RMI has been emerging: modernisation of the enterprises. The new owners of mining enterprises have started to invest money into their assets and some organizational changes have also happened.

Based on my research I argue that Russian Mining Industry has gone through an extraordinary transitional development, which results in the following: Firstly, the development of the RMI during the transitional period has been contradictory, and as a result there are now two approaches to mining as business: In the first approach mining is regarded as an intracompany source of raw materials for the group's own factories. The mines are located lowest on the production chain, which aims to the production of finished products, not raw material.

Another approach of the RMI is to have mining as an independent raw materials or commodity trade business. The mining companies trade only with their own raw materials selling them to processing plants, which are owned by separate business groups.

Secondly, power has returned back to the centre, to Moscow. Before the transitional period of Russian Mining Industry there were six mining ministries, which were monopolies. After 15 years of transition, the previously autonomic and then private mines in the Russian periphery are now parts of about a dozen Moscow based oligarchic mining conglomerates, which have taken the role of earlier branch ministries. The autonomy of mines has been liquidated, and the mines are now almost in the same position, in which they were before the liberalization. Their independent decision making has been reduced to bare minimum.

Thirdly, old Soviet structures have reappeared. Mainly, this concerns the vertical integration, which is evident in the mining companies of RMI, in which mining is regarded to be the intracompany source for raw materials and mines, processing plants and smeltries form vertically integrated business structures.

Furthermore, a special Russian type of governing the enterprises has been born: so called management companies are typically in charge of the business activities of the mines. These management companies do not own the mines they are running, the mines can be owned by offshore companies, but the owners of the mines have authorized the management company to run the business activities on their behalf. This type of corporate governance appeared together with the Yukos case, and can be regarded as the owners' attempt to avoid confiscation by the government. The whole responsibility of non-paid taxes would be on the management companies, and would they be bankrupted the original offshore owners could keep their assets.

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Corporate governance in Estonia: Intact despite 2007 amendment to Commercial Code

by John JA Burke

The Baltic Times in its 22-28 February 2007 edition published an article entitled "Experts: Estonia to become haven for shady corporations". The charge of attracting disreputable corporations purportedly would result from an amendment to Estonian law relaxing director liability, protecting any decision made in "good faith". Statements from local experts support the stories' spin. The publication and its expert commentary imply that Estonia has reached the bottom of the regulatory arbitrage barrel symbolised by Delaware Corporate Law. That implication does not withstand legal analysis and misrepresents the law of Delaware.

The publication states, "Under the changes, which will come into effect in March [2007, authors' addition], directors and board members cannot be prosecuted if their decisions were made in good faith". The Justice Minister is quoted as saying "the new corporate law was copied from the U.S. state of Delaware and was designed to attract more investment to Estonia". The sweeping statement follows: "Delaware is well known for its lax corporate laws, which allow company directors to absolve themselves of liability for any decisions, including those that adversely affect stock prices or even consumers."

An expert, the Vice-Dean of Business at International University Audentes, claims, "Delaware law brings Estonia into conflict with the European Commission." He elaborates, "Such laws allow boards to remove themselves of any sort of liability. They can hide behind the law in terms of product safety and fiducial (sic) responsibility." The Vice-Dean cites Enron and Worldcom in support of his views, and concludes: "Any place that has this law will be a major attraction, particularly for companies dealing with a product that has the potential to cause harm." Expert practitioners and statements from a Ministry of Justice spokesman fail to add any clarity.

The Delaware legislature adopted Article 102(b)(7) in response to the decision in *Smith v. Van Gorkom* that cracked the citadel of the "business judgment rule" under which directors were liable to shareholders under a theory of breach of due care only in extreme cases of managerial incompetence. The court in *Van Gorkom* required directors to actively acquire information to produce the best premiums for shareholders in connection with a sale of the company. The decision was regarded as applying a full-blooded version of the duty of care and was perceived as a threat to Delaware's reputation as the state of choice of incorporation.

Nevertheless, jurisprudence subsequent to *Van Gorkom*, has developed new doctrines to assess director liability given the diminishment of the duty of care standard. These standards often referred to as enhanced scrutiny for transactional duties are exemplified in decisions such as *Unocal Corp. v. Mesa Petroleum* [formulating standard of review, existing between business judgement rule and entire fairness rule, for action taken to respond to threat of corporate control], *Revlon v. MacAndrews & Forbes Holding, Inc*. [requiring directors to maximize company's value for sale over preservation of corporate entity when sale is a virtual certainty], and *In Re Caremark International, Inc.* [stretching duty of care to include a requirement that directors assure an adequate reporting system of information].

This trend continues unabated, addressing recent events, such as backdating options [*Ryan v. Gifford*, finding that when directors backdate options they cannot meet the business judgment rule test thereby exposing them to director liability], and [*In Re Tyson Foods, Inc. Consol. S'holder Litig*, finding that where directors "spring-loaded" options, that is, timed them to take advantage of non-public, material information when granted potentially constitutes a breach of the duty of loyalty, given sufficient proof.

The Baltic Times' claims disintegrate before the facts. Estonia is not analogous to Delaware. The two regimes are the product of entirely different legal traditions, though Estonia may have "sampled" a Delaware provision. It is beyond dispute that Delaware has a court system and jurisprudence on corporate law that is pre-eminent in the world. The same cannot be said for Estonia. In addition, given Delaware's sophisticated jurisprudence, as well as federal and state law applicable to company activity, it is impossible to reduce to a single axiom the scope of director liability.

Consequently, the bald assertion that "Such laws [apparently Article 105(b)(7)] allow boards to remove themselves of any sort of liability" is false. Moreover, the subsequent assertion that "They [directors] can hide behind the law in terms of product safety and fiducial (sic) responsibility … as long as their decisions were in good faith" is first difficult to interpret as Delaware litigation arises in the context of derivative shareholder suits. Product safety claims would come into play directly only if the company first were found to have violated a law and was ordered to pay damages. Under this scenario, a shareholder filing a derivative lawsuit would have to show oversight failure, a standard that if met exposes directors to potential liability. If the company intentionally violated the law, Article 105(b)(7) provides no protection.

Whether the Estonian amendment contravenes EU policy is a premature question as first the EU has not provided a definitive stance on the issue, and second, legal progress in this area moves with extreme caution. For the record, Enron was incorporated in Oregon and Worldcom was incorporated in Georgia.

More important, legal rules do not solve corporate control problems. It is shareholders that must undertake active roles in selecting directors and voting on management and company issues. This tactic is difficult but not impossible to achieve. In the United States, for example, minority shareholders have managed to place propositions on proxy statements to protect their interests. Even if these propositions fail to pass due to a lack of adequate votes, the fact that some propositions have generated substantial shareholder support sends a clear message to directors and officers: shareholders are watching, ready to act, and intolerant of abuse of authority.

John JA Burke

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Patience is a virtue in EU-Russia relations

by Olli Rehn

Since the 2004 enlargement, the Baltic Sea cooperation is developed more and more in the context of the EU-Russia relations. This provides good basis for further development and deepening of the cooperation. But at the same token, these relations are also burdened by the overall situation in the EU-Russia relations.

The European Union is ready for closer partnership with Russia, once Russia is also ready for that. This would be for our mutual benefit. There is a positive interdependence between the EU and Russia. What is now needed is a willingness to solve common problems in a business-like manner without politicising them unnecessarily.

In its internal dealings the EU bases itself on the principle of the rule of law and in its external relations on the principle that "might is not always right". This is why the EU endeavours to resolve conflicts on the basis of facts and in line with the international law.

At the EU-Russia relations, the EU has shown strong solidarity with its individual Member States. EU's solidarity is demonstrated, for example, in the case of Finland, where the EU defends Finland's legitimate interests in the dispute over export duties on roundwood; and for Estonia in the case of removal of the war monument. Solidarity between the 27 member states is not an empty word but one of the basic values of the EU.

Reasonable and realistic cooperation

The relationship between the EU and Russia is marked by strong interdependence. Since 2000, EU exports to Russia have tripled and over the same period EU imports from Russia have doubled. This positive development has benefited in particular the states and businesses around the Baltic Sea. It has made this region a centre of economic growth, trade and investments. There is a great potential in the Baltic Sea area which can be materialised even further.

The interdependence is seen in the energy relations. Europe will remain dependent on Russian fossil energy for many years, even though it is trying to improve its self-sufficiency and create new import routes through South-East Europe. Russia needs EU's energy demand and market. Russia is also dependent on EU technology and business, without which it will not be able to reform its economy.

The interdependence between the EU and Russian can create the basis for reasonable and realistic cooperation, and we should build on this.

An EU – Russia cooperation agreement based on shared interests is in the long term just as important for the EU as it is for Russia. The EU is trying to achieve a comprehensive and legally binding agreement with Russia that builds on the previous arrangements and extends to issues like energy.

The same drive towards common rules applies also to Russia's membership of the World Trade Organisation. The EU supports this objective. Efforts are under way to conclude the negotiations still this year. The opening-up that the WTO membership will bring supports the competitiveness and diversification of Russia's economy. It would be in EU's and Russia's interest to adopt the rules of the game and improve predictability in our trade relations.

Even if the EU – Russia relations have hit a sticky patch, it has been important to keep the EU-Russia dialogue alive and channels of communication open.

There have been some positive steps in 2007. People-to-people contacts between EU and Russian citizens became easier as the visa facilitation agreement entered into force at the beginning of June. This benefits most the people and business contacts in border regions and facilitates further also the Baltic Sea cooperation.

There have also been positive developments in the policy of the Northern Dimension which has offered a good and solid framework for the EU-Russia cooperation in the Baltic Sea region. In the EU-Russia Summit in 2006, during the Finnish Presidency, the Northern Dimension entered a new phase when it became a common policy between the EU, Russia, Norway and Island. Russia and President Putin committed to develop common policy for North-West Russia. President Putin, coming from St Petersburg, understood the possibilities offered by closer political cooperation and economic development in the Baltic Sea.

In the future, we need to develop the economic potential and tackle ecological concerns in the Baltic Sea region. The strategic importance of the Baltic Sea will increase as it is becoming an important hub for energy transports.

New challenges ahead

Russia is going through a phase of political transformation. As regards domestic politics, the elections to the Duma will take place in December and the presidential elections next spring. There is speculation regarding Putin's role after his presidential term and who will be his successor. The uncertainty in domestic politics is manifesting itself in a hardened foreign policy. One example of this is Russia's position on the future status of Kosovo which is discussed in the UN Security Council.

Stand firm, stand united

The EU's relationship with Russia is at times something of an acid test for the EU (and sometimes a bit of a headache too), but it is also a great opportunity.

I do not believe that trading insults or cutting off dialogue would produce any results. Megaphone diplomacy rarely bears any fruit. At the same time, I do not believe that an over-flexible policy of appeasement would produce anything positive either.

What is needed is for the EU to speak with one voice, also about difficult issues, and commit itself to long-term cooperation with Russia. This should be based on a realistic assessment of the situation. There will be times when our patience will be tried, but those are precisely the times when it is most needed. Now is not the time to lose our patience.

Olli Rehn

Member of
the European Commission

The future of Estonian economy and economic policy

by Juhan Parts

When I took the office of Minister for Economic Affairs and Communications in April this year, some people were joking that they envy me, because our economy is doing well and my task would be fairly easy, as the main challenge would be finding a comfortable chair to sit in and marvel the growth curve. On one hand, of course there are reasons for complacency – economic growth of 11,4% in 2006 and average growth of 9% during 2001-2006 or unemployment falling to 5,9% by the end of 2006 which is lowest in many years – are all nice numbers. But on the other hand, such a starting point puts high pressure on new government to find and implement policies to keep this "Baltic tiger" running and avoid over-heating.

The success of Estonia has been built upon hard work, smart policies and good neighbours. One of my priorities will be keeping and developing our open, simple and transparent business environment. Estonian liberal economic policy has resulted, and for good reasons I think, in high rankings in various indices – 12th in economic freedom ranking, 17th in "Doing business" report to name but few. Openness in terms of trade and investment has brought along the highest level of FDI inflow per capita (7985 EUR as of end of 2005) in Central and Eastern Europe. Rapid capital inflow has been accompanied by considerable technology and skills transfer. Importantly, FDI has also contributed to strong integration into Nordic and Baltic value-chains, as more than 80% of all FDI has come from this region.

Openness alone is not enough; attractive business environment must also be simple. That is why Estonian Government is committed to continue with 0% tax rate on reinvested profits, which has clearly helped companies in developing and expanding their businesses. In the face of labour shortage, that we are now experiencing, we are planning to bring more flexibility into employment contracts act. I believe that in rapidly developing economy like Estonia, it is needed to make hiring easier, encourage more efficient use of part-time working, but also make it easier to fire or lay off people in sectors or companies that cannot keep up with fast changes.

Simplicity is not only about legal framework, but also having supportive e-solutions. Estonia's e-tax board (86% of income taxes for 2006 were declared online), e-voting (1st parliamentary e-lections in the world in March 2007) are rather well-known by now. Since late 2006, it is also possible to found and register a company online in only 2 hours. We have realised that economic policy is increasingly also becoming IT policy – that is why we also push ahead with new for e-invoicing and e-procurement solutions that will cut administrative cost for both public and private sector.

Another area where Estonia needs to simplify legal environment, is saving and investment of private actors. Rapid rise of salaries (real wage growth 10,9% in 2006) and favorable credit situation have led to strong growth of domestic demand (real growth 15,1%), which gave impetus to rising inflation (4,4%) and also contributed to worsening of current account deficit (-14% of GDP by end of 2006). That is why we need to give better incentives and legal opportunities for private persons to invest, instead of fuelling already buoyant domestic demand.

The third pillar of business environment – transparency – needs also attention. Despite positioning as the least corrupt Central Eastern European country (24th in Transparency International ranking), we are still lagging behind our Nordic neighbors who all are in top ten of least corrupt countries. Therefore Estonia needs to renew its anti-corruption strategy. Transparency means also stronger competition and functioning of internal market. We are currently working on wider usage of leniency program, to give incentives for co-operation with our competition authorities.

Most of the policy measures that I have described so far clearly support entrepreneurship and investment. But in order to stimulate the emergence and growth of smart and dynamic companies who could compete on global markets and to help transforming Estonian economy into a knowledge-based one, we need sophisticated micro not macro policies. Government program sets a target to increase R&D investments to 2% of GDP by 2011 and 3% by 2015. One of the major new initiatives is Estonian Development Fund that starts to invest into pre-seed and seed phase of innovative technology-based start-ups to have more the likes of Skype. We will also invest more into our Competence Centers which are linking our best people from university and industry in key areas. We will also introduce a new measure to support the mobility of highly skilled international innovation specialists to bring in extra competence. All these and other micro level policies that we have in place will help to change old business models, create new co-operation and market opportunities and very importantly also attract more knowledge-intensive FDI.

n terms of cooperation in the Baltic Sea region, I am confident that Nordic countries and Estonia will continue to have intense economic cooperation. The challenge is to climb up the value-added ladder so that in the future we have partnership in more sophisticated areas, bringing thus higher returns to all.

Juhan Parts

Minister of Economic Affairs and Communications,

Estonia

The role of Belarus in the Baltic Sea Region

by Andrei Yeudachenka

The region of the Baltic Sea in a broader meaning can be defined as the territory of its water basin area – thus including a significant part of Belarus with major rivers the Nioman (Niamunas) and the Zahodniaja Dzvina (Daugava). A specific character of the Belarusian geographical relation to the Baltic Sea region is that the country's com-pact territory is located on the watershed of the Baltic Sea and the Black Sea making it in a natural way possible to link the two huge areas.

With regard to this transit location Belarus is responsible for a significant part of goods, service, information and migration flows both in east-west and north-south directions. This is relevant for mutual relations of Belarus with the other Baltic Sea nations as well as in a wider perspective considering various cooperation possibilities between different European regions like, for instance, the EU and the CIS or the Council of the Baltic Sea States and the Black Sea Economic Cooperation.

Geographical proximity of Belarus to the Baltic Sea as well as the well-developed transport infrastructure and trade advantages of the region increase the role of the Baltic Sea for Belarusian large-scale exports – as well as imports, which, in its turn, benefits to the development of the sea-ports of Lithuania and Latvia. This is also the case concerning the transit role of Belarus for Ukrainian and Russian exports/imports in the northwest direction.

Particular attention should be paid to energy flows and concerns in the region. Belarus hosts important transit pipeline routes both for oil and natural gas thereby supplying the energy resources to the other states of the Baltic Sea region. Moreover, there is evident interdependence between Belarus and the neighbouring Baltic Sea states as far as energy shipments, production, exports and consumption are concerned when it comes to the available energy infrastructure in the countries in question. As most of the Baltic Sea states – including Belarus - are net importers of energy resources it is essential to jointly ensure secure energy deliveries in the region. This issue becomes especially important in relation to the diversification of delivery routes for energy resources in this part of Europe and construction of new ones like, for instance, the North-European Gas Pipeline Nord Stream, which decreases the role and possibilities of the Baltic Sea region transit states as well as may have an impact on the regional environment.

The EU-enlargement of 2004 shaped a new political reality in the region, making the Belarusian border in the west and northwest the common EU-border. This has increased the significance of promoting cooperation vs. creating new dividing lines in Europe. In this regard an important instrument is the European Neighbourhood Policy that includes all the adjacent states. In turn, Belarus has declared the importance of good neighbourly relations with the bordering countries contributing to mutual cooperation, confidence and security in the region.

Migration issues are closely related to cross-border cooperation. In coordination with the other countries of the Baltic Sea region Belarus has consistently worked on fighting illegal migration, trafficking and organized crime favouring the development of the regional stability and security.

Environmental security is a common concern of the Baltic Sea states and is characterized by mutual dependence. Belarus as well as other countries in the region bears the responsibility of environmental protection, as its watercourses can be a source of influence. All exchange of information and experience in the field of environment is welcomed, not least regarding energy transportation and production. Having suffered from the Chernobyl disaster Belarus is anxious about safety of nuclear energy production and waste storage both within the country and in its neighbourhood.

Belarus pays much attention to the development of cross-border cooperation with the other Baltic Sea states, in particular by creation of cross-border regions of cooperation such as "The Region of Baltic States" Neighbourhood Programme of the European Commission. These entities play an important role in resolving a wide range of problems of mutual interest as well as in promotion of cooperation between the Baltic Sea countries and sub-regions.

It is worth underlining that as a part of the Baltic Sea region Belarus serves the purpose of being a transit link to and from the region in relation to other parts of Europe. For development of both the country and the region it is important to make use of the existing potential that not only comes from Belarus' geographical location, but also from historical experience and opportunities offered by the available infrastructure. Political implications should also be taken into account when it comes to creating the basis for cooperation with mutual benefit as well as for resolving problems of common interest, such as, for instance, environment protection or migration where joint actions are needed.

Andrei Yeudachenka

Deputy Minister of Foreign Affairs of the Republic of Belarus

Russian-Finnish neighbouring area cooperation

by Alexander Rumyantsev

In January 2007, fifteen years had passed since Russia and Finland concluded the intergovernmental agreement on cooperation in the neighbouring areas. During that time, the unique mechanism of direct collaboration between Finland and the four subjects of the Russian Federation that are adjacent to the Russian-Finnish state border - the City of St. Petersburg, the Republic of Karelia, the Leningrad Region and the Murmansk Region - has convincingly proved its indisputable significance in strengthening neighbourly relations between our states. Contacts between neighbouring areas form a harmonious part of the many-sided complex of Russian-Finnish partnership, covering practically all spheres of life in the neighbouring areas – environmental protection, the sector of transport and communications, customs cooperation, improvement of border infrastructure, development of the social sphere and health care, agriculture and forestry, power industry, promotion of the development of business activity, combating cross-border crime, strengthening democratic institutions. The results of this collaboration are weighty and visible on both sides of our more than 1200 kilometre-long border: hundreds of successfully implemented projects, thousands of jobs created thanks to contacts between neighbouring areas, tens of thousands of partnership contacts forged between Russian and Finnish private persons, companies, power structures, and non-governmental organisations.

During the last fifteen years, implementation of the bilateral Russian-Finnish agreement has not only promoted favourable socio-economic development of our states and improved the quality of life of our citizens living in neighbouring areas. One of its merits is also that collaboration with Finnish partners within the framework of the mechanisms established by the Agreement – the Intergovernmental Group on Neighbouring Area Cooperation, coordinated by the Russian and Finnish ministries for foreign affairs, and its territorial subgroups – has paved the way for the North-West Russian regions' closer ties to international economic cooperation, and on the whole promoted increasing positive interdependence and strengthening stability throughout the North of Europe. Today, neighbouring area cooperation between Russia and Finland has long ago expanded beyond the boundaries of the bilateral format and, combined with wide-ranging collaboration within such regional forums as the Barents Euro-Arctic Council and the Council of the Baltic Sea States, is becoming an integral part of the network of transnational contacts in the North of Europe.

It is quite natural that the evolution of the Russian-Finnish neighbouring area cooperation cannot be considered detached from the intensification of strategic partnership between Russia and the European Union. Moreover, the interregional and the transnational factor play today an active role in forming the four Common Spaces of Russia and the EU. In this context, the fifteen-year experience of Russian-Finnish neighbouring area cooperation has proved to be very useful in the construction of the neighbouring-area component in the Russia-EU relations. Based on this experience were jointly compiled and approved within the framework of the European neighbourhood and partnership instrument the new transnational programmes, the implementation of which is expected to start in 2008.

By the Russian-Finnish border, three European transnational programmes will be in effect: "Kolarctic" (in which Sweden and Norway also take part), "Euregio Karelia" and "South-East Finland – Russia". It is gratifying that they have managed to "absorb" all that is positive in the accomplishments of the Russian-Finnish neighbouring area cooperation. The new programmes reflect the aspiration of the regions involved in neighbouring area cooperation to perform this work on the basis of the principle of equal partnership.

Founded on the same principle is also the policy of Northern Dimension, to which a new impulse was given by the leaders of Russia, the European Union, Iceland and Norway in Helsinki in November 2006. The philosophy of the partners' equal participation in making and implementing decisions, as well as of equal financing of the coordinated projects was unanimously supported by the participants of the Northern Dimension, which is in fact becoming regional implementation of the "roadmaps" for the Common Spaces of Russia and the European Union.

Today, 15 years since the day when the Russian-Finnish agreement on neighbouring area cooperation was signed, neighbouring area collaboration between our two countries is in a responsible, challenging and busy stage of adaptation to the new forms of regional cooperation in the North of Europe. But its essence remains unchanged – to promote complex economic and social development of the border areas of our states, to improve the quality of life of people on both sides of the common border. Our common task is to construct a comprehensive and correct model for further collaboration, in order to avoid competition between different formats and to take maximum advantage of the synergetic effect of their mutual supplementation. This will obviously be the key theme in the following, twelfth in succession, session of the Intergovernmental Group on Neighbouring Area Co-operation, which is scheduled for this year in Helsinki.

Alexander Rumyantsev

Ambassador of Russia to Finland

4 times Chernobyl on the shorelines of the Baltic Sea

by Satu Hassi

4 copies of the Chernobyl reactors in Sosnovy Bor

"An elephant in the living room" is a problem, which everyone in the family knows and is stressed by, but which is rarely mentioned, e.g. the alcoholism of one of the parents. The elephant in the living room of people around the Baltic Sea is the nuclear power station in a small town called Sosnovy Bor. It is the biggest security risk for people living in that region, especially in St Petersburg, Southern Finland and Estonia.

In Soviet time Sosnovy Bor was a closed city, because it was built only for nuclear installations. You still need a special permit to enter the city. It is located on the southern shore of Gulf of Finland, 70 km west of St Petersburg, 200 km of both Tallinn and Helsinki. What makes Sosnovy Bor nuclear power plant very special, is the fact that the 4 reactors there with 1000 MW capacity each, are of the same basic design as the reactors in the infamous Chernobyl nuclear power plant.

The RBMK reactor design was originally created for military purposes. For several reasons it is especially dangerous. First, there is graphite inside of the reactor. Graphite is used as moderator, to slow down the speed of the neutrons. Second, the fission process is more unstable than in the more common water-moderated reactors. What happened in Chernobyl was that the nuclear chain reaction went unstable; it started to speed up itself, leading to very rapid heating of the reactor. This led to an explosion, which broke the pressure vessel. Thereafter the hot graphite was contacted by air, and started to burn. The fire was extinguished only when there was no more graphite in the reactor.

Because there was no containment, which was the norm in Soviet Union, the smoke of this huge fire spread around, contaminating vast areas. More than half of the radioactive fallout went outside that time Soviet Union, mainly in Europe. But radioactive isotopes from Chernobyl can be traced as far as in Japan.

There are also no containments around the reactors in Sosnovy Bor.

In the early 1990ies international co-operation was started in order to improve the safety of the reactors in Sosnovy Bor. The instrumentation of the plant was modernized with money from west, the staff was re-educated and fire preparedness was improved. Finland is still every year funding projects to improve the safety of the reactors. The Finnish radiation and nuclear safety authority, STUK, visit Sosnovy Bor regularly.

All RBMK reactors should be closed

But the basic problem, the fact that there is graphite inside of the RMBK-type reactors, cannot be changed afterwards. Therefore, all reactors of this type should be closed urgently. For example a precondition of the EU membership of Lithuania was the closing of the RBMK-type nuclear power station in Ignalina. The EU Commission has several times stated that also the RBMK type reactors in Sosnovy Bor should be closed.

The original 30 years operating permit of the oldest reactor block expired in 2003. The Russian nuclear authority extended the permit by 15 years. The same process is going on with the block nr 2. The permits of the reactor blocks 3 and 4 will expire in next decade.

I was the Finnish minister for environment in 1999-2003. During that time I discussed a couple of times the situation of Sosnovy Bor with representatives of the Russian atomic energy ministry. They simply stated that the reactors meet Western safety standards, after the internationally financed improvements. This is simply not true. According to Bellona, a Norwegian environmental organization, and Zeleny Mir (Green World), a Russian environmental NGO, the renovation which was done in the reactor block nr 1 before the lifetime extension, only upgraded the reactor to present Russian standards. This means that the other reactors do not even meet present day Russian nuclear safety norms.

What instead?

If the reactors in Sosnovy Bor would be closed, how to find alternative sources of electricity? Personally I think that the best alternative is "negawatts", energy savings, or energy efficiency. In early 2000ies the statistics of Russia and EU showed that to produce a GDP of 1 million Euros, Russia consumed more than 10 times the energy needed by EU-15 countries to produce an output of the same economic value. This can be traced back to Soviet time, when the price of energy in domestic market was almost nonexistent. Still, the price of energy is artificially low in the Russian domestic market. In the 1990ies the German Öko-Institute estimated that the energy efficiency potential in Northwestern Russia is so huge that all Soviet type nuclear reactors in that region could be closed without any economic loss. Much has changed since that, but I am convinced that there is still a huge potential of very cost efficient energy savings, given the fact that the world market price of energy has gone up in recent years.

The Russians are planning to gradually replace the reactors in Sosnovy Bor by four water moderated VVER-1000 reactors. The problem of this plan is that the opinion of neighbors has not been asked. This reactor does so far exist only on the drawing board.

In all countries constructing nuclear power stations or planning to do so, the people involved assure that in our country this is safe. But almost all nuclear power stations are very close to the borderlines. The Espoo Convention on international environment impact assessment came into force in 1997. It lays down a general obligation of countries to notify and consult each others on all major projects under consideration that are likely to have significant environmental impact across the borders. Russia has not consulted Finland and Estonia on the plan to build new reactors close to the capitals of both countries. Russia has not ratified the Espoo Convention and says that therefore it is not obliged to do this. But Russians themselves have demanded an international environmental impact assessment on some projects planned on the Finnish side of the Finnish-Russian border. I think that they should follow the same procedure with the projects on their side.

Estonia joined EU in 2004. The Finnish-Russian and Estonian-Russian borderlines are now also borders between EU and Russia. To improve the safety of the whole Baltic Sea region Finland and Estonia, together with the EU Commissions, should intensify efforts to first close down the Chernobyl type reactors in Sosnovy Bor, and secondly to create funding for alternative, non-nuclear investments, which would save the same amount of energy, and/or replace it with less dangerous energy forms.

Satu Hassi

Member of the European Parliament

Metropolitan centres of the Baltic Region

by Kurt Bodewig

The Baltic Region is an exciting, interesting region in which we can observe the rapid development of a number of metropolitan regions. These metropolitan regions can look forward to a very promising future as far as their economic and social development is concerned. Researchers are already reporting a new trend for populations to move back into urban areas. The density of settlement in a city has many advantages – the trips people make tend to be shorter, amenities can be reached more easily and, above all, facilities are close at hand. These advantages are also driving the formation of larger metropolitan regions.

The fastest growing metropolitan region in Europe is Helsinki. In fact, hardly any other city has such a high proportion of graduates in its population as Helsinki. Central to this is the capital's university, which includes the famous Otaniemi Campus – Northern Europe's biggest high-tech centre. When the Helsinki region was picked out as one of the most innovative in Europe, the European Union justified this accolade by pointing to the many innovative new high-tech firms that have been set up there, particularly on the Otaniemi Science Park.

It is very clear that Helsinki is putting its faith in education and high-tech industries, and is building this sector up as one in which the region specialises. This specialisation is also "spilling over" to Estonia – Tallinn has the biggest university of technology in the country with more than 10,000 students and 1,000 employees working in research and development. One third of the country's gross domestic product is generated in Tallinn, and it is where most Estonian and foreign companies have established themselves. A good example in the neighbourhood encourages others to follow its lead. In the mean time, people are talking of a single region called "Talsinki". Admittedly, the two capitals are connected by several daily ferry services and there is close cooperation between the cities' universities and administrations. But the differences are evident – Tallinn still needs time to reach the same level as Helsinki, while the absence of a land link, the lack of a common labour market and the fact that they use different currencies make it more difficult for them to grow together. As a prospect for the future, triangular cooperative arrangements with St. Petersburg could well be of interest.

The twinned cities of St. Petersburg and Hamburg are both ports with favourable geographical situations. St. Petersburg's proximity to Western Europe's transport systems – it is about 200 km from Finland and the EU's external border –, its port on the Baltic Sea and its relatively convenient rail, road and waterway connections to Russia's industrial centres, are important locational factors that make the city a transport node of national importance. At the other end of the Baltic Sea, Hamburg has always been a meeting point for worldwide trade flows and transport routes. Furthermore, in recent times the Port of Hamburg has expanded into one of the biggest transhipment centres for the Baltic Region.

The trading metropolis of Hamburg lies at the intersection of significant trans-European transport axes, which link Scandinavia with Western and Southern Europe. They create close links between this metropolitan region and Berlin as well as Central and Eastern Europe. Through targeted incentives for the aviation industry and companies specialising in environmental technology, Hamburg has built up a distinctive skills base and come to occupy an outstanding position among the Baltic metropolitan centres.

As a metropolitan region with 4.5 million inhabitants, St. Petersburg is truly flourishing at the moment. Events like the city's 300th anniversary (2003) and the G8 summit last year (2006) have brought a breath of fresh new air to the city itself – a great deal of renovation work has been done and St. Petersburg now has a special atmosphere that makes it quite unique – people who know the place intimately call it the "Petersburg metaphysics". By 2012, a business quarter with total floorspace of 150,000 square metres is to be created at the heart of St. Petersburg – just one example that illustrates how dynamically the city is developing. Further major investment projects are being planned or realised at the port – including a coal loading facility and two oil terminals.

Another metropolitan region on the Baltic Sea has grown up along the Øresund, with its centres at Copenhagen and Malmö. Overall, 20% of Denmark and Sweden's gross domestic product is generated in this area. The boom was made possible by the construction of the Øresund Bridge and its opening in 2000. Universities and their close ties to the economy are playing a fundamental role in Øresund, where the emphasis is on biotechnology. In total, about 330 biotech companies are based in the region, and the sector's annual growth rate is estimated at between ten and twenty percent.

Nor should we overlook the concentrations of activity at Riga, Stockholm and the Polish Tri-City conurbation of Gdansk, Sopot and Gdynia, which have smaller populations, but are just as economically, culturally and politically vigorous.

Specialisation and innovation have now become essential to the success of any metropolitan centre. Progress in these respects can be achieved through creative approaches to the development of new technologies and knowledge transfers. It is true that people tend to describe an administrative unit of between 500,000 and 1 million inhabitants or more as a metropolitan region, but any area that wants to establish itself as a player in our globalised world needs to grow a little more or concentrate on specific activities – which is exactly what the cross-border metropolitan regions of Copenhagen/Malmö and Helsinki/Tallinn have done. Smaller metropolitan centres also have to pursue the correct marketing strategy if they are to make a name for themselves and attract investors. And they need the right infrastructure: it is therefore not just economic strength that is important to the development of a metropolitan region. A metropolitan region must exert a strong appeal and send out signals that make people far away sit up and think. Cities have to offer their citizens a stimulating environment and also draw European and international attention with events, trade fairs and congresses.

The formation of large metropolitan regions is a trend not completely without its dangers. When a region specialises and concentrates on a single sector, this always involves a certain risk of failure. There is also the threat of rural regions becoming impoverished in terms of "know-how" and resources. Metropolitan regions are the key to economic success and should be strengthened accordingly, but at the same time rural areas should be protected from decline and unmanaged out-migration.

The Baltic Sea has been and remains a permanent uniting factor in the relations between the neighbours along its coasts. Water does not divide people, but brings them together. It is a great enrichment for all concerned to learn from one another, cooperate, study positive experiences and absorb the lessons of each other's mistakes. Only if we work together, both in regional and national contexts, will we be able to make the most of the chances we get and so hold our own in global competition. The "Metropolitan Areas" project

has seen several metropolitan centres in the Baltic Region join forces to exchange information and discuss their experiences of the development of polycentric structures in metropolitan regions, put in place a framework for decentralised concentration, open up opportunities to drive this process forward and draw up strategies for sustainable development. The members of this project include the following metropolitan centres, along with the areas that surround them: St. Petersburg (Russia), Stockholm (Sweden), Oslo (Norway), Vilnius (Lithuania), Warsaw (Poland) and Berlin (Germany).

Our metropolitan centres are having to cope with a continual process of transformation. Yet, despite their many similarities, these cities have retained their individuality. If you were to look down on Europe from outer space at night, you would see these metropolitan centres standing out as big glowing points that form a chain of lights around the Baltic Sea. All of them glow brightly, but each city has its own individual attraction and beauty.

Kurt Bodewig

Member of the German Bundestag,

Chairman of the Baltic Sea Forum

Helsinki and regional challenges in the Baltic Sea Region

by Jussi Pajunen

The Baltic Sea region is an area of cooperation of special importance for Helsinki, and in the future perhaps the most important field of activity. Even now, a significant proportion of the activity and turnover of Helsinki businesses comes from the region – the economic and labour growth is increasingly based upon free movement across borders. One can say that Helsinki is returning to its roots. Indeed, the city itself was founded specifically for Baltic Sea region trade. Using modern day terms, when establishing Helsinki, King Gustav Vasa utilized urban policy as a tool for strengthening the State of Sweden and for spreading its sphere of influence.

Today's governments should also consider this. Why are national urban policy, EU urban policy and international regional policy in their own, separate operational fields? In particular, maintaining a strict separation in regional cooperation for the Baltic region at state, regional and city level, and also the separation of foreign and domestic policy at each level in organizations and discussions, is increasingly becoming a barrier to cooperation. The real integration of the Baltic Sea region can only progress when these border fences are surmounted.

Swedish Foreign Minister Carl Bildt has proposed that the CBSS (the Council of the Baltic Sea States), one of the most important forums for cooperation between the Baltic Sea states, should develop as a forum for dialogue and cooperation between the EU countries and Russia, and that it should concentrate on issues that directly affect the citizens. He also emphasized the importance of the regional dimension for solving common problems. The proposal is excellent, but it requires governments to undertake activity that is more purposeful and flexible than at present in order to involve actors at local and regional level.

In this matter, the existing networks for cooperation between the cities, Baltic Metropoles (BaltMet) and the Union of Baltic Cities could be part of the solution as to how cooperation between the countries and between the cities could, within the framework of the CBSS, direct and develop cooperation expressly for concrete issues that directly affect people. Such partnerships are already being developed through the Baltic Development Forum, which promotes the competitiveness and profile of business in the region, and in the BaltMet network of large cities.

The Baltic Sea is often referred to as the EU's inland sea. However, this does not indicate that the region is also of critical importance to Russia, most of whose foreign trade is transported via the Baltic. Moreover, the fastest growing centre of this so-called inland sea is Russia's second capital, St Petersburg. The Baltic Sea must therefore be seen above all as a sea shared by the EU and Russia.

Referring to it as an EU inland sea may even be misleading. The coherence of the Baltic Sea economic area, if one can still even talk of such a thing, should be approached from this perspective. Indeed, the whole spectrum or organizations that can be found in Europe (EU, EEA, NATO, CIS, EMU, Schengen) are represented in the Baltic Sea region.

There are also major domestic issues in the regional development of the region, which are of vital importance to Helsinki. In terms of the current challenges where cooperation is needed, three matters stand out above all others: logistics, population decrease, and the state of the Baltic Sea environment.

In spite of all the globalisation and the development of the information society, logistics and transport connections continue to be of vital importance for the cities. Within the framework of the BaltMet cooperation, we are involved with other cities in organizing discussions and forming a common viewpoint on the development of a transport infrastructure for the Baltic region.

The EU's TEN-T project, Rail Baltica, a railway connection from Tallinn to Warsaw, is a key project supported by all the capital cities as well as St Petersburg. The cities believe that the extension of this railway northwards to St Petersburg, and westwards to Berlin, might also improve the profitability of this project. Research into the feasibility of a tunnel under the Gulf of Finland has also been put forward. The present Rail Baltica traffic predictions do not include the flow of goods from Finnish foreign trade.

In thirteen years' time Finland will have the second oldest population in Europe after Italy. The change in the population structure of Finland will be a major challenge for us far into the future. The need for services will increase, and the number of workers that can produce these will decrease. The situation is almost equally challenging in the other cities in the Baltic Sea region. We can find a solution to this problem by making the production of these services more efficient and by attracting labour from abroad.

Although there is beginning to be a shortage of labour almost everywhere, it is in our common interest to increase the mobility of labour in the Baltic Sea region by removing barriers, both legislative barriers and structural barriers in the labour market. A remodelled CBSS could be a forum where the different parties together seek a solution. Within the framework of the BaltMet cooperation, the cooperation on innovation policy for the region, which is already on a sound footing, should be extended to seek new innovations for boosting the efficiency of the production of services.

The Helsinki and Turku initiative, and the campaign that we have recently made to challenge other cities and actors, has headlined the saving of the Baltic Sea. Initially, Helsinki and Turku carried out a thorough study on how they could contribute to improving the state of the Baltic Sea through their own actions. The idea is to challenge all actors to find efficient and feasible measures within their own activities, and then commit themselves to implementing these measures. For our own part, we are strongly committed to cooperative work. And we propose the same to the others. We have started to gather together cooperating groups in Finland, but without the involvement of all areas, cities, businesses, farmers, yachters and boaters, and, of course, all the responsible authorities in the Baltic Sea region, we will not have the prerequisites for success. The saving of the Baltic Sea is an urgent matter.

Jussi Pajunen

Lord Mayor of Helsinki

The Leningrad region - is an investment magnet

by Valery Serdyukov

I appreciate this opportunity to introduce the Leningrad region to you. Today our region is one of the most dynamically developing, economically successful, industrialized regions of Russia. Starting from 1999 average annual growth rates as regards industrial production volumes in the region were about 17%. How was it possible to reach such a high economical result? First of all owing to the establishment of favorable investment climate in the region, mild tax legislation, development of specialized market infrastructure. Because of its great location, natural resource wealth and informational openness, our region has become a formidable magnet for investors.

There may exist various options when it comes to attracting investments into a regional economy. Some administrations use demonstrative tactics, others prefer personal lobbying efforts. The Government of Leningrad Region bet on the powerful companies, which could integrate into the world economy and succeeded. Over the last ten years over two hundred companies arrived to stay in Leningrad Region, the Russian gateway to Europe and Europe's gateway to Asia, looking to implement their business strategies.

The Leningrad region holds third place in Russia in the volume of investments per head of population. Ahead of it are only the oil regions. The Leningrad region has brought together on its territory true "investment stars" IKEA, Swedwood Tikhvin, Philip Morris, Caterpillar, Ford, Kraft Foods, Rockwool, Metsä Botnia and Nokian Tyres. Every region would be glad about the coming of such companies.

The investment policy implemented by Leningrad Region Government is based on using the advantages of geopolitical location, natural resources capacity and economic, scientific and technological potential of the Region. Favorable taxation regime contributes to increase of investment appeal of the Region and forming of the wide range of market infrastructure institutions and civil society.

Those investors that are currently implementing the projects on the territory of Leningrad Region work within conditions created for successful business. The Leningrad Region Government ensures favorable environment for investors including tax incentives, a transparent information environment for business, and commitment of the government to upholding rights and contractual obligations regarding business and investments.

The investment climate of Leningrad Region is predicated by the following factors:

- Unique geopolitical location of the Region;
- Strong innovation and industrial capacity and human resources potential;
- Established system of legislation aimed at stimulation of investment activities;
- System of tax concessions and measures of state support of investors;
- Informational transparency;
- Certain level of political, social and economic stability.

Advantages of geopolitical location:

- Advantageous maritime location, several opera-ting ports and ports under construction;
- Developed transport hub, located within the 9th European transport corridor;
- Intersection of sea, river, railway, motorway, air, pipeline and telecommunication routes;
- Boundary location (bordering with European Union).

The proactive investment policy conducted by Leningrad Region Government is aimed at effective usage of accumulated economic potential of the Region. This policy attracts over USD 3 billion of investments annually and supports establishment of dozens of new enterprises and provide for continuous growth of volume of tax income to the budget. The main result of this activity has become the creation of sustainable basis for economic development of the Region that includes the establishment of new industrial enterprises, new technologies and, not less important, actual absence of employment.

In 2004 the volume of direct investments made up about USD 2.5 billion and in 2005 - about USD 3.3 billion. In 2006 the volume of direct investments made up USD 4.5 billion. National companies prevail within the investment structure of the Region. The greatest unit weight in total amount of investments belongs to the sector of development of industrial production and transport.

In 2006 the regional economy received USD 540.4 million of international investments (1.5 times more than in previous year), of which USD 361.6 million (i.e. 67%) are direct international investments. The main investors are: USA - USD 115.7 million (21.4% of total amount of investments); Finland - USD 83.2 million (15.4%); Spain - USD 76.3 million (14.1%); Denmark - USD 60.9 million (11.3%); Netherlands - USD 60.8 million (11.2%).

As long ago as 1997 the statute on investment activities in Leningrad region was adopted. And still this statute is unique having no analogues in Russian Federation. It specifies a complete set of activities including state support and protection of the investors carrying out activities at the territory of Leningrad region in such spheres as industry, construction, communication, transportation agriculture. This document ensures equal rights to both Russian and foreign investors including both large-scale and small-scale investors. It determines a number of privileges and additional guarantees.

The preferential treatment providing for significant assets and profits tax benefits is given to investors for the entire investment payback period plus two years after the completion of the investment project. When the constituent entities of the Russian Federation were prohibited by Federal law from granting profit tax exemptions, Leningrad Region made an unprecedented move by passing in 2003 a new version of the Law "On Governmental Support of Investment Activities" entitling investors to regional government subsidies through corporate profits tax relief.

Investment environment in our region, surely, depends on work of the authorities: represented by people with their approaches and attitudes… We do not thrust our opinions of preferable sectors on companies, considering the investment potential of the sector to be defined by the market itself. What is advantageous for investors is advantageous for us. Our main goal is to create favorable business environment for investors.

We are ready to cooperation. Welcome to Leningrad region as investors, tourists and visitors. We wish all our business partners success!

Valery Serdyukov

Governor of the Leningrad Region

Progress in logistics cooperation between the European Union and Russia

by Juhani Korpela

Finland's presidency of the European Union elevated transport logistics into the centre of Europe's transport policy.

Finland's initiative took aim at improving the competitive capability of Europe's logistics. Basic knowledge of the cost dimensions of logistics alone is fragmented in Europe. In the United States, the development of logistics has already been given attention for quite some time.

The policy decisions formulated during Finland's presidency provide new guidelines for EU operations. The next EU presidency country, Germany, has taken the matter forward with the goal of an operational plan embracing the European Union as a whole.

Russia has also been interested in the development of transport logistics. Russia is also endeavouring to gain more advantage from its position as a transit nation.

The foundation for cooperation between the European Union and Russia is the Partnership and Cooperation Agreement, undersigned in 1997. With this, Russia approved, among other things, the goal to harmonize transport and customs legislation in accordance with the EU model. Both have undergone advancement in the field, though plenty of work still remains to be done. The cooperative framework operations connected with the cooperation agreement have remained sporadic with respect to transport.

A new type of cooperation arrangement was born a couple of years ago when, at Russia's initiative, a transport dialogue based on five work groups was launched. The work group deals with general transport strategies, infrastructure, transport safety and special transport format-related questions. All work groups have already convened several times.

During Finland's presidency period, an additional sixth ad-hoc work group was established to clarify the logistics problems between the EU and Russia. The lorry queues extending dozens of kilometres and waiting periods lasting days on end could be found in the background. Combined recommendations to ease the problems of crossing the frontier from the work group are expected by the end of June 2007.

Frontier-crossing problems have also been clarified in the past. Finland, Germany and Russia established the joint TEDIM programme in 1995 to promote the utilization of telematic resources in Baltic region transport and logistics. Within the context of the programme, telematic solutions serving international transport and logistics have been developed and their initialization has been promoted. Estonia, Latvia, Lithuania and Poland joined the programme later. Denmark and Sweden have also monitored the project.

Within the limits of TEDIM, it has been noted that switching to electronic documents as well as incorporating the beneficial use of information technology are pivotal instruments to accelerate frontier crossings. Moreover, with electronic data transfer it is possible to reduce the so-called 'double billing' connected with customs clearance, by which the Russian market is resultantly distorted and considerable customs income remains unpaid to the State. However, the ready-developed 'green line' has not been taken into wide-scale use.

Another problem of the Russian frontier is the number of officials. When the number of officials on the EU side is only two—for freight transport customs and for passenger transport frontier guards—there may be 7–8 officials on the Russian side. This causes delays, multiple labour and unnecessary billing. A solution to the problem looks promised by Russia's Duma having approved new legislation designed to cut down this unnecessary bureaucracy.

On May 15th and 16th, 2007, an international TEDIM seminar was arranged in Helsinki with participants from 14 countries. Those at the seminar heard, for instance, about the plans on the part of Russia's Customs in initializing electronic customs clearance and reorganizing the operations of officials.

Up to this time, the utilization of electronic data transfer has progressed the farthest in the rail transport going on between Finland and Russia. It is natural that similar progress is also expected with respect to lorry transport.

Russia's advancement in electronic customs clearance requires, of course, that corresponding readiness exists in the European Union. The Finnish Customs has functioned actively both under the auspices of the EU and in the international customs organization on behalf of accelerating the commissioning of electronic customs clearance.

In the Baltic, over 300 million tonnes of hazardous substances are transported each year. The possibilities to avert, sooner or later, a major catastrophe from occurring on the open sea are minimal, due to the lack of the required vessel-carried oil destruction equipment. However, GOFREP—a marine transport supervisory and control project based on the collaboration of three nations, substantially reducing the risk of accident—has been implemented in the Gulf of Finland. A project has also been launched under the auspices of TEDIM by which there is an ongoing attempt to improve collaboration between officials and businesses to increase the safety of the transport of hazardous substances.

Finland's Ministry of Transport and Communications has functioned actively on behalf of the development of logistics and the information technology connected with the same. This has necessitated investment in the research and development operations thereby required. The research grants have nevertheless been eliminated from the Ministry in the State's budget for 2007. The field of activity of the Ministry has been divided between two ministers, so that cargo transport is the responsibility of the one and the development of information technology that of the other. Hopefully these solutions will not weaken Finland's possibilities to remain, in the future as well, a skilled partner with considerable initiative in the advancement of logistics and the information technology serving the same.

Juhani Korpela

The writer is the former Secretary General of Finland's Ministry of Transport and Communications and continues operating within the context of the TEDIM programme.

Updating St. Petersburg economy: new heights, old problems

by Nina Oding

The economy of St. Petersburg has been showing growth during the last nine years just as the rest of Russia, though its growth rates have always exceeded the Russian average. In recent years, the GRP growth has been propelled by a surge in telecommunication services, in the retail trade turnover, and by a sustainable growth in transportation services. Judging by the main economic indices, 2006 was one of the most successful years for St. Petersburg, especially in terms of investment flows.

However, the positive dynamics of economic indices in the last years was not based on a profound modernization of all industries, which, among other things, is evident from the manufacturing output rates. In 2006 the manufacturing output index fell to 93.0% of 2005. Above all, these fluctuations were determined by the specific character of shipyard and electric-power machine production processes involving large orders with long-term delivery deadlines. In recent years, these problems were further exacerbated by outdated management techniques, lukewarm innovation/equipment-replacement activities, low labor culture, and low professional skills.

In the first two months of 2007, investments in the city grew 44% reflecting its increasing investment potential and a new investor-friendly environment. One can safely speak of stable economic growth conditions created in the city, while the quality of this growth and the possibility for sustainable development are still open to question.

The City Administration sets its sights on luring large investors and on providing individual support for investment projects. Such well-known international companies as Toyota, Nissan, General Motors, Bosch and Siemens, Knauf, and Elcoteq have moved their operations in St. Petersburg as the result of these policies. Besides this made it possible to launch such large infrastructure projects as the West High-Speed Diameter, Orlovsky Tunnel, and Pulkovo Airport Renovation under private-state partnership arrangements.

A driving force behind the city's modernization plans is mobilization of all budget revenue sources, including the registration of new corporate taxpayers, federal budget transfers, and tax administration improvement.

The main resource to support the achievement of these goals is the city budget, the revenues of which have almost tripled by early 2007 from 2003. The 2006 city budget revenues amounted to R215 219.9 million, which was R74 942.4 million (40%) over 2005. Despite a fairly high revenue budget for 2007 (a revenue of R229.8 billion against an expenditure of R261.7 billion), the first quarter results show that the initial revenue forecast will have to be revised upwards.

These revenues received in excess of the plan became possible not only due to the improved financial and economic activities of enterprises and higher population incomes, but also because some Russian flagship companies operating in other regions have chosen to register as taxpayers in St. Petersburg.

The huge budget revenue size and growth rates seem to make the City Administration forget its ultimate goal, i.e. public goods production. The St. Petersburg Master Plan and the Social and Economic Development Program for 2005-2008, approved by relevant city laws, aim at a sustainable improvement of living standards in the city up to the existing European levels. The economic growth has sparked off real-income growth in the city. However, instead of reducing the socio-economic stratification of the population, these measures contributed to its growth. The average wage in the city grew from R12 900 in 2006 to 14 400 in January-February 2007[1]. On the other hand, real wages in the new economic sectors (especially in services with a large share of "shadow" wages) are significantly higher than the official figures, which is evident from the registered upsurge in goods and services consumption in St. Petersburg.

The unemployment levels in St. Petersburg has been traditionally low during the last decade and amounted to 0.5% of the economically active population at the end of March 2007. Unfortunately, high employment rates do not automatically entail higher wages. Poverty in St. Petersburg is common not only among pensioners but also among those employed, including young working families with children. Even Governor V. Matviyenko recognizes that the last three years' economic achievements have not made a commensurate positive impact on the living standards in the city. 329 000 families live in shared apartments, most city buildings and structures are in an inadequate status, the number of available recreation and greenery areas is insufficient, garbage dumps surrounding the city and dusty streets adversely affect the environment and human health. The increasing motorization of the city resulting from higher population incomes has created enormous traffic and environmental problems, while the City's decisions are aimed at expanding the road network to accommodate the constantly increasing private car flows to the detriment of the public transport systems. This creates numerous conflicts which cannot be resolved due to the absence of a clear legal mechanism to handle them, low involvement of residents in the decision-making processes and the absence of efficient local self-government. At moment the most active player, initiator, and executive of all ideas, projects, and decisions in St. Petersburg are the City Administration.

The Governor's Address to the City Assembly of May 23, 2007 announced a goal to enhance the city's competitive power by updating all its key economy, infrastructure, municipal service, and social service sectors through mobilizing all budget revenue sources, creating conditions to lure investments, developing innovation activities, and utilizing the city's competitive advantages.

In order to close the development level gap between St. Petersburg and cities in leading EC countries, St. Petersburg has to ensure cardinal changes in its economy by significantly improving its efficiency based on innovations and expansive use of post-industrial technologies.

So far, neither innovation activities, nor the use of the city's competitive advantages have produced any palpable results in the tourism, transit cargo shipment, or science-intensive industry sectors. In fact, the city's transport industry development is impossible without new logistic solutions that would make it possible to generate substantial added value, including development of new port areas, port access routes, as well as warehousing and terminal/logistics zones.

The City's efforts to provide for a transition to an innovation economy include the creation of IT-parks and a special engineering-implementation zone, the establishment of a venture foundation and a business incubator for small programming, instrument-making, and bio-technology businesses. However, one cannot expect immediate results from these efforts, especially when the issue of providing incentives for new technology development remains unresolved. Meanwhile, the competitive power of St. Petersburg enterprises mostly relies on their comparatively low resource costs.

[1)] 1 EURO=35R

However, the city has yet to go a long way to resolve its long-standing problems such as the poor state of its housing stock, inadequate street-cleaning and garbage collection arrangements, poor potable water quality, and decrepit water-supply and engineering infrastructure facilities.

These are exacerbated by new accelerated-development problems such as the deterioration of the urban environment, transport bottlenecks, and a downturn in ecological indices. Especially painful is the problem of the so-called “in-fill” housing developments (allowed under the pretext of an alleged lack of plots for new construction) which ruin the appearance of the historic city center accounting for only 6% of the total city area.

We believe that the scope of the problems facing the City has expanded considerably, and in the medium-term they can be dealt with only through feedback arrangements such as a dialogue with residents and public organizations and a broad participation of city residents in the preservation and development of St. Petersburg.

Nina Oding

Leontief Centre,

St.Petersburg

The Turku region is a junction point for Scandinavian and Baltic transport - a bridgehead between east and west

by Tuomas Mikkola

The Turku region has a favourable international location along the East-West transport corridor (especially the E18) which links Russia and Scandinavia. Its location is also central on the North-South marine route, linking Finland and Central Europe. Road, railway, marine and air transport all intervene effectively in the Turku region to support a competitive business environment.

By the year 2010, the EU intend to complete its trans-European Transport Network (TEN), designed to combine all modes of transportation. In the Turku region, this network will contribute especially to the development of the ports of Turku and Naantali, Turku international airport, and as far as road and railroad systems go, the motorway E18 and the railway link between Turku and Helsinki.

One part of the TEN project is so called Nordic Triangle, which is the transport corridor linking Denmark, Norway, Sweden and Finland. In Finland, the West-East corridor of the Nordic Triangle begins in Turku, extending all the way to the Eastern boarder of the country.

The Nordic Triangle has many connections to the so-called "Motorway of the Baltic Sea. Together, these two form a fixed transport system in the Baltic Sea Region. The Motorway of the Baltic Sea is one the four "motorways of the sea" established by the EU. A "motorway of the sea" is the concept of developing logistics chains with the aim of increasing maritime transport.

A direct route from Turku to China

As Russia has opened up, ports in Finland together with the E18 and the railway connection to Russia and China have become increasingly important as part of the pan-European transport system.

Turku is gaining as a bridgehead for goods transport to China, with cargo pouring in from the other Nordic countries. Cargo travels the other way, too, from China to Turku, continuing by the sea to the other Nordic countries and Baltic ports.

Turku's asset, considering transit traffic in Finland, is that it hosts the only train-ferry port in Finland. The whole of Finland in fact has a competitive edge, owing to the fact that Finland has the same track gauge as in Russia.

LogCity brings added value

Road, railway, marine and air transport all intervene effectively in the Turku region to support a competitive business environment. Pilot Turku Ltd is public-private-partnership company specialising in marketing and logistics process for companies that are either offering or seeking logistics services in the Turku region. Pilot Turku is charge of the new business area in the surrounding of Turku International Airport, LogiCity. It will be a new type of business area based on effective logistics. LogiCity's unique strength is its location at a hub where all modes of transport meet. The city plan for LogiCity currently allows the construction of some 400 000 square metres of floor space. Once the land-use plan for the northern side of the airport has been completed, more than one million square metres of floor space will be open for construction.

Companies providing or using logistics services will gain the largest synergy benefits from establishing themselves at LogiCity. Sectors represented in the area include transport and value added logistics, distribution centres, warehousing and wholesale operations, and logistic functions for hi-tech industries, for which LogiCity offers an operating environment that generates genuine added value.

Trump cards in the Baltic Sea Region

The aim of Pilot Turku Ltd is also to promote the status of the region and to develop a better operating environment for logistics-related businesses. Pilot Turku is building a logistics cluster in the Turku region. With the gateway position between East and West, and the efficiency in running logistics operations, the Turku region, Turku and LogiCity hold the trump cards in the Baltic Sea Region.

Tuomas Mikkola

Liaison Manager of Pilot Turku Ltd

Climate change and the futures of Baltic Sea

by Juha Kaskinen

Introduction

In futures work we talk about alternative futures. When we think about climate change discussion there seems to be a wide spread view on only one alternative; climate is warming. (It does not matter if the change is caused because of human activities or if it caused by other more 'natural' reasons.) But there are many views on what are the effects of global warming. No one knows for sure, what it means for the world or Europe or Baltic Sea region. So it is worth to think about possible, plausible and preferable futures of Baltic Sea. And how should we be prepared for different futures.

Threats

Baltic Sea is quite vulnerable from natural environment point of view. We know that oxygen lost, eutrification and blooming of algae for example already are severe problems of Baltic Sea ecosystem. The sea suffers from poisonous substances. Climate change in next 100 years might increase the temperature of water 2-4 degrees of Celsius and temperature of air 3-5 degrees. Ice coverage decreases, increasing rain fall will especially during winter time wash more nutrients for forests and fields to lakes, rivers and Baltic Sea. Increasing number of high winds and storms has negative effect on sea safety. Level of sea water is expected to rise. New southern species will spread to the Baltic Sea. All these threats will have mostly negative effects on the Baltic Sea ecosystem. (www.fimr.fi/fi/tutkimus/uutiset)

Increasing oil and other shipment creates risks for big oil damage. The amount of oil transported in the Gulf of Finland increased over 150 % between 200 and 2005 (Finland's Natural Resources and the Environment 2005).

But some of the scholars have proposed that climate change will stop the Gulf Stream which would mean new ice age to the Baltic Sea region. This scenario is even worse than the warming scenario. If it would become reality, almost all living conditions of the region would disappear.

But not only nature will suffer from the changes. Effects on human life are also apparent. Even if humans are perhaps one of the most adaptive species in the globe there will be many kind of human suffering. Economical consequences could be quite severe. We already know that insurance companies have paid more compensations because of natural disasters than ever before during the last few years.

Baltic Sea has been popular recreation area. Fishing, yachting and tourism overall are very important for several Baltic Sea countries. The price of summer cottages and land on seaside has been going up so far. If the natural environment deterioration continues tourism industry is in danger. Not to mention fishing industry.

Social and cultural effects can be severe too. Changing ecosystems can parish traditional ways of life. A counter argument to it is that cultures and habits have been changing as long as humans have been on this planet.

Possibilities?

Is there any good news related to climate change and the Baltic Sea? One thing is for sure: the effects will vary from regions to region. Already for example Finnish Gulf is suffering more nowadays than Gulf of Bothnia. The growing season will be longer and summers will dry and warm. It could benefit e.g. agriculture and in some cases tourism. It is quite hard to imagine many positive features. In Finland it has been stated that environmental technology could be one of the new areas of business. One can expect that better environmental technologies could help us in solving some of the environmental problems Baltic Sea suffers.

What we can do?

Climate change forces us to change our way of living. It is of course possible to wait and see what happens and try to adapt to the new circumstances. But if we want to postpone climate change, radical actions have to take place. Some experts state that we have already lots the game. Our energy production and consumption patterns need rethinking because greenhouse gases emissions should be cut down rapidly. Traffic and transport is in the same situation as long as we use carbon based fuels as a main source of energy.

Countries around the Baltic Sea have been active on the level of speeches but perhaps a bit slow on taking action. First joint action Helsinki Covention took place in 1974. Now when all the other countries except Russia are members of EU the role of EU's policy is more crucial that before. It also means that EU and Russia must have a constant dialogue going on also on matters of Baltic Sea.

In futures work ethic and values are always present. Because climate change is a global phenomenon global actions are needed. This is what makes decision making hard. Different ethical and value codes exists all around. Additional problem is that we define the problems and their seriousness quite differently.

It up to us and our decision making to decide what type of world we leave to the next generations. Even if we do not know what will happen for sure, it is possible to take positive actions on the basis of information we have gathered so far. We should be prepared for different possible futures not only to most plausible. And we should have a joint vision, mission and action plan for living and healthy Baltic Sea. Obviously, more research, data and information is required, but I would argue that basically the willingness to act is more important.

Juha Kaskinen

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Towards a Baltic mining cluster

by Magnus Ericsson

The global mining industry is experiencing a boom longer and stronger than any for many decades. Commodity prices are shooting up and exploration for new deposits is being intensified. These two industries exploration and mining, and it is important to note that exploration is indeed a sector in its own rights, were only a few years ago considered to be dying and mainly associated in both the public discourse and on the political area with environmental problems and backward thinking in general. However the quick growth of demand for metals and minerals in emerging economies, not only China and India but also - for example - the CIS countries linked to a more metal intensive economic phase in the industrialised countries than expected by most observers, has rapidly led to a situation where security of supply has become a political focal point.

This new situation opens up opportunities for countries which are well endowed with mineral resources such as Sweden and Finland. Indeed the entire Baltic region could become *the mineral powerhouse of Europe*, including the copper and coal resources of Poland, the rare earths of Estonia and industrial minerals abundant throughout the region. The region has all the necessary prerequisites for the birth of a *Baltic mining cluster*, when also the downstream and upstream industries, such as highly specialised steel industries and the global leaders of mining equipment and mineral processing are included in the analysis. Recycling technologies should also be included in the cluster.

Most of these growth opportunities will be picked up by the private sector, both local mining companies, international mining TNCs and international exploration companies, so called juniors. Most experts seem to be convinced that metal prices will fall again but there is also a wide spread belief that the cycle will be prolonged and that prices will stabilise on a higher level than that prevailing before the boom started. The challenge for governments in the area will be to create a climate in which these private companies will be interested in choosing the Baltic region for their investments among all the opportunities available globally and to make sure that their efforts are benefiting not only their shareholders but the host countries as well.

There are several areas in which a joint approach would make the Baltic region more competitive and which would also ensure that public interests are met. Firstly coordination of mineral legislation and regulations. Steps in this direction would remove barriers to explore in the countries without having to follow national borders but only geological boundaries. In Finland and Norway new mining legislations are underway and consultations could probably facilitate their introduction and become the first steps in a harmonisation process even if it is premature to expect one joint law at this stage already. Secondly the coordination of geological information necessary for exploration would facilitate the exploration process. A joint Baltic Geological Survey would be a natural way of pooling resources and breaking down the artificial divisions set up when the present geological surveys were established in the nationalistic era of the mid 1800s. Thirdly environmental research and regulation of the sector would benefit from a joint approach both in terms of removing barriers between countries and avoiding unhealthy competition because of lower environmental demands in certain countries but also by making research into how to avoid emissions and how to make wastes harmless or at least less harmful more effective. A fourth area of cooperation within the cluster is training of mining engineers and exploration geologists. The lack of skilled people is today seriously hampering the development of mineral resources globally. R&D in mining and exploration technology is a fifth area, where Baltic cooperation could prove fruitful given the centres of excellence that already available in both Sweden/Finland and Poland. These could flourish even faster with proper coordination and additional resources.

Magnus Ericsson

Chairman and founder

Raw Materials Group

How to improve the EU's economic and trade strategies towards Russia?

by Christer Pursiainen

As the current Partnership and Cooperation Agreement (PCA) between the EU and Russia will formally expire in December 2007, a new PCA, perhaps to be called a Strategic Partnership Agreement (SPA), will be sooner or later negotiated. It will form the new legal basis for the implementation of the so-called Four Common Spaces between the EU and Russia, including the Common Economic Space (CES).

This provides a possibility to rethink the strategies for the EU, its Member States and enterprises when dealing with Russia in economic and trade issues. It is proposed to distinguish between three levels of strategies, which all are currently simultaneously present in the EU-Russian relations. Each of the strategies could however be considerably intensified.

Integration strategy

The current CES approach cannot provide any tangible framework solutions for EU-Russian economic relations. The CES with its Road Map, being actually a "list of priorities" rather than any road map, is lacking two things in particular: a clear-cut goal and a schedule.

The first stage should be to detail the CES so that a clear goal of a free trade area (FTA), followed by a single market would be articulated. A realistic goal for the FTA could be to reach it by 2015 and for the single market by 2020. While Russia joining the World Trade Organization (WTO) should be regarded as a natural starting point for preparatory discussions on the preconditions of a FTA, the goals of a FTA and a single market should also be included into the new PCA (or the SPA).

During the preparatory phase, Russia's voluntary approximation of relevant legislation closer to that of the EU would be necessary in order to create a minimal regulatory basis for the FTA. Moreover, to be realistic, the FTA should be rather flexible with sectoral transitional periods safeguarding both the EU and Russian short-term interests.

Similarly, the single market negotiations could be started with preparatory discussions on the necessary preconditions, in particular defining the necessary level of legal approximation.

The legal approximation question would basically define the nature of the EU-Russia single market regime, namely whether it would resemble some existing bilateral (Switzerland) or multilateral (EEA) solution; or whether a new model should be created, perhaps including a system where the EU consults Russia in the preparatory phases of the legislative processes concerning single market legislation, giving Russia the ability to make comments and proposals. Consensus agreements so achieved would be automatically and voluntarily proposed or included in the relevant Russian legislation.

In any case, the goal should be an EU-Russia single market regime (with sectoral transitional periods), which would enable Russia to participate in most fields of the EU Common Market by 2020. More difficult questions, such as the degree of labour market or service market integration/liberalisation could however be solved after this deadline.

Problem-solving strategy

Current EU-Russian relations are characterised by several trade-related problems, be the issue the import sanctions against Polish meat, Russian round wood export customs (which the EU regards as a violence of the 2004 agreement on Russia's WTO membership between the EU and Russia), transport-related problems, unfair treatment of EU- based companies in Russia and so on. From the EU's perspective, the issue is Russian protectionism, discrimination or the violation of commonly agreed upon norms and rules. The current problem solving is not functioning very well from the EU's point of view. The nine Sub-Committees, mentioned in the PCA, do not resolve or even deal with any real problems, and often there are long periods when they do not meet at all. The specific "dialogues", be they in the field of energy or transport, do not in practice moreover even attempt to resolve any of the major problems between the EU and Russia. The different working groups around the CES do not do any better.

This has led to a situation where two possibilities exist. The first is that the Member States are left alone to sort out their problems with Russia. Bilateral negotiations with Russia are, however, difficult, because any Member State, at least the smaller ones, rarely have enough tools to pressure Russia.

The second possibility is that the EU defines the problem as not bilateral but as 'European'. This usually takes place only after a considerable and prolonged bilateral conflict. In this case however the only level where the EU can more or less effectively deal with the problems, often initiated by some Russian middle-level bureaucracies, is the highest Commissioner (EU)/ministerial (RF) level discussions. By the time they reach this level, they have already been politicized and a lot of face saving is necessary.

The lesson here is surely that the EU's problem-solving approach does not work with Russia to the benefit of the Member States.

Yet an effective solution could have been to impose, without delay, symmetrical joint EU trade sanctions on Russia, making perhaps illogical linkages between issue areas in the same way as Russia does.

Thus, while the integration strategy must be based on a patient search for the best possible long-term solution, the problem-solving strategy should be based on backing the negotiations with the potentiality of sanctions. If this would be done automatically at the middle-level of European Commission bureaucracy, the issues would not necessarily become so politicized. This automatic solidarity and reactive practice would also, after a while, also have the likely effect of preventing Russian bureaucracies from taking arbitrary decisions and violating previously agreed upon rules, because such decisions would become too costly.

Adaptation strategy

The adaptation strategy is best suited to the sectoral and company level, although individual companies may also benefit from the actions taken by the EU and/or Member States. Given the problems with regard to Russia, such as protectionist legislation, companies might decide to avoid or withdraw from Russian markets while waiting for Russia to become more closely integrated into Europe. Instead, the best alternative might be just to study the current Russian circumstances as carefully as possible and then to try to better adapt to these circumstances.

This might include, for instance, competing with Russian enterprises with efficiency, flexibility, specialist knowledge or equipment; creating affiliated offices, registered in Russia, in order to avoid protectionism and discrimination; moving production to Russia. In the latter case, it might often be rational to try to control the whole cycle of the respective field of economic activity, thus avoiding vulnerabilities by not opting for the externalisation of parts of important elements of economic activity. The necessary agreements for investment protection should be worked out at the EU-Russian level (integration strategy).

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Beware: dragons out of cage

by Valtteri Kaartemo

According to UNCTAD, China's FDI outflows reached US$ 11 billion in 2005. The figure is about one fourth of its outward FDI stock, which indicates a remarkable change in the pace of the outward expansion of Chinese companies. Although the official (not necessarily realistic) outward FDI stock remains only a half of that of Finland, there are already more than 10,000 Chinese firms operating overseas. The phenomenon – competitive companies originating from emerging markets – is considered being one of the most important trends shaping the global economy in the future.

It is expected that there will be new booms for FDI from China in the near future. Especially with the yuan's expected appreciation, it is likely that Chinese companies enhance their international acquisition portfolio, when foreign assets become less expensive for them. In line with these expectations, China's Ministry of Commerce has estimated that China's outward FDI is to total over US$ 60 billion between 2005 and 2010. In turn, estimates by Straszheim Global Advisors show that Chinese companies will invest some US$ 80 billion already during 2006–2007.

High share of Chinese imports in the countries of the Baltic Sea region indicates that China has already increased her economic role within the region. Finland and Russia show even greater dependence on Chinese goods. Generally, exports to China are of less importance, although Russia and Germany are among China's ten most important trading partners.

According to International Trade Center (ITC), the greatest potential in the Baltic Sea region's trade with China is in the Baltic States and Poland, which partly indicates poor performance of these countries in their exporting activities in China.

Regardless of soaring imports (average annual growth about 30 %) and huge trade potential, FDI outflows from China to the Baltic Sea region have remained low. In Germany, the year 2006 showed a remarkable increase in FDI outflow relative to the FDI stock, nevertheless the Chinese FDI stock remains just a fraction of a percent of the overall figure. However, as Chinese foreign investments are expected to grow and Chinese companies are found to be market-seeking by nature, the soaring export levels may lead to a growing number of Chinese companies to invest in the region.

Currently, the most widely-known Chinese investments in the Baltic Sea region are perhaps the huge Baltic Pearl project in St. Petersburg, factory investments in Kaliningrad by television manufacturer TCL and automaker Chery, and R&D investments by telecommunication giants Huawei and ZTE in Kista, Sweden.

A recent research on the motives of Chinese foreign investments in the Baltic Sea region indicates that Chinese companies are not only interested in securing markets for their low cost products but are willing to become a part of the value adding network of the region. This may sound concerning, as the region's countries have just started recovering from China's impact on the global movement of manufacturing jobs. However, the entry of Chinese firms may also provide business opportunities for the local companies in the Baltic Rim, as Chinese companies are willing to have new partners. In addition, Chinese companies are becoming increasingly important sources of knowledge, which makes them interesting partners together with their linkages to the Chinese market.

Thus, companies in the Baltic Sea region should be prepared in advance for the emergence of Chinese companies in the world economy. This means following up their maneuvers in given industries, and acting accordingly in order to prevent losing market shares and deteriorating competitiveness and, most of all, in order to exploit the new business opportunities which Chinese companies provide in the local market and globally.

The new role of Chinese companies needs also actions from policymakers and most of all measures to attract Chinese investments to the Baltic Sea region. One idea is to establish a common investment promotion agency, which would combine the resources of the countries surrounding the Baltic Sea. This would provide not only more financial resources and economies of scale but also a larger pool of enterprises which could be marketed for Chinese companies interested in the company networks of the region. Through networks of companies, the benefits of the investments could also be dispersed among those countries who shared the costs – regardless of the final target country.

In order to help the region's companies and policymakers, funding should also be found for the academia to develop an economic monitoring system which would track Chinese investments in different sectors and regions, providing thorough analysis for decision makers both in private and public sector.

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Full report "The motives of Chinese foreign investments in the Baltic Sea region" can be downloaded at www.tse.fi/pei/e

Table 1 Baltic Sea region's trade with China

Country	*Value of exports in 2005 in US$ million*	*Share of country's exports*	*Value of imports in 2005 in US$ million*	*Share of country's imports*
Denmark	1,190	1.4 %	2,789	3.7 %
Estonia	58	0.7 %	311	3.1 %
Finland	2,628	4.0 %	3,626	6.2 %
Germany	30,723	3.1 %	32,527	4.2 %
Latvia	9	0.2 %	282	3.2 %
Lithuania	11	0.1 %	361	2.8 %
Norway	1,144	1.4 %	1,322	2.9 %
Poland	557	0.6 %	2,595	2.6 %
Russia	15,890	6.6 %	13,211	13.4 %
Sweden	3,122	2.4 %	2,574	2.3 %

Source: ITC calculations based on COMTRADE statistics, author's calculations

The Baltic Sea cooperation

by Danuta Hübner

The Baltic Sea region is an excellent example of the importance of cooperation for economic growth and success as it has developed into one of the most dynamic regions in Europe. It is a region where over decades dozens of networking structures have grown and where the accession of Estonia, Latvia, Lithuania and Poland to the EU added new competitive advantages and opportunities for cooperation. Stability is now a feature of the region and economic development is thriving. It is one of the fastest growing regions of Europe: between 1995 and 2004 its GDP grew by 42%. The Baltic Sea Region is also characterised by a strong cluster base with a rich portfolio of regional clusters operating in traditional and non-traditional industries. Nordic states are front-runners in this respect and provide quality expertise for the other countries of the region.

Baltic Sea cooperation as a role model for other regions in Europe

The Baltic Sea cooperation has become a role model for successful cooperation for many other regions of Europe. EU Regional Policy has significantly contributed to this success and it will continue to do so in the future by providing opportunities for discussion of common issues, possibilities for cooperation and partnership and financial investment for common projects within the financial framework for the period 2007-2013. These have already been the main features of cooperation programmes in the Baltic Sea region during implementation of the INTERREG programmes, which from 2000 onwards have covered, with positive results, all the partner countries, including the then candidate countries and Russia.

This work together has been a great success. It has given concrete expression to the Northern Dimension policy of the EU, through partnership-building and specific projects. Many excellent initiatives supported by EU Regional Policy such as EcoForum Baltica, promoting the development and knowledge of Environmental Management Systems in SMEs and public authorities or the Baltic Gateway, which aim is to pave the way for transport investments in the south Baltic Sea area, should be followed in the future. This obviously requires good coordination between the countries and regions involved. And for this, the Union's Regional Policy, in particular through its cooperation programmes, provides a perfect platform.

The Baltic Sea region has already made major strides in terms of economic growth and job creation. But in order to remain competitive in a global world, countries in the region need to further invest in education systems, research and development and innovation, and have to reinforce the links between universities and industry. The entrepreneurial energy of SMEs by improving their access to finance must be unleashed. Finally, stress has to be put on environmental sustainability as environment in the Baltic Sea area is very fragile and already badly polluted.

Contribution of EU Regional Policy to growth and jobs

Here Regional Policy can be of help. It is the major instrument at Community level to strengthen the competitiveness and innovation capacity of Europe's regions. Across the Union we will invest around €200 billion in areas such as innovation, RTD and the knowledge economy, for promotion of entrepreneurship, infrastructures of European importance and human resources development.

The aim of the new Regional Policy is to create circumstances which will actuate the regions. It is designed to allow regions to discover the comparative advantages which they possess, and to put themselves on the path of sustainable development. An essential part of its design is partnership towards which we have a two-fold approach. First, there is the multi-level involvement of all relevant decision-makers – public authorities at EU, national, regional and local level. Second, there is also a horizontal partnership, which includes the economic and social partners and other bodies representing civil society. Coordination between different partners is a key issue in order to optimise the synergies and to reduce the risk of lost opportunities.

New possibilities for cooperation in Baltic Sea

Territorial co-operation has a prominent place in the architecture of Regional Policy for the period 2007-2013. The financial envelope for co-operation has been increased significantly compared to the previous programming period, taking into account new border regions in the EU. This is a significant indicator of the importance attached to co-operation by the European Union. In the Baltic context, countries like Sweden, Poland, Lithuania and Latvia will all receive significantly more EU funding for co-operation than in the past. This provides both greater possibilities for co-operation and greater responsibility on the partners to ensure the success of projects.

New rules of Regional Policy provide also for a wider geographical scope for cooperation. In fact cooperation across sea borders will be possible up to a distance of 150 kilometres. For the Baltic Sea region, this increases the opportunity to have new programmes across the Baltic Sea.

The new Central Baltic programme will, for example, now include the current Swedish-Finnish Archipelago and Finland-Estonia programmes as sub-programmes. Due to the maritime 150 km rule, the programme area is enlarged to cover parts of Latvia, many Baltic islands, and several additional regions on the Swedish coast, as well as Gotland. This new quadrilateral maritime programme will be a new and exciting experience in a cross-border context.

The new South Baltic programme also offers much new potential for cross-border programmes. It will include coastal regions from southernmost Sweden, Poland, Lithuania, Germany and the Danish island of Bornholm. This means that almost the entire Euroregion Baltic will be included in this programme. Finally, the Öresund-Kattegat-Skagerrak programme will cover coastal regions in Denmark, Sweden and Norway.

On top of this, the new Baltic Sea transnational programme involving all EU Member States around the Baltic Sea plus Norway, Russia and Belarus will promote continued cooperation with St. Petersburg, Kaliningrad and Belarus. This is a major instrument in itself, and addresses vital issues in the most comprehensive way.

The aim of the Commission is to approve these programmes in the course of 2007. We must demonstrate that cooperation programmes can be prepared and launched in good time to avoid unnecessary delays and to avoid discouraging potential applicants. The responsibility for this rests squarely with the countries and the regions of the Baltic Sea region.

Promotion of new forms of cooperation

Another new feature of the future co-operation programmes is that of management structures. The experience with INTERREG has proved more than ever the need for fully joint structures for managing such programmes. To assist

programme partners in this regard, a new legal instrument has been created – the European Grouping of Territorial Co-operation (EGTC).

The EGTC is a radical step forward in the management possibilities for cooperation. It offers regional and local authorities the option of creating a cross-border grouping with legal personality. EGTCs will be able to manage individual projects or take on the role of a programme's "managing authority" responsible for the implementation of the whole cooperation programme. In this role, an EGTC would operate just like any other managing authority – with the added bonus that it would be genuinely joint, representing both sides of the border. This solution offers a range of practical advantages, not least simplifying the employment procedures for programme staff.

EGTC should be viewed as a framework tool which has been provided, and it is very much for the implementers to assess how to use it to their advantage, including the co-operation outside the regional policy area.

Boosting exchange of experience and best practice

Finally, European Regional Policy can help in transferring the positive experience of the Nordic countries to other countries of Baltic Sea Region, especially in developing relations between research and business. For 2007-2013, increased funding will provide even more possibilities to speed up the economic development, especially for the new EU member states of the region. The EU provides the political context for cooperation, peace and prosperity around the Baltic Sea. All these factors increase the tremendous endogenous potential of the Baltic Sea Region to become one of the key regions of the European Union which will be able to face the challenges of the globalising economy.

I am convinced that the EU Regional Policy is an excellent instrument to boost the competitiveness of the European territory, especially in the peripheral regions like many in the Baltic Sea Region. First of all, it is enabled through strategic concentration on topics closely linked to the Lisbon strategy such as innovation and entrepreneurship, environment and improved accessibility. Secondly - through its unique delivery mechanism based on shared ownership and partnership between European, national, regional and local actors.

Through our cooperation programmes we can pool resources together to ensure a more efficient and joint management of economic, environmental or social challenges. Our programmes encourage citizens of different regions to work together in order to make their region more attractive, both for job creation and to live in. Thus, people can easily experience the concrete benefits of these projects in their region and in their day-to-day life.

I am confident that the countries and regions of the Baltic Sea Region will make full use of the opportunities provided by EU Regional Policy to reap the benefits of partnerships with other regions. Cooperation programmes, like those in the Baltic Sea area, will be central to this effort.

Danuta Hübner

Member of the European Commission

responsible for Regional Policy

Russia's role in the Baltic region

by German Gref

The Baltic Sea region is one of the most promising regions in Europe in terms of economic growth, competitiveness, rising standards of living of its inhabitants, as well as the overall quality of life.

Cooperation in the Baltic Sea region is a priority for St. Petersburg, a leading city in Russia in the field of social and economic development, and the largest metropolis in the Baltic region with a unique geographical position.

St. Petersburg is a multifaceted city, integrated into the world economy with the potential of increasing economic activity. The role of St. Petersburg as a leading Russian centre between the Baltic region and North-West Russia has been consolidating further.

2006 was a very successful year for the development of external ties. While preserving traditions of constructive dialogue and mutual respect, the city has entered a new era of serious competition with leading European capitals.

External trade turnover in St. Petersburg in 2006 reached about 20 billion dollars. Compared to the previous year, 2005, turnover grew by 30%.

The following countries represent five of the major partners of St. Petersburg in 2006: China, France, Germany, the Netherlands, Finland and the USA. In general, the city's active role in the Baltic Sea region is a positive factor. One third of total trade in St. Petersburg is generated with the countries of the Baltic region.

Economic cooperation, the promotion of industrial know-how and technologies and cooperation between universities will remain major priorities for St. Petersburg in the current year. Public support, as a rule, has been directed at industries that require major investments, produce considerable budgetary revenues, and to hi-tech sectors, all of which ensure sustainable development for St. Petersburg and other regions.

St. Petersburg has been the scene of major international events such as the G8 Summit and the International Economic Forum.

Last year, the 10th International Economic Forum was attended by the President of the Russian Federation, Vladimir Putin, the President of Finland, Tarja Halonen, the President of Slovenia, Janez Drnovšek, and leaders of the Parliaments and Governments of other countries.

The main themes of the10th Economic Forum in St. Petersburg were the competitive advantages of developing countries and the challenges of globalization. The organizers of the Forum managed to invite prominent speakers and to encourage substantial and informal discussions.

The 10th International Economic Forum in St. Petersburg also had significant practical objectives. About a dozen agreements with a total value of 1 billion dollars were signed at the Forum. Several exhibitions were held in connection with the Forum, e.g. Investment Projects, Innovation Achievements and New Fuel and Energy Technologies.

The next, 11th International Economic Forum will be held from June 8 to 10, 2007. The upcoming Forum promises an interesting and comprehensive programme. In addition to the three plenary meetings, round tables, exhibitions and presentations will be held, as well as a traditional meeting between the Russian President and the chief executives of major international companies, an informal meeting of the members of the Government of the Russian Federation with the heads of the world's mass media, a ceremony for the International Global Energy Award, the signing of investment agreements and a cultural programme. I hope the upcoming Forum will be at least as significant as the previous one.

Surrounded by the countries of the Baltic Sea region and not linked to the continental part of Russia, Kaliningrad deserves special mention when reflecting on the role of Russia in the Baltic region.

Among the main development challenges facing the Kaliningrad region are those aimed at sustaining the territorial security of the region and ensuring the general Russian, European and world standards of the civil rights and the standards of living in Kaliningrad, as well as the need to integrate the region into the European Economic area.

Achieving these goals requires a differentiated approach to the problems of the Kaliningrad region as a region with many specific features produced by its historical development. Only in this way can the region's unique character be perceived and a realistic approach to its planning and development be implemented.

Compared to other regions in the North-Western Federal District of Russia, Kaliningrad is developing very fast, being among the three Russian regions with the highest rates of development.

Thus the Baltic Sea region is correctly viewed as being one of the most stable, safe and dynamic regions in Europe and the world. Today, it could be called the locomotive of the entire development of Europe.

German Gref

Minister of Economic Development and Trade

The Russian Federation

Structural Funds and perspectives for Polish science

by Michal Sewerynski

In the financial perspective 2007-2013 Poland will benefit from the inflow of 67 billion euros of structural and cohesion funds. These funds will be used to modernize infrastructure and enhance the productive capacity of human capital in many sectors and across the country. About 6% of this amount, or over 4 billion euros is earmarked for various projects concerned with science sector. On average this represents additional one half of the annual science budget in Poland (at present close to 1.0 billion euros).

While related new opportunities for the Polish science are very promising, the administration is determined that these extra funds will be primarily directed towards raising an innovative capacity of the science sector and intended to help the industry to create increasing demand for innovation.

One of the fundamental weaknesses of the Polish R&D lies in lacking of sufficient links with the economy and society. This situation is rooted in multiple causes, such as traditionally high esteem associated with basic research, politicizing of science under the soviet system and a fragile industrial base unable to create sufficient demand for scientific results and innovation.

Since the 1990's scientists have gained the freedom to perform research according to their interests. What is more, in the name of full democracy they collectively became responsible for science policy and funding allocation. The commercial exploitation of scientific achievements was not a universal priority. Particularly, that science funding was inadequate and aiming rather at obsolete, abstract targets than the real needs. In response, the society turned out to be disillusioned with the usefulness of science, which lead to further reduction of science funding.

In this context participation in the European Framework Programmes, first as an associated country and then as a member with the full rights, was to certain extent an eye opener. While Polish teams from academia and research units have been able to engage in competition, albeit at low but acceptable level, the industry based teams are virtually nonexistent. This unfavourable situation continues to date and it is increasingly clear, to the scientists themselves and to the science policy makers that prolongation of such isolation from the real life problems is very detrimental and will result in eventual deterioration of both quality and capacity of the scientific research in Poland.

The science administration, particularly since Poland's accession to the EU, has undertaken a number of initiatives to reverse this isolationist trend. However, with persistently low funding from both public and private sources it became a task doomed to failure. For the modern industry requires modern science, capable of providing innovative solutions, developed in high-tech laboratories and using up to date infrastructure. Unfortunately these in the first place are lacking in Poland. The severity of such situation is aggravated by the fact that Poland intensified production of university graduates, creating on an unprecedented scale large numbers of well educated, dynamic young people. But the scientific career is not sufficiently attractive for them.

These developments therefore lead to recognition that if Poland wants to realize its capacity to be a useful and meaningful player on the European science scene, it needs a steep change in investment in science. The present government plan, still in early stages of implementation, to double the current science funding within four years and to gradually aim for the Barcelona target of 3% GDP, is clearly a step in the right direction, but in the present circumstances does not seem to be sufficient.

However, mentioned above additional financial resources should open new horizons in front of the Polish science. The bulk of these funds, under the National Programmes "Innovative Economy" and "Infrastructure and Environment" will be used to modernise existing and develop new research and academic infrastructure (1.3 + 0.6 billion euros). Interdisciplinary, integrated research centers will be created in the fields of materials sciences (Warsaw and Wroclaw), in the biomedical sciences (Warsaw), in the advanced technologies (Poznan), in the physical sciences (Krakow) and in the clean coal technologies (Katowice).

Second biggest component of the funds, under the National Programme "Innovative Economy", will be dedicated to development of new technologies (1.3 billion euros). Again, the relevant activities will be carried out in selected, leading research centres across the country in many diverse research domains. They will include fields such as high temperature reactor technology, nanotechnologies and new materials, medical diagnostics and therapies, body armour technologies, biodegradable materials and high energy transmission.

Finally, the strengthening of human capital (1.0 billion euros) will be undertaken under the National Programme "Human Capital". This activity will include various schemes and programmes of continuous and tertiary education as well as assistance in early stages of professional career. Selected, top universities will be given tasks to undertake specially designed professional education programmes. Also, an emphasis will be placed on raising the number of doctoral students. The most aspiring of these activities concerns a plan to establish 'elite' interdisciplinary PhD studies, targeting the brightest and ambitious to become future leaders in many aspects of the society life.

Important aspect of all these activities will be to enhance an innovation absorption capacity of enterprises, by system of sponsored projects, undertaken jointly with research units and academia, and grants enabling employment of scientists in non-research sectors. The other key issue will be to raise attractiveness of the research career, particularly amongst university and PhD graduates.

While such a perspective looks very promising, its realisation in reality will require a great effort of all stakeholders, namely the scientists and research institutions, the industrial enterprises and the administration. Absorption of additional funds and their wise and effective use constitutes considerable challenge. In order to make this a successful operation, modernisation and reform of science system is indispensable. Such reform has been already initiated, and its key element includes creation of two funding agencies. One concerned with the realisation of large, strategic research programmes and the other directed towards the frontier research. Further actions will also include streamlining of existing research institutes, both industrial and those belonging to the Polish Academy of Sciences. The underlining theme of this reform will be a separation of science policy making from research financing and from research performance. However, the above mentioned challenges cannot be met only by the administrative measures. The change of attitudes towards more entrepreneurial, more pro-innovative, more society oriented has to take place foremost in the minds of scientists. The science administration in Poland is working together with many scientific communities to achieve this transformation.

Summarising, it should be underlined that availability of structural funds for Polish science opens many new and exciting perspectives. It will change Polish science landscape during the coming decade. However, it also brings new challenges, which will require mobilisation of all stakeholders and resources available to them.

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Poland

The Baltic Sea needs to be politicized

by Eija-Riitta Korhola

Recent news about the state of the Baltic Sea has not been very good. Last summer, for instance, we saw an exceptionally large oxygen-depleted area and the state of the bottom sediment as at its worst since measuring started in 1999. Last summer was also exceptionally grim in regards to the bottom fauna. An abundant and multi species bottom fauna community was only found in four of all together 47 measuring spots.

In order for permanent improvements to be made there needs to be a significant reduction in phosphorus and nitrogen loads both in the Gulf of Finland as well as in all of the Baltic Sea's catchment area.

We human beings are almost solely responsible for the eutrophication of our coasts, archipelagos and inner seas. It is up to us to fix the situation. Special focus needs to put on the sporadic loading of agriculture. The agricultural industry is responsible for a little over half of the phosphorus load and little under half of the nitrogen load in the Baltic.

A broader examination shows that the main problem of the Baltic Sea and the Gulf of Finland are effluents and sewage waters deriving from Russia, Poland and the Baltic States. The aim of international cooperation should be the nutrient load reduction as well as the renovation and repair of efficient chemical-biological sewage facilities in these countries.

There is, how ever, also some good news. The results of the BIREME program of the Academy of Finland show that properly directed actions result in surprisingly fast improvements in the state of the Baltic Sea. This news is contrary to the reports from Sweden where some researchers have claimed the Baltic already to be in a state of lock that cannot be opened. Finnish studies are more promising. It has been shown that a decrease in external loads lead to a decrease in internal loads.

Calculations also show that a 25 % decrease in the nutrient effluents of Russia and Poland would result in a significant decrease in the amount of blue-green algae already in just five years. After 30 years the 25 % cut in effluents would reduce the biomass of blue-green algae by 60-70 % and the quantity of other harmful algae would also have been decreased significantly.

Simply by applying modern purification techniques used in the Finnish and Swedish sewage plants to all the countries surrounding the Baltic Sea, effluents can be reduced by 40 %.

Research is an important factor in recognizing all potential threats. We know now more about the origin of the species of the Baltic and the recognition of new alien species and their potential harmfulness is easier thanks to research.

The stress of fish farming can be decreased through precision feeding and better feed as well as by using bag pens instead of the now used net pens.

The Baltic Sea is an environmental problem of the European Union. The enlargement of 2004 made the Baltic an inner sea of the EU. This means that we now truly have the opportunity to save the Baltic Sea.

I would also propose we ask the question whether the Baltic Sea could save the EU. After 50 years of European unity our continents leaders are looking for a way forward. The popularity of the union amongst its citizens is at a record low. This would be a concrete example of what the EU can accomplish. Taking a firm stance on saving the Baltic would be a way to show that together we are stronger than alone.

For this reason I have suggested that we politicize the Baltic Sea. It should be marketed as a model example of what the EU can at its best achieve. The Baltic Sea should not only be seen as an environmental problem of some border states but a political priority high on the Union's agenda. According to an old saying a clever politician makes one's own interest into a common interest. With the Baltic Sea this should not be very difficult. We have to politicize to Baltic in order for us to get ample resources for research and protection.

Eija-Riitta Korhola

Member of the European Parliament

Branding the Baltic Sea Region: " Just do it"

by Uffe Ellemann-Jensen

Branding – everybody speaks about it and takes possession of the word as if it alone is a stamp of recognition and respect. If you are talking about branding you must be up to something big whether you are a local politician or the CEO of a huge corporation. The word has been used and abused so much and so often by politicians, businessmen and marketing hot shots that it is on the verge of becoming a cliché, defunct and useless.

Let me tell you that within Baltic Development Forum (BDF) branding is not just a fad or a fancy buzz word. We have been looking at branding the Baltic Sea Region ever since we first put in on the agenda of our St. Petersburg Summit in 2001. In the past few years it has gained a still higher priority as we have recognized the need to create more awareness and give the region a more distinct profile so it can stand out in an increasingly competitive global environment.

In the global competition, you have no choice – there is only the fast lane. That's why we, at BDF, have decided to focus on the region's strengths and not ignore our weaknesses in order to identify our comparative advantages and devise a strategy that will ensure that the region can remain a frontrunner and a magnet for capital, talent and innovative thinking.

What we may lack in natural resources we have, over the years, compensated for by developing infrastructure, bringing our education systems up to the highest levels, and creating friendly business environments. When we look around in the region and its 11 fabulous countries today, it is obvious that this strategy has paid off. What we see are the clusters of biotech companies in Medicon Valley, the global leaders in high tech, the prowess of the region's financial sector, and the power houses of innovation backed and funded by a combination of private and public resources. All this testifies to the fact that the region already has accomplished a lot and has a lot more going for it.

At a string of conferences, seminars and, of course, at several summit sessions, BDF has taken a stab at how we can present the Baltic Sea Region as a coherent region that is equally attractive to investment, business, research and tourism despite the obvious differences and obstacles in geography, history and culture. Whether we would call it branding or something else, the task and the challenge was to define the differences that divide the region and the similarities that tie it together in order to build identity and help it with positioning itself as a leader. The issues at stake are image, identity and perception.

The goal we set for ourselves was to promote the Baltic Sea Region in a way that in future rankings by the Economist or other respectable magazines and organizations, the region would come up on top of them all as the leading region preferred by companies and people from all over as their favourite place for business, investment, education, entertainment and leisure. This is setting the bar very high, but the point is that this is where you want to go when you start a branding campaign – you want to be on top and not running just as one of the numbers in the pack.

We have clearly chosen to be on top of Europe, and we have, indisputably, much working for us in that respect. One of our core advantages is the high level of education in the entire region – one of the absolute preconditions for achieving success in today's world. Research and development comes on top of that and several of the regional centres have over the years proved that they can be world leaders in their particular fields. But life in the fast lane of global competition does not let anyone rest on their laurels. In yesterday's world there was not such a thing as a free lunch. In today's world, there is not such a thing as a secure position when we talk about competition in a globalized market place.

I feel that history has given our region a unique chance not just by putting the conflicts and divisions of the past behind us, but also by bringing together societies that are quite diverse in economic development and creating a dynamic mix between mature economies and the transition economies which show growth rates that are very hard to achieve for others. There is no doubt in my mind that with the adequate policies, we will be able to exploit these differences and turn them to our advantages both in our own growing home market and in our position as a gateway to the EU.

The free movement of labour and the exchange of talent across the borders will become one of the region's lifelines and help building the foundations for its future success. One of the future challenges will not just be to keep attracting capital and investment, but to create an environment that will remain attractive to the best and brightest among the talents that our region will keep producing. In today's reality, there is no doubt that many of them will go to other parts of the world in search of opportunity. It is our task to create the conditions that will appeal to our home grown talents and make our region appear as the most attractive place for them to pursue their professional aspirations and fulfil their dreams.

To brand an entire region is an enormously ambitious task. It's much easier to talk about devising the right policies, cross border collaboration and coordination, and implementation of strategies. Whatever word we choose, whatever road we prefer, and whatever tool we select, it is clear to me that the Baltic Sea Region, after the years of post-cold war euphoria, now is in the process of taking ownership of the new opportunities and transforming some of the dreams into reality.

It certainly is more demanding than cheering and toasting with champagne. But we have already seen some of the results and despite hardship and some inevitable failures, the progress is encouraging. It will be the prerogative of the future generations to pass the final judgment on how successful this process has been whatever name or label they will put on it.

Uffe Ellemann-Jensen

Chairman of Baltic Development Forum

The Baltic Economic Area represents a major opportunity for Finnish industry

by Antti Herlin

The Baltic Economic Area offers great opportunities for Finnish industry, but this has not always been the case. Twenty years ago, Europe was still divided by the Iron Curtain, which placed major restrictions on the development of economic cooperation. Finland, for all practical purposes, was an island. To the East and South the Soviet Union, to the West, across the sea, a more knowledgeable but, for a little brother, difficult-to-approach Sweden.

Following the EU's expansion in 2004, the Baltic became almost an inland sea of the European Union. Of the nine countries bordering the Baltic Sea, eight are EU members. Approximately 80 million people live in the sea's catchment area, representing a third of the entire European Union's population, and member countries bordering the sea also produce a third of the European Union's total output.

Finland is rooted by religion and culture in the West. For a long time the sea served as the major means of communication, supporting the introduction and maintenance of western influences in our country. Across the long common land border with Russia, on the other hand, Slavic culture and Eastern Orthodox religion also found their way into Finland. In addition, Finland's position on the northern edge of Europe, largely surrounded by the sea, significantly influenced the national character of the Finnish people. Seafaring in arctic conditions helped build Finnish toughness and persistence while also teaching humility when confronted by the great powers of nature.

The Baltic Sea has given birth in Finland to a prominent shipbuilding industry, whose significance as a bearer of prosperity has been important. Today, shipbuilding has evolved into an even more widespread marine technology industry with a vast network of partners and suppliers. Marine technology industries are a significant source of livelihood along Finland's southwestern shore in the provinces of Satakunta, Southwest Finland and Uusimaa. The development of marine technology industries has contributed to Finnish industry's long-standing and ongoing dependence on marine transport. The majority of Finland's foreign trade is transported along "the Baltic seaway".

Modern economic globalization makes industry increasingly dependent on logistics. Increasingly expensive energy, and the desire to make environmental protection more effective, place heavy demands on the efficiency of the entire logistics chain. With the help of information technology, it is possible to make logistics chains increasingly efficient and as seamless as possible. The growth of the service sector and development of information technology, however, have done nothing to change the fact that transportation infrastructure continues to play a very important role in determining the location of industries.

During the past ten years the transport of goods on the Baltic Sea has increased significantly. Trade continues to grow in the Baltic Area, and so does the volume of goods being transported. The logistical goals of international companies are based on treating the entire Baltic Area as a domestic market without national boundaries.

The Baltic Area is currently one of Europe's most dynamic growth centers. The economies of Russia and the new EU member countries are growing briskly. The Baltic Sea has become a corridor connecting the West, North and East.

Many new "Baltic enterprises" have sprung up in the area. Finding it too challenging to reach for global markets, they consider the Baltic area a proper environment for expansion. This group includes not only many industries but, to an increasing extent, commercial and financial enterprises. Smaller regional growth centers are emerging within the expanding European Union. For the Baltic Area to solidify its position as a true growth center, it must improve the efficiency of internal markets by removing the trade barriers that still remain and increasing the free movement of labor. It is also important for the new EU countries to adopt the Schengen Agreement and the use of the euro as soon as possible. Reducing the number of invoicing currencies creates a significant advantage for companies.

The economic area should undertake the rapid implementation of a "seafaring highway" strategy. This requires, above all, close cooperation among the various countries. The goal is to form transportation chains in which diverse forms of transport converge to form broad and functional wholes. The projects to be carried out in Finland are very important, especially the E 18 highway to Vaalimaa connecting East and West. Transportation investments to be implemented elsewhere in the Baltic Area must also be taking into account by Finnish planners and decision-makers. For example, projects to improve major traffic arteries in Russia, Poland and the Baltic states impact on transportation in the entire Baltic Area and, thereby, also in Finland.

The greatest opportunity for the Baltic Economic Region is represented by the potential for improved integration of Russia and EU markets. Serving as geographical points of contact are southwestern Russia and the Baltic Sea. Russia's economy is largely dependent on export revenues; consequently transportation connections are very important to Russia. Gulf of Finland ports should be developed into logistics growth centers, which can be of benefit Russia's western economic area, whose capital consists of St. Petersburg and its surrounding economic zone. In the expansion of economic cooperation between the EU and Russia, it is precisely the St. Petersburg area that is in a key position. Its industrial foundation, though still thin, is rapidly growing stronger.

So, excellent opportunities exist for strong development of the Baltic Economic Area. One great risk exists, however. The Baltic is one of the world's most polluted seas. It is a shallow and relatively young inland sea, which came into existence at the end of the Ice Age some 10,000 years ago. The runoff from melting glaciers filled the depressions they had left behind, and little by little a brackish basin was formed. Freed from under its icy burden, the land began to rise and formed one of the world's most extensive and beautiful archipelagos. Even though a lot has been done in recent decades to attenuate the amount of excess nutrients in the Baltic, eutrophication is sea's severest problem. Finnish and Nordic industries have largely taken care of their own share in cleaning up the sea. Eutrophication weakens the attractive power of the entire Baltic area, and cooperating to reverse it should therefore be a top priority for all countries surrounding the Baltic Sea.

Antti Herlin

Chairman of the Confederation of

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Elinkeinoelämän keskusliitto

The challenges of the EU's Baltic Sea strategy

by Teija Tiilikainen

The EG was once a central-European project. Its various enlargements have given cause to new policies focusing on the particular challenges of the new geographic dimensions. The enlargement to the UK and Denmark strengthened the EG's transatlantic policies and the whole Mediterranean policy programme, the so called Barcelona process, came into being along with the southern enlargement.

The need of a particular political strategy for the Baltic Sea region has been discussed for a couple of years now in the EU. When Finland and Sweden joined the EU a Northern Dimension programme was launched to raise the challenges of the Union's northern borders and border areas to the common agenda. A change of emphasis was, however, needed along with the enlargement of 2004. This enlargement implied essential changes in the Union's external borders in the north. The Baltic Sea became practically an inland sea in the EU. Of its current coastal states only Russia is not an EU member. When the European Parliament adopted in November 2006 a report on a Baltic Sea Strategy for the Nordic Dimension this was an important first step welcomed by many actors. The parliament focuses both on the positive and negative challenges of the Baltic Sea region, economic perspectives and ecological concerns among them. It also raises a variety of issues from the EU-Russia relations to the core of the Baltic Sea Strategy. The role of Kaliningrad, energy policy cooperation and external border cooperation belong to these.

The EU has often been criticised for a weak ability to formulate coherent policies. One reason for this inability has been found in the divergent national interests of the member states, which challenge their commitment to common policies. This challenge becomes accentuated in the EU's external relations, where many member states have their special interests linked many times with firm historical roots. Another reason for the Union's incoherence can be traced to the complex set up of policy instruments. If relations for instance with a neighbouring country are conducted in the form of a variety of political and economic instruments like agreements and forms of political dialogue, the contours of an overall EU policy remain easily fuzzy.

Even if a particular political strategy for the Baltic Sea region can be useful just in order to respond to the EU's incoherence in its policies linked with the Baltic Sea region as it clearly defines the Union's priorities, it is faced with the same challenges identified afore. A Baltic Sea policy meets first the divergent national interests of the Union's member states in many both general and more detailed issues linked with the policy. The first of them deals with itself the utility of such programmes with a regional focus. While some member states perceive them to be perfectly compatible with their all-European policies and interests, others see too much unnecessary regionalisation and creation of dividing lines in them. Due to these reasons neither the Mediterranean programme nor the Northern Dimension programme has received a completely positive reception.

The formulation of a coherent Baltic Sea policy will face many challenges also what comes to many of its key issues of content. It is well known that the major differences in the member states' policies concerning the EU's relations with Russia can be found among the Baltic Sea states. When Germany has traditionally represented a more constructive position and policy in relations with Russia and has also like most other big member states shown some inclination to a bilateral conduct of issues with it, Estonia, Latvia and Lithuania together with Poland belong to the most critical members. They belong also to the ardent supporters of a multilateral way of dealing with Russian policies. These policy differences are reflected in issues which form the core of the Baltic Sea policy like for instance energy policy cooperation, border control cooperation and problems linked with the role of Kaliningrad.

The utilisation of the economic potential of the Baltic Sea area undoubtedly gets the support of every EU member in the region. The region has been identified as one of the most promising economic sub-regions in the EU, linked with strong economic growth and growing flows of trade and investments among the states. The overall picture is, however, not that rosy as the region is also characterised by large economic and regional inequalities and by remarkable environmental challenges. It is the attitude towards these problems, the means of preventing economic inequalities as well as environmental risks, which easily forms another dividing line among the Baltic Sea states and forms another challenge to a coherent Baltic Sea policy. The new EU-members have this far focused more on the economic premises of their international competitiveness and have been less concerned about the social or environmental endurance of their policies. Germany and the Nordic countries again have aimed at more balanced policies in this respect.

The EU's Baltic Sea Strategy thus faces the challenge of divergent national interests of the member states which, of course, doesn't decrease its value. The complexity of policy instruments was identified as another major factor challenging the formulation of coherent policies in the EU. In order to become an efficient policy the EU's Baltic Sea policy should have a clear-cut position in this respect and should be supported by proper instruments of funding. The European Parliament proposes a Baltic Sea Strategy to be created as a continuation of the Northern Dimension (ND) and to become its priority area. This might be well-motivated as the geographical scope of the ND programme is very wide covering in addition to the Baltic Sea region also specific parts of the Arctic Sea area. It should, however, be deliberated how the recent change that has taken place in the ND's character affects this policy combination. The ND has recently been changed from an internal policy programme of the EU into a common undertaking of all of its parties comprising the EU as well as Norway, Iceland and Russia.

Anyway, one should try to avoid the risk that the Baltic Sea Policy becomes another ambiguous part of the Union's already manifold policy instruments used in relations with Russia. Its aims and profile should be kept clear from the beginning and its relations to other policy-instruments as well. Otherwise the well-motivated effort to sharpen that dimension of the Union's recent enlargements which undoubtedly might risk to remain in the shadow of the more Central-European dimensions will fade away.

Teija Tiilikainen

Director

The University of Helsinki Network for European Studies

Nuclear energy in the Baltic-3: Dilemmas and determination

by Amelia Hadfield

Nuclear energy is back on the agenda[1]. Both the force majeure of environmental degradation from CO2 emissions and the political and economic dangers associated with rising import dependence have forced EU member states to re-evaluate their energy portfolio. The European Commission – a reliably tacit opponent of nuclear power – may also be reconsidering its position. This short exposé provides a snapshot of the nuclear profile of Latvia, Lithuania, Estonia and Finland within the context of recent European energy dynamics.

The Baltic Sea region is a critical area in a number of ways. Materially, the region is characterised by strong mutual dependence in both foreign investment and foreign trade, which has buoyed regional economies and contributed to the transport system. The Baltic Sea itself is becoming an increasingly important conduit for Russian oil and gas, whilst the territory of the three Baltic states promises potential for enhanced electricity transport frameworks. While only Lithuania and Finland are key nuclear producers, the region may in the future be capable of launching an indigenous nuclear industry.

Politically, the region is the site of much activity within the Northern Dimension, an EU-Russia project launched and led by Finland since 1997. Its 10 year anniversary should re-invigorate the programme with new regional priorities, such as enhanced foreign investment to fortify national and commercial energy industries, ecological measures to protect the increasingly busy Baltic Sea, and a more robust agreement with Russia in which both security of supply and demand are addressed. As the latter issue continues to defy the EU's ability to summon the necessary political will to act collectively vis-à-vis Russia, and as environmental degradation shows no sign of slowing, the 'nuclear option' now needs to be addressed.

The issue of security of supply is a tricky one for Baltic states. Whilst each country relies increasingly upon Russian oil and gas imports, the Nord Stream gas pipeline project (running under the Baltic Sea connecting Russian natural gas exports to Germany) is viewed by many in the region as a project that could actually strengthen the position of Baltic as a key EU transport route. While increasing the percentage of Russian gas imports (and arguably increasing European dependence), the pipeline could also be of serious benefit to the Balkan-3, making them something of a lynchpin in future EU-Russia cooperation.

The strategic importance of the Baltic region is undeniable. Yet import dependence is an equally potent concern, one which could easily see the Baltic states on the wrong side of the security of supply dilemma should relations with the national and commercial energy entities of Russia (or indeed any other major exporter) deteriorate. For these and other reasons, the idea of indigenous energy generation via nuclear power must therefore be considered.

Finland continues to act as regional patron of the Baltic. While the Northern Dimension has been accused of a somewhat lacklustre performance, Finnish nuclear energy has seen a renaissance in the past decade. Indeed, Finland has to be energy-saavy: it is second in the world (after Canada) for the highest per capita consumption of kilowatt hours of energy. Like Canada, Finland must contend with a harsh climate, long distances and energy-intensive industries, all of which contribute to increased energy intensity. 36% of Finnish electricity is currently generated by nuclear power thanks to four units, running in two separate stations. The two Loviisa units are of Russian design, nicknamed 'Easting-house' models (as opposed to Westinghouse), while the two units at Olkiluoto are Swedish in design.

Finland's nuclear profile will increase with the fifth unit currently being built by Franco-German vendor Areva, with audible industry agitation to begin a sixth unit (with E.On as a possible investor). As measure of the urgency of the project, former Prime Minister Lipponen, criticised the slow progress of Areva in building Olkiluto-3 in July 2006, arguing that the plant must commence operations for Finland to meet its Kyoto Protocol carbon emissions target. The nuclear industry however is not the speediest of animals. While the strict requirements by the Finnish nuclear regulatory authority (STUK) have acted as a brake on the speed of completion, Lipponen has had to argue that the agency's rigorous standards remain a calling card for Finnish nuclear credibility[2].

Latvia on the other hand has no nuclear generation, only a five megawatt Russian research reactor in Riga which is presently being de-commissioned, with the remnants of its fuel shipped to Russia. Remaining behind as part of the research reactor establishment are the 'hot cells', with plans to use these independently for radioisotope production in industrial radiography and medical research, enabling Latvian research and development to viably capitalise on this area. Lacking a discernable nuclear strategy, the benefits of upcoming Lithuanian nuclear plants may provide Latvia with a proxy nuclear policy.

The northern-most of the three, Estonia also has the farthest to travel in terms of becoming a nuclear energy player. Estonia possesses no nuclear plants and has had to deal with the nuclear leftovers of the Soviet presence, in the form of the naval training base at Paldiski which trained crews on two nuclear submarine reactors. Despite having been partly filled with concrete after the change of governments, the reactors were largely left intact and are only now being decommissioned. Estonia also possesses an ex-Soviet uranium extraction and fuel fabrication plant, and is currently making a name for itself in the supply of rare earths (rare and valuable minerals including hafnium and lanthanum, which being rare require large amounts of ore for their production). With no indigenous energy sources, Estonia too is heavily dependent upon imported Russian oil and gas.

Of the three Baltic states, Lithuania has the strongest nuclear profile. The two 1,500 megawatt RBMK units at the Ignalina plant have run well, but suffered from being the same design as Chernobyl. In a rather ignoble use of EU accession criteria, the first of these two units was forced to shut down at the end of 2004, and the second unit is to close by the end of 2009. Lithuania has invested much in constructing a facility to transfer partly-used fuel from Unit One to the still-functioning Unit Two, an operation that is expensive, difficult, and in the view of some, wholly unnecessary. This option however may be better than sourcing more fuel from Russia. Operating together, Ignalina's two units had granted Lithuania a pre-eminent place as Europe's highest nuclear-generating country at close to 80%. The first unit supplied the domestic market and the second generated power for export[3]. However, the closure of Ignalina has effectively eliminated Lithuania's ability to export power, transforming it from a net exporter to a net importer (buying around 20-25% of its energy needs from abroad). This rests uneasily with the EU's 2007 Energy Policy for Europe and its goal of reducing Europe's overall import dependence.

[1] Grateful thanks to off-record interviews with a relevant IAEA staff member, March 2007

[2] Ann MacLachlan, *Nucleonics Week*, Vol. 47, No. 27, July 6, 2006, p.5.

[3] Ariane Sains, *Nucleonics Week*, Vol. 47, No. 37, September 14, 2006, p. 3.

Market realities may be kicking in however. The current ambition to construct a replacement to Ignalina has aroused much interest among its neighbours. Latvia, Estonia, Sweden and a Polish-German consortium have all bought shares of the proposed new multi-unit complex with a target date of 2015. The possibility of converting Lithuania back into a major Baltic power export is keenly felt in the country and beyond, as the project should yield reliable profit margins and shift the balance of energy power back to the Baltic. With accompanying infrastructure a vital part of any such project, the news that new electric power lines are to be built between Poland and Sweden by 2013 is welcome in terms of expanded cross-border systemisation.

As ever, the impetus of national projects needs to be converted into political capital, preferably with a national energy strategy which makes clear its choice of power source. Lithuania appears close to publicising such a strategy, balancing government choices and heavy foreign investment. More encouragingly, the country appears to be leading a Baltic 'regional strategy' that can be reflected in each country's national energy priorities. Lithuanian undersecretary Danius confirmed in September 2006 that this approach is 'more reasonable compared to just a national strategy'.[4] Such views were reinforced the following month when a joint review of all three states confirmed the need for new nuclear capacity to replace the Ignalina closure, citing the triple goal of a diverse energy portfolio, Kyoto emission goals and security of supply thanks to the ready availability of nuclear fuel from a global, rather than monopolistic market.[5]

In order not to remain an 'energy island' - linked to the EU by overland transit through Poland or Baltic Sea cables and overly-dependent upon Russian exports - the Balkan-3 have no choice but to reform and work collectively. All share the same legacy and face the same challenge of profitably and safely making use of their ex-Soviet nuclear infrastructure. A necessary corollary of this ambition is mustering the political strength to make the hard decisions necessary to achieve increased energy efficiency, reduced imports and realistic carbon emission goals. Like the EU itself, a synchronised collective approach rather than a series of individual projects is preferable. Similar to the Balkan Energy Community Treaty, the Baltic-3 may have an opportunity to operate as a regional vanguard by visibly keeping the nuclear option on key agendas in the national capitals and at the EU level – representing the Europeanisation of energy.

Following the Balkan developments, the Baltic states have at least tentatively agreed to overhaul the existing inter-connection of their Soviet-legacy power grids, unifying around a central control and guaranteeing maximum flexibility and responsiveness. Connecting the Baltic grid to western European grids is an obvious extension of such a project, and the size of any individual nuclear power plant unit would be a factor in such an endeavour.

What is evident in such grid projects - as well as the 2006 connection of the Estlink undersea transmission cable between Finland and Estonia to the Nordic transmission grid (Nordel) - is the growing sense of collective political will between the Baltic-3. Defying the electric isolation of the region, the three states now need to capitalise on the security of supply inherent in such infrastructure by generating indigenous power. A greater goal may therefore be the Poland-Lithuania inter-connector linking the Baltic States to continental grids. Until these projects come to fruition, the group remains a litmus test for the choices made by other newly-acceded buffer states.

In sum, the Baltic states appear to have three foreign energy policy choices: first, they can elect to continue bilateral relations with energy suppliers like Russia. Second, they may attempt a regional energy consortium. Third, they may support the ambitions of the European Union to construct an Energy Policy for Europe in which energy operates as an inter-sectoral policy area concomitant with trade, investment, security and foreign policy, demanding greater competence than previously seen.

Of these, the regional option seems the most likely. What is needed is a sense of a Baltic energy neighbourhood to accompany its initial attempts at regional integration – an energy acquis in which regional energy cooperation features heavily and the nuclear option kept open. Equally however, the EU needs to agree upon and disseminate far clearer messages on the role of nuclear in its burgeoning energy policy. The Commission has hedged its bets and this will prove unhelpful in the long run. Nuclear power currently remains a national option. However nuclear safety, security, non-proliferation and indeed the competitive nature of its very output are already cross-national issues, and an obvious area of future harmonisation. The 2007 Commission Communication, An Energy Policy for Europe, tacitly acknowledges that nuclear power can play a role in addressing the three-pillar goal of security of supply, competitiveness and sustainability. Clearer indications from Brussels are urgently needed in order to assist the burgeoning development of the Baltic region as it strives to integrate itself with the EU.

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[4] Ariane Sains, *Nucleonics Week*, Vol. 47, No. 37, September 14, 2006, p. 3

[5] Ariane Sains, Nucleonics Week, Vol. 47, No. 43, October 26, 2006, p.7.

TriCity - Kaliningrad - Baltic Europol?

by Tadeusz Palmowski

One of the rapidly developing forms of cooperation and new relations initiated by political transformations in the 1990s are the intensely developing transborder contacts. Transborder contacts provide grounds for overcoming social barriers and restrictions. This is also noticeable along marine borders.

On the opposite sides of the Gdańsk Gulf there are two settlements systems. On the western side, there is the TriCity metropolis, and the Kaliningrad agglomeration on the eastern side. The Gdańsk Gulf and connected Vistula Lagoon with neighbouring land are the borderline between Kaliningrad Oblast of the Russian Federation and the Republic of Poland. Both settlements developing around the Gdańsk Gulf for over fifty years, though distanced merely 160km from each other, did not maintain consequential relations.

European Union enlargement in May 2004 resulted in the Baltic becoming an internal EU Sea. Geographical proximity, coastal location, relatively good transport infrastructure, development of border crossings both inland and sea crossings indicate the special opportunities for developing transborder cooperation between north-east Voievodships of the Republic of Poland (RP) and the Kaliningrad Oblast (RF).

Two of the decisive factors for the development of TriCity metropolis are: the geographical factor resulting from its coastal location and the historical factor of relatively independent development of three big towns forming the nucleus of the metropolis Gdańsk; Gdynia and Sopot. This three member settlement structure forms the functional union called TriCity. In the last few years, the relations between the three towns lying on the coast of Gdańsk Gulf became very intense creating in fact the TriCity metropolis, which with economic development of the coastal area extended to cover neighbouring towns.

The position of Kaliningrad is unique in historical, economic and geopolitical terms. The disintegration of ZSRR meant that the region, which was a closed military base for decades and up to 1991 remained completely isolated from the West, came again into focus of European discussions. After Lithuania gained independence, the Oblast became a Baltic exclave. After EU and NATO enlargement eastwards, the Kaliningrad exclave became "the Russian window to the European Union".

The Kaliningrad agglomeration was also determined by geographical, historical and geopolitical factors, quite different, however, than in case of the TriCity. The most important city of the Oblast is Kaliningrad, which concentrates 46% of the population and 60% of the industrial potential. Kaliningrad is a historical city with more than four hundred thousand inhabitants lying on the Pregolya River, formerly the capital of Eastern Prussia, destroyed at the end off World War II, and assigned to the Soviet Union under the agreements of the Potsdam Conference. The entire agglomeration comprises 650 000 inhabitants.

The present changes taking place in the Pregolya River region give a lot of hope and to a minor degree some anxiety. The contemporary Kaliningrad, part of Russia, is subject to continual transformations in all spheres of life. Cut off from the world for decades it is now dynamically catching up economic and cultural neglect. The attempt to cut away from the past failed. We can see the trend of coming back to the roots, though these vary from the state and ethnic origin.

The new geopolitical situation created a good environment for the framework of the new metropolis around the Gdańsk Gulf. The main centres of this bi-centric metropolis would be: Kaliningrad and TriCity.

The first stage of infrastructural premises of bipolar development of the metropolitan region and development of its competitiveness is the connection linking both core transport and communication infrastructure.

Present TriCity and Kaliningrad relations

Cooperation between the Kaliningrad Oblast and Poland is taking place along two lines: as cooperation between Poland and the Russian Federation, and as transborder cooperation between Polish north east Voievodships and the Oblast. Cooperation going beyond solely official measures, since the first agreement was signed in 1991, spread wider to particular gminas and towns, companies and non governmental organisations. A General Consulate of the Russian Federation was opened in 1993.

An important area of cooperation for the Pomorskie Voievodship and the Kaliningrad Oblast is that of contacts between schools of higher education in both regions. For example an agreement was signed between the State University in Kaliningrad and the University of Gdańsk.

Gdańsk and Kaliningrad also cooperate on many initiatives and Baltic programmes such as Baltic Sea States Subregional Cooperation (BSSSC), Union of Baltic Cities, VASAB 2010, Baltic Port Organisation (BPO), Baltic Association of Regional Development Institutions (BARDI), and Baltic Euroregion.

Development perspectives of the bipolar TriCity - Kaliningrad framework

In 2007, an express road Gdańsk-Kaliningrad, part of Pan-European Corridor no I A Riga-Kaliningrad-Gdańsk, is to be commissioned for use.

Due to the intensive development of border traffic between the Kaliningrad Oblast and Poland, exceeding 3.8 million people in 2005, further development of both land and sea border crossings are planned.

Potential spheres of further actions connected with the concept of developing the bipolar system and enhancing the synergy effect can also involve such areas as: development of communication links, developing industrial links, company cooperation, cooperation in agriculture, development of business environment infrastructure, opening up to international specialist staff, power supply, scientific cooperation, protection and restoring of cultural heritage, protection and reasonable development of the national heritage, cooperation of self governments and non governmental organisation. The Polish side supports all measures taken towards eliminating economic and civilisation barriers between the Kaliningrad Oblast and countries of the region. A factor facilitating regional cooperation of the TriCity and Kaliningrad is the exclave nature of the Oblast and relatively fast pace of privatisation in Russia. Innovations and development incentives may be passed from the TriCity to Kaliningrad and further eastwards.

The bipolar framework TriCity - Kaliningrad may in future become a Baltic Europol. The development of this settlement system will contribute to a stable and sustainable development of the town network around the southern Baltic.

The development of a bipolar framework around the Gdańsk Gulf is possible provided good relations develop between the European Union and Russia. It also depends on whether Kalinigrad and TriCity are capable of taking advantage of the new more favourable geopolitical situation in Baltic Europe, the geographical opportunities - proximity of the neighbourhood, common Vistula Lagoon, Vistula Spit, and mutual relations of north east Voievodships. However, this is

a complex and long term process.

The mission of the TriCity and Kaliningrad metropolis is of international nature with high European sustainability and safety connotations. The process of involving the Kaliningrad Oblast of the Russian Federation into the sphere of European cooperation may constitute an essential input of Poland in the development of the new European order.

Tadeusz Palmowski

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Challenges to the efficient EU border with Russia at the Kaliningrad enclave: A view from Lithuania

by Alvydas Medalinskas

Like other new EU countries, Lithuania is under process of the preparation for the Schengen membership. Full adaptation of Schengen acquis, implementation of the EU Integrated Border Management, creation of Integrated Border Security Security Model are very important tasks to achieve for Lithuania in order to have efficient external Schengen borders with non EU member countries.

Various EU documents describe integrated border concept, but a universal model for border management has been neither provided by the EU acquis, nor by its 'Schengen' standards. There is clear understanding that European borders have to be open and secure with neighboring countries in order to facilitate legal cross-border activities, without creating security problems. There is also an experience of various EU countries with practical implementation of integrated EU border concept.

The border between Finland and Russia is one of such examples, which is very helpful for Lithuania to follow making effective border with Russia at the Kaliningrad enclave. Part of this positive experience deals with the cooperation between various services at the border checkpoints on both sides of EU border. It is less degree of cooperation among all institutions working on the border in Lithuania than in Finland. Finnish-Russian co-operation on border issues is based on the agreement and has a long tradition. There is still no such agreement between the Border Guards of Lithuania and Russia and no tradition of cooperation during the last half century.

One of the main problems on the Lithuanian-Russian border is a smuggling of various commodities, such as vodka, cigarettes and petroleum. It is very difficult to tackle effectively this problem without efficient cooperation of various authorities across the border, including sharing the information not only between various agencies on the border checkpoints of each country, but also between similar agencies across the border. Different national border agencies in Russia are not keen to share information even with each other and much less with EU partners. No clear guidelines from the EU side set up on data exchange in relations with Russian partners.

Without solution of this problem it is impossible to talk also about setting up of joint checking points on the EU-Russian border, which Russia views as an important measure to reduce queues of the traffic at the border, while EU countries are more skeptical. Border checkpoints in Russia are less developed than in the neighboring EU countries. Russia is happy to modernize its border checkpoints, but mainly with the EU funds.

Green border security on Russian side is very efficient. This is partly a consequence of a different philosophy in the EU and Russia. While the EU tried to invest in the system of measures before the borders, Russia all efforts concentrated directly on the border. Green border surveillance on the border with Russia in Finland is more efficient than in Lithuania. Old technical border security system with barbed wire fences, observation towers, electronic alarms etc. are still in place on Russian-Finnish border from Cold War time, while Lithuania had to build it from the scratch. It is impossible to build up all new border checkpoints on Lithuanian-Russian border. Most of them have to be modernized. Under preparation for Schengen membership Lithuania had to make improvements in existing checkpoints, splitting the lines at the border checkpoints for traffic using the green lane and red lane and also splitting lanes for Schengen countries nationals and third country nationals.

However, because of lack of space in some earlier built checkpoints, such new lines might come up on Lithuanian side in place of existing green and red lanes. But there is even bigger problem on the Russian side: not everywhere Russia has green lanes. Unlike in Finland, queues at the Lithuanian-Russian border are not structured before the checkpoints. This has not been foreseen, when checkpoints were built up and now it might take additional investments to make such arrangements.

It is a great interest in Lithuania on the system of Green corridor, which has been implemented on Finnish-Russian border according to the agreement signed between the Swedish, Finnish and Russian Customs administrations. Companies participating in this project were allotted a separate lane to handle their customs matters and customs clearance for them could be done within a few hours, while others have to wait.

Lithuania implemented system, which, apart of the Finnish example, has other additional components. The system called Kaliningrad transit has been created by custom authorities from Russia and Lithuania and could serve to the interests of various companies, which have a guarantee from the transport company association in Lithuania and Russia and cross the territory of Lithuania from Kaliningrad district to the rest of Russia or vice versus. This system is based on the advanced electronic goods declaration system and goods application customs control.

Russian services on the border checkpoints lack sophisticated equipment, such as radiation detectors, X-ray devices, computer systems, etc. It might also explain why check up procedure for example of trucks on Lithuanian side takes less than on Russian side. Without sophisticated equipment it is very difficult to do quick, but effective check up of the traffic passing through the border crossing point.

Certainly, even implementation of such systems, as Green corridor or Kaliningrad transit, splitting traffic lines, modernization of checkpoints and new technological equipment would not help to reduce queues on the border with Russia, if the situation will remain unchanged with the practice and quality of work of various institutions in the Russian border checkpoints and legal basis for such activity.

Customs work in Russia is organized on selective control, where mainly the attitude or interest of custom officer matters and which is the main source for bribes and corruption. Checking on the Russian side might take about half an hour, while average checking procedure on the EU countries side takes only few minutes, because it is based on the risk analysis. If Russia would also start to do checking procedures based on the risk analysis, it would mean less formality and corruption, more effectiveness, shorter waiting time and reduced queues on the border.

No compatible legislation on both sides of the border, different rules and regulations constitute are one of the most serious problems for the co-operation at the external EU border with Russia. Harmonization of legislation in Russia according to the European border management principles would be a very important step to make the external EU border with Russia effective and efficient. In order to achieve efficient EU borders with Russia at the Kaliningrad district it is not enough that EU countries, such as Finland and Lithuania make right steps. It is also important that Russia would implement integrated border concept.

Integrated border concept could serve as a pilot project for further cross-border co-operation between the Russian Federation and the European Union to make border more open and secure. At least such border management strategy could be introduced by Russia on the border with EU at the Kaliningrad district, particularly, if Russia, as well as EU, still regards the Kaliningrad district as a pilot project.

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Maritime transports and their future prospects in the Baltic Sea Region

by Antti Saurama

In recent years, the Baltic Sea Region has developed rapidly in economic terms, BSR states recording outstanding GDP growth rates compared to Europe in general. Between 1995 and 2004, the region's aggregated GDP grew by 42 percent, totalling an average growth of approximately 4 percent (the region including Finland, Sweden, Denmark, Poland, Lithuania, Latvia, Estonia, the western regions of Russia, the northern regions of Germany, and Norway). The fastest growing economies during this period were Lithuania (367 percent), Estonia (309 percent) and Latvia (296 percent) while the overall Russian economy grew by around 90 percent. Despite the more modest growth of some other states, considerable differences between the absolute sizes of the BSR national economies and the volatility of growth in some states, this continuous aggregated growth has fostered international trade within the region. The result, albeit not solely due to economic growth, is ever greater demand for transport, which is forecast to grow considerably in the future.

Maritime transports play an especially important role in the BSR. Dominated by the Baltic Sea at its centre, this region and its industries and consumers need maritime connections for their international and intra-Baltic trade relations. Bulk commodities play a major role in the trade and transport of BSR countries, and these commodities are usually best transported by sea whenever possible. Indeed, the BSR's maritime transportation is dominated by bulk commodities. Liquid bulk commodities (mainly oil and oil products) have a share of around 45 percent of all maritime transport in the region, while dry bulk commodities total around 27 percent, making the share of bulk products more than 2/3 of total volumes in the BSR. When analysing maritime transports between BSR States, or intra-Baltic maritime transports, dry bulk commodities constitute the lion's share at 43 percent.

Extensive, annual analyses of maritime transport development covering the whole BSR are difficult to find, partly due to statistical difficulties. The few analyses performed are customarily produced for larger individual projects on an ad hoc basis. One such project, Baltic Maritime Outlook 2006, which involved the writer of this article and the Centre for Maritime Studies, was completed in 2006. This study provided a macro-scale view of transport development, especially maritime transport development in the BSR. The study reported a gross total of 909 million tons of maritime transports in the BSR during 2003. The net total, reflecting the volumes handled in ports, was reported as 730 million tons. It should be noted that these figures included the maritime transports of Norway, the German North Sea ports and Danish North Sea ports. To some extent, the gross figure for 2003 can be compared to the author's own rough estimation based on various statistical sources from the year 2005, indicating a gross volume of around 1100 million tons in the same region. These volumes are handled in approximately 400 ports around the region, ranging from minor local ports to European and global hubs. Taken together, the figures indicate that maritime transports play a significant role in the BSR and its development.

The BSR is currently witnessing the rapid growth of maritime transports as a whole, especially in some specific segments such as oil transports and container transports. What does the future hold in terms of maritime transports in the BSR?

The longer the forecast period, the more uncertain the answer. In Baltic Maritime Outlook 2006, an effort was made to estimate future maritime transport flows in the BSR. Results based on various economic and trade analyses as well as forecast transport infrastructure development and macro-simulation indicate that the BSR is the growth centre of maritime transports in Europe. Based on these analyses it is expected that from 2003 to 2020 cargo transported by sea within the region will increase by 470 million tons. This equals a 64 percent increase compared to 2003. Based on analyses of the expected growth, more detailed results show that out of the 470 million ton increase, around 150 million will move between BSR States (an increase of 83 percent), around 270 million will represent exports from the BSR to the outside world (an increase of 68 percent) and around 50 million tons will represent imports from the outside world to the BSR (an increase of 35 percent). The overall growth in maritime transports in BSR will exceed that of the whole of Europe: in terms of transport operations (ton kilometres per year) the indexed growth in the BSR, from a base of 100 in 2003, will reach 193 in 2020 whereas in the whole of Europe it will reach 166. Total transport operations measured in ton kilometres will double within 20 years.

Some interesting remarks can be made on the presented growth figures and trends. The greatest relative growth in maritime transports is expected in intra-Baltic transports. This is a reflection of expected trade development in the BSR as, in relative terms, more goods are traded between the BSR states. Hence, maritime transports are indicative of the increasing economic integration of BSR states which is likely to occur in the future. Also, the growth of national economies and trade is expected to be proportionately highest in the eastern parts of the BSR and the analysis indicates that, in this region, east-west cargo flows will grow much faster than north-south cargo flows. On the whole, maritime transports are expected to become the leading transportation mode in the BSR in the period up to 2020, leaving behind both rail and road transports. In other words, the BSR will witness a clear modal shift from rail and road to sea. As with all forecasts, the reference study includes many assumptions and uncertainties. However, the trend is clear: maritime transports will continue to grow substantially in the BSR.

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Kaliningrad and the benefits of gambling

by Kristian Nygaard

With the signing of the law on casino zones in December 2006, Kaliningrad has moved into the tourism spotlight and is now among the candidates for most promising European tourism destination. The law has meant that the region as of 2009 will have something to offer its visitors that only 3 other Russian regions (all of which are far away) can have as well.

As of today, the casino zone will most likely be located in or close to Yantarnyy. Here the tourist future of the Kaliningrad region might well be founded and the zone would probably very quickly surpass any other attraction in the region in regards to number of annual visitors.

The establishment of this zone would create possibilities in the following fields:

Casinos
These will see great possibilities in the area, both for the Russian and European markets.

Tourism
The Kaliningrad region would have an added attraction in gambling that together with existing ones such as the Kuronian Spit, Svetlogorsk and Zelenogradsk would make up the 'Kaliningrad Experience'.

Tax-free shopping
Since being outside the European Union, Kaliningrad have the possibilities of offering tax-free shopping for visitors coming from one of the European Union countries.

So potentially for the region it could create these benefits:

Greater Income
Casinos will mean more tax revenue which in turn can be used within the public economy of the region.

More jobs
These additional jobs will be created both within the casinos as well as within any sector that could be affected, such as restaurants, hotels, taxis, shops and many more.

Growth in other sectors
Not just the casinos themselves could benefit from the zone. In order to run casinos many suppliers are needed within sub-sectors such as food, beverages, handicrafts etc.

Improved image
It is no secret that Kaliningrad has suffered from a poor image. Mostly it has been undeserved and the majority of the factors that made the region receive this image in the 1990's have been dealt with as of today. However, the negative image of the region still lingers on. The introduction of gambling and the establishment of the casino zone could create headlines and subsequent positive news about the region. So instead of being known for AIDS, Soviet style architecture and prostitution, Kaliningrad could receive a whole different image. So when people in Europe would think of the region, what first would come to mind is that of a place to go to have fun and enjoy yourself. Much in the same way as one would think of other tourist destinations, i.e. London for shopping, Amsterdam for canals, Las Vegas for casinos and entertainment etc.

Improvements in infrastructure
With the advent of casinos and other gambling establishments tourists will come. They will arrive to the zone through ports of entry located within the Kaliningrad region and via air, railway, ship or road. The infrastructure improvements that are necessary along the way will also affect and benefit the general public. For instance, the construction of a connection road would benefit the tourists, the workers in the zone and any resident in the local area. Thus the citizens that live and the businesses that operate within the region will have better options for getting to and from Kaliningrad.

More entertainment offers
Casinos have been known to provide entertainment for their clients. This could include everything from shows to sports events etc. These entertainment offers are naturally also available to other tourists not playing at the casino as well as residents of the region itself.

So the establishment of a casino zone will provide the region with many benefits. However, one should not close the eyes for the possible problems that could arise from a strong casino presence.

For instance, one should mention the following:

Higher level of criminality
Especially the economic crime forms as well as the presence of groups that live of criminal activities and practice this in an organized form. Herein lies first and foremost a responsibility of the authorities to control all relevant economic transactions that take place within the casino. Also the casino management should put up an effective surveillance system that effectively should deter anyone fro committing any type of crime within the casino.

Prostitution
It is a well known fact that wherever there exist easy money, prostitution flourish. And casinos are naturally no exception to this rule. Prostitutes will flock to a place where money are being won and lost within seconds and where historically sex has been viewed as a commodity for the winners.

Gambling addiction
The strong presence of casinos will unfortunately not only attract the tourists that come for a couple of hours of fun. Also persons who are suffering from gambling addiction will be attracted to the gambling tables like flies to honey. In this case it is important that the casinos know of their responsibility in promoting responsible gambling. Often however, this is not enough. It will also be necessary for the authorities to support and maintain help for these unfortunate individuals who suffer from this illness. Funds for this could very well derive from the taxes that the state receives from the casinos.

In summary, Kaliningrad has excellent possibilities in terms of development of gambling tourism. Within 10 years, my estimate is that the casino zone could mean more than 1800 more jobs within the casinos and in businesses that supply the casinos. On a yearly basis approximate one million people would visit the casino zone for gambling, entertainment and shopping. These are divided into day-visitors and those who would stay for 1 night or more.

The zone would have 4-5 casinos, many restaurants and bars as well as a well-stocked area for shopping, mainly dedicated to visitors from the EU.

Most visitors would arrive through: a) Kaliningrad Airport, b) Port of Baltiysk, and c) Kaliningrad Main Railway Station. From a) and b) direct non-stop bus services would operate in connection with arrivals and departures. From c) a regular train service would run serving both locals and tourists, perhaps even with a side line sometime in the future for the casino zone. Also indicated in this is the projected railway to the Airport.

Thus in 10 years time many things that are now part of the tourist image of Kaliningrad would be drastically different due to the introduction of the casino zone. Gambling would mean that Kaliningrad could get an image that is more linked to fun and entertainment. And that this would in time mean more income and jobs for the region.

To conclude, the introduction of a casino zone in Kaliningrad will have a profound effect on tourism in the region. Potentially income and jobs will be created both within the casinos, the trade sector and any other sector that supply these. Also it could benefit the region and its population in other ways, such as infrastructure and image.

However, one should also note the potential negative effects such as prostitution and criminality. In 10 years time from now, Kaliningrad could be a very different region in a tourist perspective. The casino zone could contain several casinos, hotels, restaurants as well as a large section of shops targeted the visitors coming from the EU countries. The effects would be infrastructure improvements, more jobs, and greater income.

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Quiet Russia: St. Petersburg as a mirror of Putin's political stabilization

by Nikita Lomagin

Arguably, the most important event in the political life of Russia in the first quarter of 2007 have been elections for legislative assemblies in 14 of Russia's 86 regions, including the biggest metropolis of the Northwest Russia - St. Petersburg. The elections have also some international implications for both Russia's new image as a country steadily retreating from democracy and at the same time a country which can provide more security for foreign investors through building a sort of a monolith between executive and legislative branches of power not only on the federal level but also ob the regional one.

The St. Petersburg elections seen as a rehearsal for the State Duma elections in December were the first to be held since the removal of the minimum turnout limit, which was lifted by the Russian parliament in December 2006. In this situation the parties are not seeking new voters, not trying to get more people interested in elections but rather they all target one-and-the same group of people traditionally go to polling stations.

Another novelty of the local campaign was the introduction of a proportional electoral system – also known as the party lists system that requires candidates to run on a registered party list in contrast to a majoritarian system that allows independent candidates to stand. It seems that Vladimir Putin's political credo is very much the same as of the Russian Prime Minister Petr Stolypin who almost a century ago addressed the hostile State Duma with the following call,"Give us twenty years of peace both internally and externally – and you will recognise Russia". Internal stability by all means appears to be the highest priority of the Kremlin today. Quiet Russia is, in fact, what Putin is dreaming of today.

As for the campaign itself and the way how it was run, there are three features which distinguished it from all previous contests. First, political platforms of neither party paid any significant attention to foreign policy issues or any issue related to the Baltic Sea Rim. In this sense, they were local indeed. Second, among the frontrunners of all political parties there were prominent women on party lists. For instance, the rector of St. Petersburg State University Ludmila Verbitskaya was number three in the United Russia party while a very popular State Duma Deputy Oksana Dmitrieva was on top of Just Russia party list. Third, a number of well know sportsmen participated in the campaign not just advocating for this or that party but being on party lists. Among them were, for instance, Olympic champion Yevgenii Plushenko and the captain of the national soccer team Andrei Arshavin. The message to the voters was simple: St. Petersburg does not need any longer political battles with participation of 'strong men' be they generals (this was a common place from 1993 on) or so-called 'successful businessmen' who made their fortune during privatisation of 1990s. The really successful are those who achieved a lot by hard work, and long-term service in traditionally respectful in St. Petersburg areas such as science, education and sport. Another goal was to attract to elections besides traditional voters the youngsters who admire their sport's icons. Was this campaign a success for the Kremlin?

In terms of results, yes. Pro-Kremlin bloc United Russia received 37,37%, giving the party 23 out of 50 seats in the Assembly. Another pro-Kremlin party, Just Russia, came second with 21,9% translating to 13 seats. The only opposition party qualified for the Assembly - Communist Party - won 16,02%, equal to 9 seats, and the Liberal Democratic Party gathered 10,82% and 5 seats in the parliament. The other forces selling themselves as an opposition - Patriots of Russia and the Union of Right Forces failed to entitle them to seats in the assembly, having collected 5,8% and 5,2% of votes cast respectively.

But there was another result of election which is quite a negative for the Kremlin. It is the apathy of voters – nearly seventy percent of voters ignored elections to the St. Petersburg Legislative Assembly. A total of 37,501 ballots were declared invalid, according to the St. Petersburg Election Commission.

The figure significantly exceeded that expected in normal election conditions of less that 1,5%, the statistical average of spoilt ballots. Liberal Party Yabloko - expelled from the elections on a contested technicality earlier – had asked its supporters to go to polling stations and write the words "protest", "Yabloko", or other words of discontent on the ballot.

Yabloko officials insist they were cut from out of the political process because they oppose construction of a Gazprom skyscraper near historical centre of St. Petersburg.

The Governor of St. Petersburg Valentina Matvienko who openly campaigned for United Russia – was satisfied with the results of the elections. And this is quite understandable. For the next four years she will be guaranteed from any opposition from the Legislative Assembly of St. Petersburg. It might be a good sign for strategic investors too who need stability and predictability. The Governor wants to leave little to chance of challenging a number of ongoing and planned projects which might bring to the shores of the Neva river billions of dollars.

It appears that voters in St. Petersburg as well as in other Russian regions put the so-called 'stability' promised by the United Russia far above traditional democratic values, civil rights and market economy. The results of the Levada Centre's opinion poll from December 2006 indicated that only 16% of those surveyed identified the 'Western model' of democracy as the ideal (this same figure was 25% in 1996) and 35% said that they "prefer the Soviet system before 1990s". Another 30% of those surveyed that Western democracy "wasn't suitable for Russia" and 12% said it has had a "devastating effect on Russia". Another alarming data indicates that 94% of those surveyed said they "don't have any influence on the current situation: in the country or that their influence was "relatively small" or even "too small" (13% and 18% respectively). Directly related to this is a very low sense of responsibility among respondents for what happens in the country (82%). In general, Russians appear to have reconciled themselves to the idea that all significant decisions in the country are made independently of their opinion.

The result is growing apathy, as 17% of those surveyed said they would not vote in State Duma elections this December, 11% that they yet to decide whether to vote and 23% said they were undecided for whom they would vote. The worsening of Russian attitudes towards Europe and its basic values is an alarming indicator, revealing the insufficient (if not completely absent) effort on the part of the elites looking for Russian integration into a European system of values.

The Governor Matvienko critics, however, do not agree with her optimism calling the election "a triumph of hypocrisy". "What we got was a cynical trade-off between two pro-Kremlin parties, equally loyal to the President", said Maria Matskevich, a senior analyst with the Institute of

Sociology of the Russian Academy of Sciences. “It was an imitation of choice, and a step toward a fictitious two-party system, with the difference between two cloned parties being only their names. The only genuine and strong opposition part, Yabloko, had been shut out of elections. Nearing the State Duma elections in December, liberal parties were given a clear message”.

United Russia and Just Russia were on the ballots in all 14 regions along with the Communist Party and the Liberal Democratic Party of Russia, whose leader Vladimir Zhirinovsky is seen as loyal to the Kremlin. SPS, Yabloko and several smaller parties (the Greens) were also seen on some of the ballots. In a sign of United Russia’s strength, the Party won 13 out of 14 regional parliamentary elections.

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St. Petersburg: The most important foreign city for the Finnish economy

by Kari Liuhto

Recently, regional elections were held in St. Petersburg, and the results were in accordance with expectations. The winners were the two main pro-Kremlin parties – United Russia and Justice Russia. Together these two parties garnered a full 60% of the votes cast. The 16% of votes captured by the Communists was also pretty much as expected.

The results of the nationalists and the liberals, however, were followed with greater than those of the leading trio. The nationalist Zhirinovskyites gathered a large share of the vote in St. Petersburg (more than 10%), which indicates in a regrettably telling way a growing feeling of nationalism in Russia. In assessing the state of nationalism, it is worth remembering that St. Petersburg is Russia's stronghold of liberalism. Or, rather, it was. In the event, right-wing liberalism was suffocated or suppressed, as the Union of Right Forces received less than the 7% of the vote required to be entitled to seats in the city parliament, and the Yabloko party was expelled from the elections on a technicality.

The expulsion of Yabloko from the elections was a setback not only for liberalism in Russia, but also for nationwide democratic development as a whole. In the longer term, Russia will perhaps no longer prove to be as united and just as it currently seems. In the short term, the election results are indeed hardly reflected in St. Petersburg's economic policy, and the strong rebirth of the city continues.

The city has succeeded in tripling the size of its budget in three years; and not a single other one of Russia's 86 regions can trump that. The economy of St. Petersburg is growing at a faster rate than the Russian average. The gross regional product has increased at an annual rate of more than 10% for the past decade. The growth in Russia as a whole has not exceeded 7%.

In St. Petersburg a group of significant development projects is starting up, in such fields as environmental protection, logistics and changing the city's public image.

Of the environmental protection projects, one of the most significant is the St. Petersburg waste water treatment plant, which will contribute to a considerable reduction in the environmental load that the city places on the Gulf of Finland. In addition to waste water, St. Petersburg's other environmental problems must be tackled more strongly than before. The EU's Baltic Sea Strategy and Northern Dimension policy offer excellent means for this.

On the logistics side, interest is being stirred in the development of St. Petersburg and its surrounding ports, the construction of a gas pipeline from near Vyborg along the Baltic Sea bed to Germany, the considerable increase in sea shipments of oil in the Gulf of Finland, the completion of the St. Petersburg ring road, and the construction of a high-speed rail connection between St. Petersburg and Helsinki. In their own way, all the above-mentioned projects have an impact on the surrounding countries.

As far as the revamping of the city's public image is concerned, the most publicly discussed projects are the major Chinese investment to build a new district of St. Petersburg (the Baltic Pearl) and the Gazprom City project of Russia's major gas corporation. The Chinese project, with an investment in excess of one billion euros, is the manifestation of a new phenomenon in international business – Chinese business expansion beyond the China's borders. Correspondingly, Gazprom City reflects the dawning of the migration of the headquarters from Moscow to St. Petersburg. According to Sergey Fiveysky, the First-Deputy Chairman of the Committee for Economic Development, Industrial Policy and Trade of the St. Petersburg City, energy companies (Gazpromneft ja Transnefteprodukt), logistics companies (Sovkomflot ja Transaero) and banks (Vneshtorgbank) have moved or are moving their headquarters to St. Petersburg. Although it is too early to assume that economic decision-making power will move from Moscow to St. Petersburg, moving headquarters supports St. Petersburg's economic growth and foreign trade.

Foreign trade in the city of St. Petersburg has developed rapidly. During the past decade, the value of external trade has more than quadrupled. Finns have received a juicy slice of this growing cake, as Finnish companies account for one-tenth of the foreign trade in this city of some 4,5 million people. St. Petersburg's foreign trade is still less than that of Estonia with its total population of 1,3 million, which leads us to believe that the limits for St. Petersburg's growth will not be reached, at least in the near future.

Finnish companies are also active in setting up operations in St. Petersburg and the surrounding Leningrad region. This is shown by the fact that the Finnish investments in St. Petersburg made in the first half of last year constituted 6% of all foreign investments made in the city. The corresponding figure for the Leningrad region was over 20%.

Although the results of St. Petersburg's regional elections raised some dark clouds, the economy of the city seems to be improving at a healthy pace. I would even venture to claim that an economic boom has begun in St. Petersburg, and its compound effects will also be seen in the whole Baltic Sea region, sooner or later.

St. Petersburg will experience a similar kind of economic renaissance to Tallinn a decade ago. The most significant difference between these cities, however, is that St. Petersburg is ten times larger than Tallinn, so its compound effects on the nearby economies will be considerably more powerful than those that resulted from the economic boom in Estonia. St. Petersburg has become the most important foreign city for the Finnish economy, as Anders Blom, the coordinator of the Finnish Advisory Group for the St. Petersburg City Government, has aptly concluded.

St. Petersburg's future strengthening is an axiom, which automatically also leads to increases in the flows of goods, services, money and people in the direction of the Gulf of Finland. Some of these flows are a threat, particularly to the environment of the Baltic Sea, but others offer huge opportunities to the firms in the Baltic Sea region and beyond.

Kari Liuhto

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Energy Policy for Europe: Current Energy Issues in the Baltic States

by Andris Piebalgs

Nowadays Europe faces numerous challenges for its security of supply, competitiveness and sustainability. Rising global demand for oil and gas, depletion of natural resources, dependence on handful of suppliers, insufficient investment in energy production, highly volatile energy prices – these are just few challenges for Europe's long-term supply security and competitiveness. Climate change, fostered by increased CO2 emissions, is another one, putting pressure on our stability and sustainability.

The situation in the Baltic States is not an exception. On a business-as-usual scenario, the energy demand in the Baltic States is set to increase by 50% by 2030. Demand for gas alone is expected to grow by 60% during this period. Increasing demand together with rising fuel prices, the oil and gas dispute between transit countries and Russia, the energy market reform and the pressure of new environmental legislation – all these factors have increased the strategic importance of energy issues in the Baltic Sea region. Moreover, the Baltic States remain an "energy island" largely cut off from the rest of the EU and linked only with third countries, such as Russia and Belarus.

The challenges of secure, competitive and sustainable energy can not be sufficiently met by individual Member States alone. Therefore the European Commission has proposed a new Energy Policy for Europe. This integrated energy and climate change package aims at cutting greenhouse gas emissions by 20% compared to 1990, increasing the share of renewable energy sources to 20% by 2020 and saving 20% of energy consumed by 2020. Besides it, the package introduces numerous measures for effective and competitive internal market in energy. Such a policy, which combines internal market integration, diversification of energy sources and energy efficiency, can reduce substantially the dependency of Europe from outside supplies thus fostering its energy security.

For the Baltic States energy security is particularly important. Given their isolation and dependency on one major supplier, currently there are few issues to pay more attention to.

The first one is energy interconnections. The isolation of the Baltic States is not only a challenge for security of supply but also for proper functioning of the internal market in energy. Therefore integration of electricity and gas networks of the Baltic States into the wider European network is one of the Commission's priorities for this region. The EU is helping the region through its Trans European Networks Programme for Energy. Since its creation in 1995, the TEN-E Program has supported more than 30 studies in the Baltic Sea Region with a total contribution of about 30 million euros. Two projects, Estlink and the Polish Lithuanian interconnector, have been identified as priority infrastructures for the Baltic States. In December 2006, Estlink, the underwater electricity cable that links Estonia and Finland, connected the electricity grid of the Baltic States to Nordel, the Nordic transmission grid, thus putting an end to the electric isolation of the region. It is the first and so far the only electricity connection of the Baltic States with other Member States of the EU. The Poland-Lithuania interconnector will link the Baltic States to the continental European electricity network. After significant difficulties over the years, the study phase is expected to be completed in 2007 and the line is scheduled to start operating by 2013.

In addition to interconnections, some Baltic Sea region countries have important assets which are interesting for the whole region, such as the Inchukalns gas storage in Latvia. The Commission will fund a geological and economic study on another possible underground gas storage development.

The second issue is diversification of energy supplies. In general the Baltic region has the benefit of a relatively good diversity of energy sources. Lithuania has a nuclear tradition, Estonia has oil shale. The use of renewable energy is growing slowly, due to small and large scale hydro as well as the production of bio-energy (including biofuels) from agriculture and forestry. Nevertheless, the Commission's Renewable Electricity Report identified that deployment of green electricity in the Baltic region is very modest due to the lack of a stable support systems in this area. It will need to be improved in the future. Besides it, oil and gas from Russia has traditionally made up for low domestic opportunities. Given its relative position, it is economically reasonable to say that most of the region's gas will continue to come from Russia for the foreseeable future. Through the European network, however, alternative suppliers may be found as far as Norway or Algeria. Liquid natural gas is also an alternative worth studying.

Investment is needed in new electricity capacities. In the Baltics, old power plants are being phased out, while demand is rising. With the closure of Ignalina, the Baltic States will lose a major power producer. The Commission's Energy Policy for Europe underlines that it is up to each Member State to decide whether or not to rely on nuclear electricity. Though I welcome the commitment of the three Baltic States to collaborate in a feasibility study for a new nuclear plant in the region, nuclear power generation must meet the highest safety, security and proliferation standards, while important issues such as waste management and decommissioning funds should be correctly managed.

The third issue is energy efficiency. The potential for energy savings in the Baltic States is enormous, given the energy intensity of their industries, which is still one of the highest in the EU, and low energy efficiency in buildings, transport sector and district heating systems. Though partly energy inefficiency stems from the use of out-dated Soviet technologies and insufficient investment, high consumption of energy is also related to its low price, which discourages more responsible consumer behaviour. Therefore the Commission pays particular attention to awareness rising of the people, especially at the local level, as well as provides funds for improved energy efficiency through its Intelligent Energy - Europe Programme.

In conclusion, the Baltic States have the potential to become one of the most integrated regions within the European Union, bringing greater stability and prosperity to Europe as a whole. By implementing the policy, which aims towards greater security, competitiveness and sustainability, we will not only benefit the people and industry of the Baltic Sea Region but the future energy system of the European Union as a whole.

Andris Piebalgs

Member of the European Commission in Charge of Energy

Lessons from the Finnish presidency of the autumn 2006

by Mauri Pekkarinen

Last autumn's Finnish Presidency is now over. As the dust settles, we can already take stock of what happened in the economic and competitiveness fields. What was achieved and what lessons can be learned from this intensive six-month period at the helm of the EU? What can the EU do to help address the future competitiveness challenges facing the continent?

The EU is facing an increasingly competitive external environment. In recent years, the rapid economic expansion of emerging market economies has profoundly altered the world's economic geography. Production has increasingly shifted towards Asian economies and the production practices of multinational companies have continued to change. These structural changes have opened up a host of new opportunities, but are also creating pressures in terms of competitiveness.

One should be aware that the term, competitiveness, is itself a somewhat precarious concept. Europe and its economies need to be competitive against other regions of the world, but most of all, we should ensure that we have the public policies in place that most effectively promote sustainable economic growth and employment. In this way, competitiveness is about competing against ourselves in making Europe the most attractive location in which to do business.

Since the Constitutional Treaty failed in 2005, there has been a strong sense that the EU is stagnant and has been brought to its knees. However, this mood conceals one undisputable achievement of the EU – its recent enlargement. This has been a huge success story, even when examined from the viewpoint of competitiveness ministers. As the recent Commission's study on the economic effects of enlargement shows, it has helped create strong economic growth through multiplying trade and investment as well as increasing macroeconomic stability. Overall, this is a good beginning for a process which will bring increased prosperity to all EU Member States.

Furthermore, some important EU level projects have recently been concluded, namely the Services Directive and the EU's Framework Programme for Research.

A common legal framework for the provision of services across the Union will no doubt give a boost to the European economy. During the heated debate on this item of legislation, some claimed that the end result had been seriously watered down. In reality, the Directive adopted will create a genuine level-playing field for service providers across the Union, allowing access to service markets in other Member States on considerably improved and harmonised terms.

I believe that this will not only bring about more affordable services and improved quality, especially in the "old" Member States, but also create a host of export opportunities across the Union. In other words, everybody stands to gain. Now is the time, following the final adoption of the Directive, for all Member States to focus seriously on its effective implementation.

The EU's Framework Programme for Research received its final seal of approval from the EU competitiveness ministers and the European Parliament in December 2006. This hugely important financial instrument for assisting cross-border research has a budget of Euro 76 billion for the period 2007-2013. The Programme will provide considerable help to Europe in improving its innovation and R&D performance.

However, it is evident that these measures alone are not sufficient to turn Europe into the most competitive region in the world, as envisaged in the Lisbon Strategy in 2000. More effective common action is needed to bolster the European economic agenda. In a globalised economy, knowledge and innovation capacity must form the cornerstones of European competitiveness. We can only prosper if we can jointly ensure that top-level research remains in Europe. In addition, we need a regulatory framework and the financial means to translate this knowledge into innovative products and services.

In the future, joint work at European level must focus on policies and measures that truly create added value for all Member States – and for the Union as a whole. Major potential remains in two policy fields: the EU's internal market and common EU action on innovation and knowledge.

The four freedoms - the free movement of people, goods, services and capital - is already a remarkable achievement. Nevertheless, there is considerable scope for improvement. In fact, intra EU trade in goods has been diminishing during the recent decade. The ongoing review of the internal market can show us the way to improve and modernise internal market rules: ensuring effective enforcement and taking account of the global market place will form the central tenets of the future internal market regime. Furthermore, vigorous competition is another key element in the EU's common market. Strong competition at home implies success in global competition.

In December 2006, the EU Competitiveness ministers agreed on Strategic Priorities, i.e. what needs to be done at EU level to promote innovation. There is no magic bullet and no single instrument will suffice. A package of measures is required that addresses a variety of areas.

The 7th Framework Programme will be of great help in improving innovation financing. Another challenge is to create a regulatory environment that genuinely spurs innovation. Above all, the IPR framework is crucial in this respect. It is almost inexplicable that, to date, no European solution has been found for patenting.

Public policies can also – if we act wisely and without interfering with market forces – do a great deal to stimulate demand for innovation. We need to advance European industry-driven co-operation on specific technologies through the new instruments of private-public partnership, i.e. the so-called Joint Technology Initiatives. Speed is of the essence here, in order to get initiatives started through which we can still secure European leadership. Areas such as innovative medicines and embedded computing systems appear to be the most mature candidates for the moment.

Europe also faces the huge task of bringing together businesses, universities and research institutions. The initiative for the European Institute of Technology has the potential to show the way. Universities in Europe need reform, with modern and effective co-operation with businesses as its key element.

These are examples of a blueprint for innovation action that has now been defined. Such innovation priorities have been integrated into the Lisbon Strategy. These issues are vital to the whole of Europe, and Europe must now be relentless in pursuit of their effective implementation. At the same time, the Baltic region in particular stands to gain enormously from this European co-operation. The Baltic region has proved to be rather alert in exploiting new opportunities and quick in responding innovatively to new challenges. For this reason, I believe that the European response to the globalisation challenge may also help bring about a true Baltic success.

Mauri Pekkarinen

Minister of Trade and Industry, Finland

The Baltic Sea gas pipeline - power or partnership?

by Heidi Hautala

Energy is power. Russia assumes a new role in world politics and wants to secure its oil and gas transports through the Baltic Sea instead of certain countries which cause trouble to it.

So far, the project can also be seen as failure of all multilateral institutions in the Baltic Sea Region: CBSS, the Helsinki Commission for the protection of the marine environment - and of course the European Union.

After the EU enlargement it has been assumed that Baltic Sea cooperation would be raised to a new level now that, with the exception of the Russian Federation, all riparian states are now Members in the European Union. The achievements of the Northern Dimension of the EU were supposedly to be the very best in its environmental partnership.

The Baltic gas pipeline shows that when national interests are at stake, even the EU parties are following their own basic instincts. Germany's bilateral deal with Russia is of concern to its EU Baltic Sea partners. The Baltic Sea Region is again divided after 15 years, this time by the Baltic gas pipeline. The pipeline is inevitably a part of Russia's foreign policy and a part of its top sensitive logistical infrastructure.

The politics of the pipeline tells of the lack of confidence between Russia and a number of countries in the so-called post-Soviet space. One can ask why the EU could not do more to help to heal the phantom pain caused by the divorce of Russia and its former parts? Brussels has taken cool distance to the uncompleted border agreements of Estonia and Latvia with Russia, rather than facilitating them.

Even more difficult will it be to help the Ukraine to define its place between Russia and the EU, not to say anything about White Russia. This problem is now a direct cause of the need of Russia to find new channels for its gas and oil exports, notably the Baltic Sea routes. A rational approach to common challenges in the Region is not possible until the larger political picture will be clear.

To come to a conclusion on the European Energy Charter on the basis of mutual rights and obligations is a matter of high importance. Europe should have the courage to realise that Russia is at least as dependent on Europe as vice versa. A democratic Russia is what makes true partnership possible. The European Union must continue to discuss energy and values at the same tables, at the highest level.

A test on common rules

Russia is going to double its oil exports from its harbours on the coast of the Gulf of Finland. The Baltic gas pipeline has reached the stage of the international environmental impact assessment. At a time when zero tolerance as for the pollution into the Baltic Sea is called for ever more often, we are entering into new risk levels.

Many of the environmental arguments against the pipeline have been put forward to amplify other, more directly political concerns. The environmental impact assessment may yet prove to be the only instrument to deal with these "larger" aspects of the pipeline. Few understand that the process requires looking into several alternatives to the plan. These include land-based alternative routes either via Latvia, Lithuania and Poland or via White Russia and Poland. Even so-called "zero" option must be analysed with the view to the final decision.

The Espoo Convention on environmental impact assessment of transboundary projects is facing its biggest test in our Region so far. The Russian Federation has not ratified the Convention, though it has announced that it will fulfil its requirements. This leaves the other parties to rely upon the good will and arbitrariness of a major party to the project. This may suit the notion of "sovereign democracy" but not that of reliable partnership.

It is not surprising that the EU Member states have not found unanimity for EIB loans to the project. The transparency of the project is suffering from claims that Nord Stream has already chosen the producer of the pipes, without a tender. Full disclosure of the financial flows and expected economic feasibility is also necessary to ensure is generated for the future financing of environmental costs.

As the main partner to the gas pipeline, Germany has a special responsibility to interpret the applicable law to Nord Stream and its major stakeholder Gazprom. Germany must emphasise that a global power must adapt to international law rather than trying to circumvent it.

The wake-up call to the risks of excessive dependency on Russian gas and oil has been sudden. There should be no illusions about becoming totally free of such dependency, as energy is a global commodity in a global business environment. The energy cooperation should be seen as an exercise to argue for common rules, based on common values. Chancellor Merkel's statement that the pipeline benefits the whole of the European Union deserves many critical questions.

Towards energy efficiency

At the time of V.I. Lenin electrification was the synonym of socialism. The inheritance of this idea is that Russia is probably the least energy-efficient economy in the industrial world. Many see the low energy prices as the equivalent of the low bread prices of 1917. A social policy would be a good alternative to subsidised energy prices.

Russia will be able to save many megawatts ("negawatts"), as energy prices move towards market values. Market pricing is a real power switch to a sound energy economy, irregardless of the political system. Industrialisation and economic growth have gone hand in hand with increased consumption of energy. Decoupling the two is the most important path to environmental sustainability, with clear benefits for competitiveness and security of supply.

Lenin had unfortunately no monopoly to this fatal idea of connecting growth of the economy to the increase in energy consumption. The whole industrial world has suffered from it. Now efficiency is a key component of the new "post-industrial energy revolution" which the EU Commission's President Jose Manuel Barroso is calling for. Russia and the EU are both bound by the commitments of the Kyoto Protocol to reduce their climate-affecting emissions. This commitment is yet another reason to argue for a strengthened energy cooperation based on common values.

Heidi Hautala

The chairperson of the Green parliamentary group in the Finnish Parliament and the founding member of the EU-Russia Centre

St. Petersburg - the leader of Russian modernisation

by Valentina Matvienko

St. Petersburg is the largest metropolis in northern Europe, with more than 4.5 million inhabitants, making it the fourth most populated city after London, Paris and Moscow. The city on the Neva is a world cultural treasure trove, a museum under the open sky. At the same time, St. Petersburg is a large transport and industrial centre, one of the leaders of the growing Russian economy as on rates of economic development and volume of investments involved and on increase of people's standard of living.

In recent times, St. Petersburg has attained exceptional success in social and economic development. For the last three years we have tripled the city's budget. Such an increase in revenues has not been seen in any other part of the Russian Federation. This has been possible thanks to the stable work of industry, the development of small and medium-size businesses and the influx in the city of the largest national and international companies with internationally recognised names.

Our budget is socially orientated and furthermore, this is a budget for the development of the city. Funds are invested primarily in the implementation of the largest infrastructural projects, the reparation of housing and the equipment of housing courtyards. They are also invested in supporting social programmes, modernising and replacing engineering and electrical systems and communications and the restoration of historical buildings. As the budget increases, the level of our citizens' prosperity grows and raises people's standard of living.

One of the main components of the success of the St. Petersburg economy is the rising level of investments. We have made all possible to create favourable conditions for investors. In 2004–2005, investment rates in the city's economy rose by 40% a year, and in the first half of 2006, foreign investments in the real economy increased by 3.5 times. At the same time, foreign direct investments have doubled in volume. In 2005, global credit rating agencies raised St. Petersburg's investment rating in four times. Today St. Petersburg investment climate is quite rightly considered the best in the country, having won in the All-Russia competition for Lowest Investment Risk and Best Social Climate. In 2006, the city was rated first for effective governance of the region, and was victorious in the National Ratings for Transparent Acquisitions supported by the State Duma's Anti-Corruption Commission, the Federal Antimonopoly Service and the Audit Office. At present we like to say that if Russia is perspective market for investors, then St. Petersburg is the best place for entering that market.

We understand that the city's investment attractiveness is not limited to a system of concessions for investors. It also includes transparency of city finances, competitive tenders for real-estate and land, the stability of city socio-political life, a readiness to adhere to investors' exact strategic guidelines for the city's development and the development of new areas. In 2005, the new St. Petersburg General Plan was accepted for the period until 2025 becoming the fundamental strategic document for the city-planning development.

St. Petersburg is a multifunctional centre with a differentiated economic structure. Ship-building and metal-working industries, manufacturing of electronic components, food industry, pharmaceuticals and many other sectors are flourishing in the city. We are carrying out a serious reconstruction of the economy with an accent on modernisation, development of the science-driven and high-tech sector and unveiling modern enterprises. Only recently, seven new high-tech enterprises were built and operated by large domestic and foreign companies including Gillette, Elcoteq, Knauf, Izhorsky Trubny Zavod, Russky Standart. Also in the pipeline are projects from Bosch and Siemens, Technopolis and Alkan Packaging.

We would be right to call St. Petersburg the leader of Russian modernisation, a centre for progressive ideas, an example which today serves as the model for mutual relations between Russia and the West. Under the decision of the Federal Government the country's first special economic zone for the development and implementation of innovative technology, Russia's first Technology Park has been created in the Neva's city. Global brands are ready to be participants, including companies from the Baltic States. The town of Peterhof, famous to all as one of the architectural jewels in St. Petersburg's crown, has been given the status of Science Town.

Our city is the 'European Gateway' of Russia, one of the largest ports in the Baltic and a crossroad of the most important transport routes. St. Petersburg is an essential part of Greater Europe, a fully legitimate participant in international cooperation, above all, with the Baltic States. This is precisely why we are promoting the most significant infrastructural projects with the cooperation and support of our partners, with particular importance given to projects in the fields of transport and logistics, tourism and innovation and energy and municipal services. The South West Wastewater Treatment Plant ecological project put into operation in St. Petersburg is now ranked as the best ecological project in Europe. It has been recognised a bright and unique example of partnership in the framework of the Northern Dimension Environmental Partnership (NDEP). The opening of the South West Wastewater Treatment Plant has allowed a twofold reduction in the pollution load to the Neva and the Gulf of Finland and brought its water purity up to 85%. After the commissioning the modernisation of the Northern Collecting Sewer, the disposal of waste water will stop almost completely.

St. Petersburg collaborates very closely with many associate-towns from the Baltic States. Our city holds the chairmanship of the Union of Baltic Cities' Commission on Information Society, created on our initiative. We are also collaborating with the Council of Baltic States. St. Petersburg is a member of the international Baltic Metropoles Network (BaltMet). At the recent Mayor's Meeting in Helsinki the major St. Petersburg projects in the fields of innovation, transportation infrastructure and ecological security received approval and support from the eleven BaltMet cities. Three of St. Petersburg's largest projects were on the BaltMet's list of 26 focal infrastructural projects: The construction of the Western High-speed Diameter, the Orlovsky tunnel under the river Neva and also the completion of the Northern Collecting Sewer drainage system. Their realisation, without a doubt, will benefit not only St. Petersburg but also our Baltic neighbours, opening greater development prospects for the Baltic States in Pan-European and global development.

Furthermore, the implementation of a high-speed railway service on the Moscow - St. Petersburg - Vyborg - State Boarder line could become one of BaltMet's priority projects and our Finnish colleagues are particularly interested to support it. It is suggested that it will be possible to travel from St. Petersburg to the border in an hour and a half, significantly shortening travel time to Helsinki.

Since 1997 St. Petersburg's Government has been collaborating with the Finnish Advisory Group, an informal

alliance of large Finnish companies. St. Petersburg together with Leningrad Oblast is actively working with Finland's South-East regions under the EU's INTERREG South-East Finland – Russia programme.

A whole range of large infrastructural projects have been launched in St. Petersburg and are being carried out through the direct participation and active support of the Federal Centre. They add a completely different dynamic to the development of the city. This year, the eastern half of the ring road around St. Petersburg was opened. At the same time the construction of the Western half has been started with the aim to complete the entire ring road by 2008. The ring road is not only extremely important for the city, as its final completion will help to significantly improve the transport situation in the city. The ring road is an important part of the Moscow - St. Petersburg – Helsinki federal highway and an essential part of the Ninth Intermodal Corridor between Europe and Asia.

In addition to this, there is the construction of 'Baltic Pearl' a multifunctional complex of residential, commercial and administrative buildings on coast of the Gulf of Finland, the construction of a new, modern football stadium, the reconstruction of the unique architectural heritage of New Holland Island, the construction of a second stage at the great Mariinsky Theatre and many other projects that characterise the scope of our work in modernising the city's amenities. Furthermore, we held a best concept-design tender for the Gazprom-City administrative-business development where the world's leading architectural firms took part.

We are also starting the construction of the Western High-speed Diameter, a motorway that will link the north and south of St. Petersburg and allow the constant flow of traffic through the city. After an eighty year break it will become the first in Russia to be built on the basis of a concession agreement. This is a major project not only for St. Petersburg and Russia but also for our close neighbours on the Baltic coast. A number of foreign and domestic consortiums have shown their great interest in the concession agreement and are ready to take part in the investment tender. The World Bank has given this project an outstanding score and is prepared to provide its financing. Our project enjoyed a great popularity in the held not long ago exhibition of the largest international infrastructural road show in London. The winning bidder for the construction of the Western High-speed Diameter will be chosen at the beginning of 2007.

For the first time in the history of St. Petersburg, a new aspect was brought to the city's economy in 2006 – automotive construction. Three global automotive giants, Toyota, Nissan and General Motors, have announced their decision on locating their factories in the area. This is more than a statistical sum of investments, taxes and quality of new work places. It is a vivid example of the build up of competitive advantages in the city.

Today, with the assistance of the federal centre we are working on 15 high-priority infrastructural projects. One of our main tasks is the modernisation of the energy infrastructure. On the list of the largest objectives is the construction of the South-Western Thermal Power Plant, the first private Thermal Power Plant in Russia, and new electrical substations. The Government of St. Petersburg has signed a very important agreement with RAO UES of Russia for the modernisation of St. Petersburg's power supply and power complex development. The extent of this investment in the city's power supply until 2010 constitutes more than ten billion Euros.

We have embraced St. Petersburg's development Programme as a tourist centre from 2005 to 2010. This was created on the basis of research of the Boston Consulting Group, commissioned by the federal government. In that research, a system of measures is outlined, aimed at realising an important goal – to become one of the top five tourist centres in Europe by 2010, attracting up to five million tourists a year to the city. On the list of basic undertakings, amongst others, is the development of Pulkovo Airport; the construction of new hotels, modernisation of museums, the creation of a network of tourist information sites and the development of congressional tourism. We have already built a range of new hotels. The realisation of the large-scale project for developing Vasilevsky Island is proceeding at full speed with the construction of a passenger terminal and with the prospective rapid development of cruise tourism. This year saw the introduction of a Tourist Angels – volunteers assistants helping city visitors. This will be followed shortly by the launch of an information 'hotline' for tourists.

This year, with the help of the federal centre, St. Petersburg has been accorded institutional status. Deputies of the State Duma took the decision to move the Constitutional Court of the Russian Federation to the banks of the Neva. Henceforth, St. Petersburg is Russia's second capital, not only de facto but also de jure. This event of great historical significance will undoubtedly give a new dynamic to the development of the city, bringing about substantial growth of all our foreign-policy and foreign-economic links. Furthermore, the national television station Channel 5 is based in and broadcast from our city, enhancing St. Petersburg's capital status.

Realising our historical mission, we have opened our city to the whole world. We happily await and welcome our friends and partners. Those who have still not come to Russia to do business can begin their journey in the city-on-Neva. You can rely on the full support of the Government of St. Petersburg. Welcome to St. Petersburg!

Valentina Matvienko

The Governor of the City of St. Petersburg

Protection of the Baltic Sea urgent task: Local actors have key role in EU maritime policy

by Aleksi Randell

The role of regions and cities in the upcoming maritime policy of the EU is pivotal. They are between policy and delivery. The European level and the nation al level shall have a natural role in drafting common policies. But regions and cities shall have the main responsibility to ensure that the policy lines are put into concrete actions.

Of course the European wide maritime policy includes elements that shall be put into practise and monitored by the European institutions and national administrations. But there are dimensions that shall fall into the responsibility of local actors as well. Delivery of best practises and the surveillance of policy elements are in the responsibility of local and regional actors.

The division of labour in the maritime area follows the logic of subsidiarity. Coastal areas and coastal authorities certainly have the best knowledge of condition of maritime regions under their administration. They have the best expertise. No doubt local authorities must be able and willing to exploit all the outside expertise they enjoy in their regions.

Protection of the Baltic Sea is our most urgent task. We have drastic evidence that joint action must be undertaken to stop the degeneration of this Sea which is so important for all of us. Increasing traffic of oil tankers is one of the potentially greatest dangers.

Cleaning of the Baltic Sea requires action by all stakeholders - from local levels to national governments, the Baltic Sea Region organisations to the EU. Here, the local and regional authorities can play a crucial role. More funding from national and EU sources must be channelled to them, ensuring at the same proper coordination between various actors. There is a strong will but insufficient tools to tackle this most important question.

Specifically, we need to ensure that the Baltic Sea will receive its own place and budget line in the EU decision-making.

The challenges that cities and regions face in the delivery of the common European maritime policy demands new actions and new thinking. The City of Turku, as the centre and key actor of a wide coastal region in South-West Finland, is fully aware of this. Our answer to the challenges has been the creation of a regional maritime cluster. In this framework we aim at putting together all the maritime expertise that is available in the region.

Our cluster is based on a combination of strong shipbuilding tradition and expertise present in the region. Turku is also turning into the most important administrative centre of maritime affairs in Finland. For instance the Headquarters of the Finnish Navy shall move to Turku. The third key element of the cluster is a strong input of research and development, both on marine environment and maritime issues. This gives us strength and excellence in maritime expertise.

Recently this was recognized by the Finnish state. Turku maritime cluster was nominated as one of the national centres of excellence. The latest step in strengthening of the maritime expertise was the decision to establish a high school specialising in maritime issues.

I believe that Turku is well prepared to take its share of the delivery of the common European maritime policy. One important notion should be made, however. Maritime issues are divided in coastal regions. Therefore a great emphasis is needed to increase and enhance cooperation between maritime centres, nationally and internationally. Cooperation between the coastal cities of West-Coast Finland has recently been activated.

Five West-Coast cities have established, together with the three Turku-based universities, the Centrum Balticum - foundation. It has established a think tank specialised in promoting activities in the Baltic Sea Region. Maritime policy has a high priority in the activities of this newly established center. (www.centrumbalticum.org).

Turku also wants to expand cooperation in maritime policy issues in the wider framework of the Baltic Sea. Our primary instrument there is the Union of the Baltic Cities (UBC), which is currently formulating its own policy paper on this subject.

As a vice-president of the UBC I am convinced that that this organisation shall develop into a major actor in the maritime issues of the region.

Aleksi Randell

Chairman, City Executive Board of Turku

Vice-president, Union of the Baltic Cities (UBC)

Let´s save the Baltic Sea!

by Jari Luukkonen

The Baltic Sea is one of the youngest seas on our planet, emerging from the last ice age some 10- 15 000 years ago. It is also the world's largest brackish water system with freshwater species living together with saltwater species. Compared with the oceans, the Baltic Sea is very shallow and thus very vulnerable to human activities. Many scientists say the Baltic is the most polluted sea in the world. Today all countries around the Baltic except Russia are members of the European Union.

The Baltic Sea is a truly unique place. Where else can you find as beautiful and diverse archipelagos with thousands and thousands of islands varying from large ones with thick forest cover to small treeless skerries? Where else can you find freshwater fish and other species inherited from lakes and over 200 rivers empting into the Baltic Sea together with numerous saltwater species inherited from the Atlantic Ocean? Where else can you walk and even drive cars on the ice and then a few month later sail and swim in the same waters? Where else can you find millions of migratory birds flying above and stopping over at the sea and its shores twice a year? The Baltic Sea and all its natural features are well worth to protect.

Although the Baltic Sea is quite large, the water content is much less than one could expect because of its shallowness. The average depth is only 55 metres, compared with e.g. the average dept of about two kilometres in the Mediterranean Sea. The water catchment area of the Baltic Sea is much larger than the Sea itself and 85 million people are living within it. Their activities, be it agriculture, forestry, traffic, industry or something else, influences the Sea in many ways. When we add to that the activities at Sea, vessel traffic, ever increasing oil transports, fisheries, aquaculture etc. as well as airborne emissions from the power sector and traffic, we began to realise that the Baltic Sea is under severe pressure.

Eutrophication, caused by overload of nutrients from human activities, is one of the most severe environmental threats facing the Baltic Sea. The situation is so severe that we experience large-scale toxic algae blooms almost every summer. Large areas of the bottom of the Sea have also severe oxygen deficiencies and large parts of these bottoms are biologically dead all year round or part of the year. This situation causes severe harm to the marine ecosystem and has its implications to humans in many ways – boating in thick layers of algae blooms is not a nice experience, people cannot swim on hot, sunny days because of the algae blooms, the reproduction of fish is impossible on dead bottoms which effects fishermen's life etc.

Oil transportation from Russian harbours, along the Gulf of Finland and through the Baltic Sea proper to harbours around the world, is ever increasing. The Baltic Sea, except Russian territorial waters, is declared a Particularly Sensitive Sea Area by the International Maritime Organisation IMO. This gives a good base for different measures to mitigate the risk of oil accidents, but the more oil is transported and the more other vessel traffic there is, the bigger is the risk that a severe oil accident will happen. Not a single country around the Baltic has at the moment enough oil combating capacity in case of a huge spill.

Many scientists say that the Baltic Sea is the most polluted sea in the world. It is clear that the threats facing the Baltic are enormous. We cannot afford to loose the Baltic – therefore the actions to save the Sea must start now.

All actors and sectors must live up to their responsibility, but to get that started we need strong political leadership. The severe environmental problems facing the Baltic Sea are not yet understood by the EU as a whole, nor the understanding that the political decisions of the EU are of utmost importance for the future of the Baltic Sea.

The EU member states around the Baltic, in addition of doing whatever they can nationally to save the Baltic Sea, should put in extra efforts to increase the awareness about the Baltic Sea within the EU and to put the well-being of the Baltic Sea high on EU's political agenda. The need to radically decrease the nutrient flow to the Baltic Sea should be taken into account in all EU policies and funding mechanisms affecting the Baltic, like the Common Agricultural Policy CAP. Likewise the severe situation in the Baltic should be taken into account when the EU develops its marine strategy – The Baltic Sea should have on own strategy and own budget lines to be able to coup with the huge challenges the Sea is facing.

Last but not least, investments in improving existing and building new wastewater treatment plants in St Petersburg and smaller Russian cities in the eastern Gulf of Finland should be a top priority when it comes to EU's cooperation with Russia. EU should also cooperate with Russia to improve the security of the oil-tanker traffic, to halt the rapid increase in oil transportations and to improve the capacity of oil combating, in case of severe oil accidents.

Jari Luukkonen

Conservation Director

WWF Finland

The effect of labour shortage on Estonian enterprises

by Madis Habakuk

In the 1990s, the birth-rate in Estonia, Latvia and Lithuania fell by nearly a half. Compared to the annual birth-rate at end of 1980s, which stood at approximately 25 thousand in Estonia, it decreased to as low as 12-13 thousand by the second half of the 1990s. In Latvia, the birth-rate underwent similar decline, but in Lithuania the decrease was smaller. The problem grew worse due to emigration, which intensified after the countries joined the European Union. Emigration figures were the highest in Lithuania and the smallest in Estonia.

The current article focuses on the effects of labour shortage on Estonian enterprises since compared to other countries and areas this topic has been more extensively researched. In Latvia and Lithuania the processes differ only marginally from those in Estonia. The effects of labour shortage could be divided into two groups – the so called hard side, which is simpler to quantify and the soft side, where qualitative indicators prevail (Figure 1).

Starting with the hard side, it must be pointed out that depending on the economic field, salaries in Estonia increased by 10-25% in 2006. A similar increase for the year 2007 has been forecasted. Since the significance of salaries in Esto- nia´s GDP is slightly less than 40%, we may safely claim that during 2006 and 2007, such a salary increase will result in an 8-20% rise in the cost-price of products. The latter will decrease the competitiveness of enterprises on both domestic and foreign markets, the turnover and profit of a number of companies will fall and as a result the already negative balance of payments will deteriorate even further. Following this, not all companies will be able to continue and will therefore go bankrupt. For the country's financial state it means both decreasing income and increasing expenditure (bankruptcy costs). However, a positive result of the negative process is that a certain amount of workforce remains unemployed and labour shortage will decrease.

The soft side of labour shortage will start with the increasing flow of labour, deteriorating attitude to work and decrease in quality and productivity, all of which contribute to the declining competitiveness. Research conducted by Tartu University (R. Eamets) and Estonian Institute of Future Studies show that as a result of the abovementioned difficulties a number of enterprises will intensify their innovation processes, employing potential reserves – a situation which would not occur under usual circumstances. Changes in management, technologies and motivation systems are but a few that improve attitude to work, labour flow, quality and productivity.

It is difficult to forecast what will happen, when and to what extent. The effect of the decreasing birth-rate will not influence the labour market until year 2009, after which companies will need extra 2-3 thousand people each successive year. Due to demographic reasons, labour shortage will be 2-3 thousand people in 2009, 4-6 thousand in 2010 etc. Such a decrease will last until the middle of the next decade and the decrease is, in its turn, accompanied by emigration figures of approximately 3-4 thousand per year.

The situation will gradually improve from the middle of the next decade. The birth-rate in Estonia is on the increase. Compared to the rock-bottom, we are today witnessing a 20% increase. In addition to the abovementioned efficiency increase, other sources to compensate for labour shortage include immigration and inclusion of pensioners into work processes.

Madis Habakuk

Rector

Estonian Business School

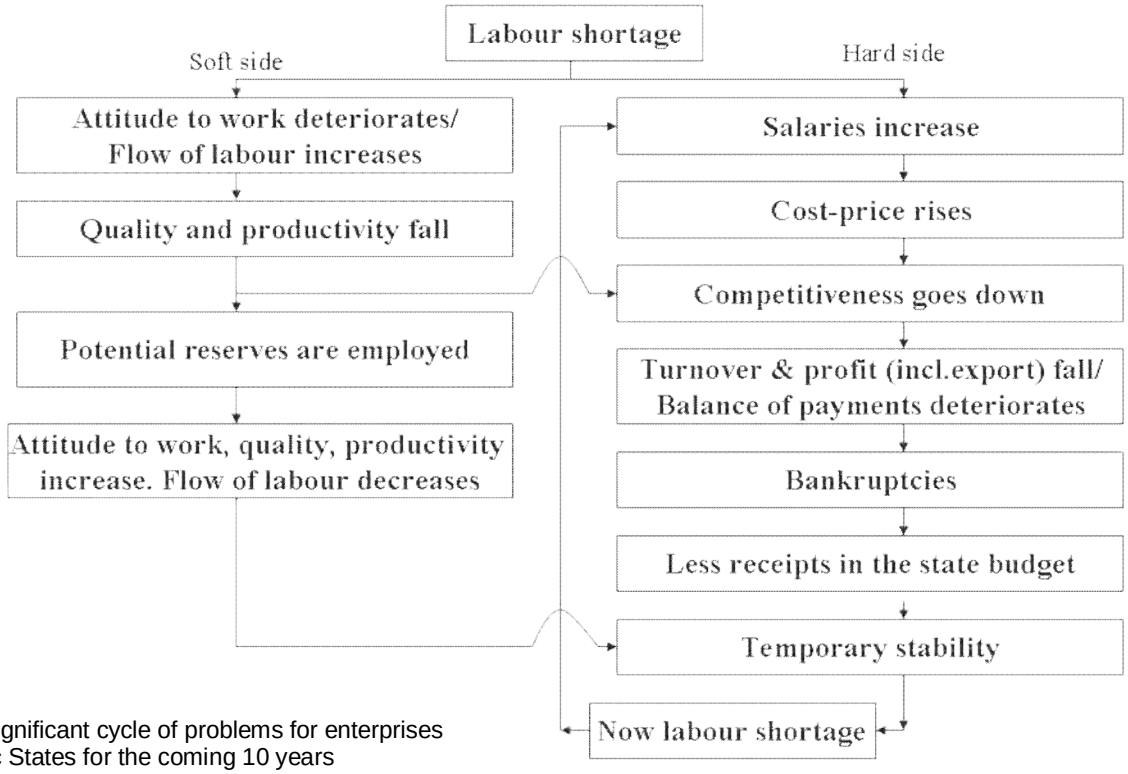

Figure 1. Significant cycle of problems for enterprises in the Baltic States for the coming 10 years

The economy of Saint-Petersburg - recent trends

by Stanislav Tkachenko

During previous several years we are witnessing sharp increase of the Saint-Petersburg's role in political and economic life of Russia. Partly it can be explained by a number of remarkable events that attracted to the city attention of the whole world: celebration of 300 Anniversary of Saint-Petersburg and 2006 G-8 Summit. Every summer the city is transforming for several weeks into diplomatic capital of the country due to numerous economic forums and congresses attended by the heads of states and governments of different European, Asian and other countries. All of that reflects significant growth of the city's economy and help to receive even more investments into industry, services and infrastructure of the city.

Successes

Saint-Petersburg is keeping for last several years the status of the most attractive Russian region for investments, both domestic and foreign. Good geographical location and capacity of the city's market are just two reasons for that. Quickly growing gross regional product has reached in 2006 the level of € 30 billion with industry as the leading sector of local economy. There is impressive record of political stability in the city, especially since autumn 2003 when Valentina Matvienko was elected as the Governor (the head of the city's executive body). She was able to create effective team of young managers with experience both in business and public sector. In December 2006, she was re-elected by local Parliament (the Legislative Assembly) for another five years, providing additional guarantee of stability and continuity for investors and businesses of the city.

Complete lack of any natural resources push regional authorities to construct economic model of modern global city. Development of infrastructure for attraction of investments into real sector of city's economy, construction, services and, especially, transport and tourism, is, by far, the most important priority for government of the city nowadays.

Russian and foreign investors characterize Saint-Petersburg as having low risk and the highest potential among all Russian regions. They point out considerable advantages that region offers to the potential investors, such as valuable industrial and intellectual potential, the benefits of access to the Russia's second most important consumer market and financial centre. In 2006, inflow of foreign investments doubled to previous year and reach annual level of US$ 3 billion. In 2006 Saint-Petersburg had impressive surplus of the city budget – about € 1 billion (RUR 32 billion).

In 2006, giant RAO EES, headed by Anatoly Chubais, and Government of Saint-Petersburg have signed a program of development of electricity sector of the city, both production of electricity and construction of new electric grids. The reason is quite obvious: now first time since the collapse of USSR Russian economy has shortage of electricity and other energy sources for fast development with Moscow and Saint-Petersburg, as well as several other regions. The aforementioned program is for 2006- 2010, and during this period of time about € 2,4 billion will be invested into the city electric grids and power stations by federal, regional budgets and private investors.

Growing number of developers' projects in Saint-Petersburg confirm new trend of improving investment climate in the city. The total income to budget of Saint-Petersburg is about € 7 billion in 2006. The city government has increased five times spending for infrastructural development of several industrial zones for inflow of investments just for last three years (2004-2006). The project "Baltic Pearl" is, probably, the most remarkable due to the fact that it is the largest oversees Chinese investment up to now. About $ 1,4 billion are to be invested into construction of apartment houses, recreation zones, business centers and transport infrastructure. Other projects to be mentioned are:

Apartment complex of 1 million square meters with investments of about $ 900 million by Industrial Building Corporation (Israel) in southern district of Saint-Petersburg.

Sea-Port Passenger Terminal as well as business offices and apartments houses are now under construction in Western part of the Vasilievsky Island on about 477 hectares of new land, which will be taken from the Baltic Sea in coming 7 years.

Gazprom City Project for the head-quarters of the oil branch of the Gazprom, which will be moved to Saint-Petersburg in 2012 with total costs of € 2 billion.

New Holland Island - Creation of the new modern culture center, commercial and residential zones on the New Holland Island with budget of $ 500 million.

Currently, several foreign trust funds are investing into the development of several city's districts in suburbs: Baltic Property Trust of Nordic countries, US-Russian Alfa Capital Partners, as well as London and Regional Properties

In 2007, the city budget will direct € 1,7 billion for development of infrastructure in preparing several city's districts for further direct investments into local economy.

Investments of foreign car-making companies in recent few years have transformed Saint-Petersburg into Russian Detroit. There are Japanese companies Toyota and Nissan, as well as US General Motors now constructing their production sites next to successful Vsevolozsk assembling facilities of the Ford Company, which invested $ 230 million into regional economy. Currently the Ford-Vsevolozsk Company is considering a possibility to double production up to 150 thousand cars per year and invest another $ 250 million. It is important to strengthen that just 10 years ago car-making sector was non-existent in Saint-Petersburg.

Saint-Petersburg is the largest road junction of Russian Federation. The network of transport ways involves 12 railways, 15 highways, the biggest sea port located in the eastern part of Baltic Sea, 2 airports, 5 railway stations, as well as 405 bridges, 35 viaducts, 25 tunnels, 152 km of strengthened embankments. The most far-reaching infrastructural projects in Saint-Petersburg are currently in the area of construction of multimodal transport links and networks. The largest project of this type for the whole Russia is Western High-Speed Diameter, a motorway, which goes from Northern districts of the city to industrial South-western part of Saint-Petersburg via quickly growing and overused Saint-Petersburg Sea Port. It will be for-pay high-way, whose total costs are exceeded € 2,5 billion with shared investments from federal budget of Russia (50%) and private investors (50%). Currently, about 19 million tons of cargo is served at the Saint-Petersburg Sea Port by auto transport. In five years, the figure will reach 63 million tons and without modern system of high-ways, connecting Saint-Petersburg with Finland, Baltic States and Central Russia there will be impossible to provide such dramatic increase of turnover of the port. That is also part of the larger problem – about 35% of whole Russian import (costs about $ 99 billion in 2005) goes via Saint-Petersburg, bringing traffic jams and

environmental damage right at the historical center of the city.

The reconstruction of the existing port facilities, improving the infrastructure and the level of services, the construction of new terminals, warehousing and custom premises became the priority of the strategic development of the city. Efforts have been made to improve the road connections from Russia to Finland and from Russia to Europe via the Baltic States. The intersection of the sea, river, rail, auto, air and pipe routes turn Saint Petersburg into a prominent transportation junction. However, this advantage is not fully realized due to the underdevelopment of the multimodal communication, which is one of the main problems to be tackled in order to turn the city into a truly modern and convenient communication centre.

Problems of the city's economy

Despite of the successful economic development of the city in recent yours, there are several political, economic and social problems, which still have to be solved. Coming elections to local Legislative Assembly (March 2007), to State Duma (December 2007) and the Presidential elections in March 2008 will pose a challenge to stability of local political institutions. Any turmoil in Moscow or other parts of Russia will effect Saint-Petersburg and loyalty of investors to local market.

There is growing shortage of labor force in Saint-Petersburg. Some professions, including software engineers, construction workers, tourist industry specialists, etc. are in huge demand. Labor force in Saint-Petersburg is quickly becoming "expensive" and that probably will result in loosing attractiveness of the city for some investors.

Recently adopted legislation on migration may pose another threat to labor market of the city. Currently hundreds of thousands low-skilled workers are illegal migrants in the city and their "legalization" may lead to outflow of them to another regions of Russia or even to home countries. That may have disastrous immediate effect for local economy in Saint-Petersburg.

Stanislav Tkachenko

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BalticStudyNet - promoting Baltic Sea region higher education worldwide

by Carsten Schymik

In a recent article for Baltic Rim Economies (see Bimonthly Review 6-2006), Tapio Reponen, Rector of the Turku School of Economics, called for more 'well-functioning networks between Baltic Sea area Universities' in order to strengthen the overall quality of higher education and research while coping with such problems as recruiting 'good students' and 'the most talented faculty possible'. A concrete example in this context is the BalticStudyNet network, which was established in 2005 as part of the European Union's Erasmus Mundus programme.

As a regional network of higher education institutions, the BalticStudyNet unites all Baltic Sea countries. The participating universities include Copenhagen, Södertörn, Turku, Tartu, Latvia (Riga), Kaunas, Gdansk and the Humboldt University of Berlin, which is also coordinating the programme, as well as two associated partner institutions in Russia (St. Petersburg State University of Telecommunications and the Institute of Europe of the Russian Academy of Science, Moscow).

BalticStudyNet is funded through the so-called Action 4 scheme of Erasmus Mundus, which is designed for measures enhancing the attractiveness of Europe as an educational destination. BalticStudyNet is thus a networking programme for the global promotion of higher education and research in and on the Baltic Sea Region. Its academic focus is on the social sciences and the humanities in general, and on Baltic Sea Region Studies (BSRS) in particular. BSRS is an English-taught study programme on Master level comprising history, politics, economics and cultural studies. It is offered as a Joint Master Degree at the universities of Turku, Tartu, Latvia (Riga) and Kaunas, or through similar programmes at the other BalticStudyNet universities.

The BalticStudyNet is one of seven projects that have initially been selected by the European Commission under Action 4. Its main activity during the first programme period, which ended in December 2006, was to collect information about academic training and research programmes on the Baltic Sea Region, and to make this information available to global audiences. An internet portal was established at www.balticstudy.net to offer comprehensive information about relevant study programmes and to provide links to higher education institutions both inside and outside the Baltic Sea Region. Other activities included conferences, workshops and an international summer school in Baltic Sea Region Studies titled 'Mare Europaeum' and followed by 22 graduate students from 13 non-EU countries during a two-week trip around the Baltic Sea, with classes held in Copenhagen, Lund, Turku, Tallinn and Berlin.

The basic idea underlying these activities was to bring about a fundamental change of perspective – away from intra-regional and towards extra-regional and truly global approaches to the Baltic Sea Region. It was therefore important to find out more about how the region is seen through the eyes of a distant outsider: How is the Baltic Sea region perceived when viewed from, let's say, Canada or Peru? What, if anything, would an Indian student find typical, extraordinary, or even unique when looking at the region?

The two-year programme yielded valuable experience, and some answers. The most fundamental must be that, for the world at large, the Baltic Sea Region has not yet become a visible and separate entity, neither in politics nor as a market place, let alone as a higher education area. It still appears to be a white spot on the global map.

How can this white spot hen become visible on a global scale? An analysis of 'Perceptions of European Higher Education in Third Countries', carried out by the Academic Cooperation Association (ACA) in 2006, provides some clues. A key finding of the study is that Europe is perceived by non-European students and scholars as an entity in general terms and as an economic union, but not with regard to culture and higher education. Moreover, knowledge of Europe is limited to a few big countries, namely the UK, France, and Germany, whereas smaller countries can only gain visibility as a group, e.g. the Nordic countries. The study also concludes that Europe's single major disadvantage vis-à-vis the US and Australia is that English is not the universal mother tongue, while English-taught study programmes at universities in non-English speaking European countries are hardly known.

The ACA study implies at least three far-reaching consequences if one wants to design a global promotion strategy to the benefit of higher education in the Baltic Sea Region. To begin with, the region's lack of visibility necessitates an even stronger commitment to transnational networking and structured cooperation among Baltic Sea universities. Only joint action will enable a region like the Baltic Sea, which primarily consists of combarably small countries, to build up a globally recognisable reputation. Secondly, the Baltic Sea Region must present itself in the larger context of Europe – and not just the European Union. The Baltic Sea Region provides more than just one example of regional integration in the framework of the EU. Its study also offers insight into the complex relationship of the EU with one of its most influential neighbours: the Russian Federation. Thus the Baltic Sea should not be portrayed as an EU inland sea but a European inland sea. In fact, it is the European sea region – a genuine Mare Europaeum. Thirdly, it must be a central message to the outside world that living and studying in the Baltic Sea Region does not require proficiency of the various local languages. The widespread use of English as a lingua franca is a particular strength of the region and asset for its potential attractiveness.

In January 2007, the BalticStudyNet entered its second programme period made possible by a new three-year grant from the European Commission. Building on the experience of the first programme period, the new BalticStudyNet will shift the focus from information to promotion. A travelling exhibition about the BSR as a region of high-quality higher education will be designed for show at universities in North America, Russia including Central Asia and the Caucasus, China, India and Australia. The exhibition will go along with 'promotion lectures' given by members of the partner universities. Seminars for so-called multipliers from international higher education institutions will be held in the summers of 2008 and 2009. A third tool will be the production of a textbook for Baltic Sea Region Studies especially designed for students in third countries. Ultimately, BalticStudyNet sets out to develop a trademark for higher education in the Baltic Sea Region. Hence a meaningful contribution to the creation of an attractive brand for the region as a whole.

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Saving the Baltic Sea: Small acts more crucial than grand speeches

by Kari Liuhto

According to a UN study, the countries surrounding the Baltic Sea have attracted some EUR 1000 billion in foreign direct investments (FDI), a sum that exceeds the FDI stock of Brazil, India and China even calculated together. Despite the fact that more money has been invested in the countries surrounding the Baltic Sea than in these 'economic drivers' of the emerging world, the Baltic Sea economic area cannot rest on its laurels.

A significant amount of the FDI in countries around the Baltic does not directly serve the Baltic Sea economic area. This is because only a fraction of investments made in Poland, Germany or Russia actually end up in the northern parts of Poland or Germany or the St. Petersburg and Kaliningrad regions, which are the Baltic portions of the countries. Although Poland, Germany and Russia are much more than just Baltic Sea economies, involving them in closer Baltic Sea cooperation would be advantageous to the whole economic area.

Now, Baltic Sea cooperation appears to have a unique opportunity, as EU Commissioner for Regional Policy **Danuta Hübner** is Polish, German Chancellor **Angela Merkel** was born in Hamburg and Russia President **Vladimir Putin** is from St. Petersburg. Emphasising the importance of Baltic Sea co-operation to these leaders should not be a difficult task.

Although the Baltic Sea region has succeeded in attracting more foreign capital than many of its competitors, the region's foreign investments have a structural problem because a company operating in another Baltic Sea country is often behind the investments. In practice, this means that capital is being transferred from one Baltic Sea area to another, in which case the total amount in the region does not increase.

Along with the small amount of capital from outside the Baltic Sea region, another problem is the fact that companies in our region invest more capital outside the region that we can attract here. Only the former socialist countries have been able to attract more investments to their countries than what companies inside the countries invest internationally. However, this is likely to be changed in the future, when their companies become more prosperous and ready to invest abroad.

In addition to the mutual dependence in investments, the mutual dependence of foreign trade in Baltic Sea countries is amazingly strong. The strong mutual dependence of foreign trade adds to the importance of a functional transport system. The majority of foreign trade in small Baltic Sea countries takes place with other countries in the region. For example, Germany, a commercial giant, does one-tenth of its foreign trade with countries surrounding the Baltic Sea. Baltic Sea countries are also exceptionally important trading partners for Russia; a fifth of its foreign trade takes place with countries in the Baltic Sea region.

Transport of Russia oil through the Baltic Sea has increased rapidly and these transports add to the pressure to develop a functional and safe transportation system in the region. Some 130 million tons of Russian oil was shipped to the west from Gulf of Finland ports, which is a seven-fold increase over the amount in the mid-1990's. At the end of this decade, oil shipments on the Gulf of Finland are expected to reach 150-200 million tons.

The gas pipeline (Nord Stream) being built under the Baltic Sea will further strengthen the Baltic Sea's position as one of the most important transport routes in the EU. In the beginning of the next decade, the pipeline is expected to carry more than 50 billion cubic metres of natural gas from Russia to Germany every year. At the moment, Germany imports via Belarus and Ukraine annually some 40 billion cubic meters of gas from Russia.

When examining energy cooperation between the EU and Russia it is essential to remember that Russia currently accounts for one-third of oil and half of natural gas imports to the Union. Russia's shares are expected to grow in the future, which will also increase the strategic importance of the Baltic Sea.

Hopefully, groups fighting against the Russian State will not consider Baltic Sea oil shipments or the gas pipeline being built on the sea floor to be a potential means of sabotaging Russia's export income, over 60% of which comes from oil and natural gas.

Industrial and community waste are more likely to threaten the Baltic Sea than terrorism. Within the framework of Northern Dimension Environmental Partnership, about EUR 200 million has been invested in the St. Petersburg Northern Wastewater Treatment Plant, but this is not enough.

Baltic Sea states should be more active in terms of saving the Baltic Sea. Rather than simply being on the EU Presidency agenda of just a few countries, protection of the Baltic Sea should addressed and promoted by every Baltic country in the EU. In conjunction with this fact, it is worth remembering that Germany took over the EU Presidency after Finland. Sweden will have the Presidency in 2009, Poland in 2011, Denmark in 2012, Lithuania in 2013, Latvia in 2015 and Estonia in 2018. If all the EU countries around the Baltic Sea furthered Baltic Sea protection in a systematic and coordinated manner, our common sea would be in better shape in the future. Also activation of Russia in terms of environmental protection is also essential, both financially and morally.

Besides state level actions, private measures are needed. It has given me great pleasure to see how certain companies have begun to invest in Baltic Sea protection. For example, The John Nurminen Foundation has initiated the Clean Baltic Sea project, aimed at reducing euthrophication in the Baltic Sea. Along with companies, individual persons have recently made significant donations to Baltic Sea protection. In early 2006, Swedish investor **Björn Carlson** donated more than EUR 50 million to Baltic Sea research and protection.

People do not necessarily have to donate millions to Baltic Sea protection: it would be a good start if every person who has ever swum in or travelled by boat on the Sea donated the change in their pocket to Baltic Sea protection. Small, individual donations soon become tens of millions of euros, and everyone benefits.

Kari Liuhto

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Professor Liuhto has acted as an expert on the World Investment Report compiled by the UNCTAD.

2006

Education and research - Key factors in development in the Baltic Sea Region

by Antti Kalliomäki

The Baltic Sea Region is an important section of Europe: one third in population terms with its 150 million inhabitants. The Region has changed with European integration. Finland, Sweden and Denmark are old EU members; Estonia, Latvia, Lithuania and Poland joined in 2004; and Germany, one of the major EU countries, is connected to the Baltic Sea and has vested interests in the Region. The non-EU country, the Russian Federation, participates in the activities through St Petersburg and the Kalingrad Oblast.

The underpinning of cooperation around the Baltic Sea has traditionally been trade and business. Today, quite rightly, we again talk of a Baltic Sea economic area, and great expectations are directed at the area as a generator of economic growth. With their brisk economic growth, the Baltic states have outdone all the other members in the new EU, and Poland is on a promising track towards growth. There are, however, large differences in the standard of living and development stage. Redressing the balance and improving the competitiveness of the Region require sustainable social and economic development. The social, cultural and economic welfare of the population is a challenge shared by the Baltic Sea countries.

Favourable development of the economy, employment and welfare is seen to be closely associated with high-standard education and the production and application of new knowledge. Production and trade based on innovations and high technology are crucial productivity factors. Interdependence between countries and regions is growing with advancing globalisation. This is another impetus for improving competitiveness, and the Baltic Sea countries should be able to step up their regional cooperation and interaction in the education and research sector. Owing to its growth potential, the Baltic Sea Region plays a major role in the overall effort to improve competitiveness in Europe. According to the Lisbon Strategy, research and education are an important component of this effort.

For the extensive university network in the Baltic Sea Region, the most natural framework for cooperation is the EU and the opportunities it offers for cooperating with Russia. A key development trend in education is internationalisation, in which all the countries currently invest. The pan-European Bologna Process offers a wide range of opportunities for cooperation. Russia, too, has adopted the Bologna goals and the European Higher Education Area 2010 as guiding principles in its higher education reform. During its EU Presidency, Finland has wanted to stress the role of mobility as a priority in internationalisation and as a major competitiveness factor.

Promoting world-class research is an important aim for Europe as a whole, and it is believed to be in the best interests of all the EU Member States. European countries are getting ready to apply the Seventh Framework Programme for R&D, which will take effect in the beginning of 2007. Other important measures in the development of the European Research Area are the competitiveness and innovation programme and wider application of the ERA-NET Scheme.

The Baltic Sea universities should be active and choose priorities of crucial importance for the Region. A good example of this is research on the ecological state of the Baltic Sea and environmental research more widely. Another critical theme is research into economic development in the Region. As an example of viable structures I would like to mention the Nordic-style graduate schools and centres of excellence, which could be developed more widely within the Baltic Sea Region. A special priority in the Region is the wide-ranging Baltic 21 programme for sustainable development, which comprises both research and education.

The Ministry of Education has allocated funding to Baltic Sea cooperation and to education and research relating to the Region during three performance management periods. The University of Turku has received funds for coordination and development and the Åbo Akademi University for participation in the University Program network. Further, both the University of Turku and the Turku School of Economics and Business Administration have received project funding for developing studies with a Baltic Sea dimension.

Another boost for research and education cooperation will be the new political framework document on the Northern Dimension in the EU, which will take effect in 2007. This was one of the objectives set for the Finnish Presidency. The Northern Dimension will change from an EU-centred policy into a common policy of the EU and the current Northern Dimension partners, Russia, Norway and Iceland, with jointly set objectives. The Northern Dimension comprises several sectors. Research and education is a very important sector in it and also one of the four Common Spaces in EU-Russia cooperation. The aim of the reform, in which the internal and external sources of funding were combined, is to create a simple and efficient funding instrument for the Northern Dimension.

As regards the future of the Baltic Sea Region, the expectation and hope is to create an increasingly integrated economic, political and administrative area. There is every reason to expect that this Region will constitute a significant zone, with an identity of its own, in the future Europe. The Baltic Sea Region will need special experts for different sectors and organisations. Promoting this aim is in line with Finland's internationalisation strategy.

Antti Kalliomäki

Minister of Education and Science

Sweden's role in the Baltic Sea region

by Carl Bildt

Our European continent has seen major and overwhelming political and economic changes since the 1990's. The changes have forced us to rethink co-operation. We have been faced with questions such as how to best promote democracy and economic growth in the Baltic Sea region and how to work together to improve our environment. In this connection I think the co-operation in the Baltic Sea Region – in the framework of the Council of the Baltic Sea States (CBSS) - has helped pave the way for increased regional integration and been instrumental in making the Baltic Sea region one of the most competitive areas in the world when it comes to economic growth.

There is a growing recognition that we need a strong, broad co-operation to deal with issues that have high relevance to all our citizens such as the horrific trafficking of women and children, the troubling environmental problems and the tragedies of refugee children who turn up in our countries unaccompanied. Energy, transport and nuclear safety are other issues where co-operation is truly beneficial.

The regional dimension cannot be underestimated for tackling many of the common problems we face. Take the terrible example of trafficking of young women. The same features that unite the Baltic Sea region - the short distances between our countries, our common historical background, our linguistic similarities, our cultural resemblance – are also the features used by the traffickers. Only they are still one step ahead of us. The same characteristic goes for many of our shared problems. How can we change this? To me, the obvious answer would be to develop and improve the regional dimension.

One effect of the changes during the last years is that the co-operation within the CBSS has changed character and reached a more concrete and diversified level. It has reached a stage which has many similarities with the long-time work within the Nordic Council. The governments are no longer in the driving seat. It is instead much more business, local authorities, universities and independent organization that co-operate on many levels and in different capacities. This I find very encouraging.

The opportunities of the Baltic Sea region derive to a large extent from the economic potential of the region where we have seen a strong economic performance for quite some time. The Baltic Sea region has been able to utilize and produce attractive opportunities for business and investment and can boast diversity and a strong track record of political and economic reform, which make it one of the world's most competitive regions.

However, it is important not to lose ground in terms of competitiveness and inward investments and the Baltic Sea region need to look on how it can position itself for the future to keep up the growth figures. One important thing is how to achieve a truly integrated market in the Baltic Sea region, including Russia.

Russia presents probably the largest potential for trade and investment but it also has very cumbersome barriers to trade. Regional efforts such as those undertaken by the CBSS to remove barriers to trade and investment and encourage customs co-operation need to continue and to be intensified.

In general, during the Swedish Presidency of the CBSS (1 July 2006 - 30 June 2007) the Swedish Government has focused on developing the co-operation in trade and investment, the environment and sustainable development as well as on civil security issues.

There is still much to do to improve the practical co-operation in these areas and Sweden has taken the initiative to a number of projects such as seminars on corruption, joint work on environment and to strengthen the capacity to manage assistance in the event of a large-scale emergency - to take a only a few concrete examples.

What is then my vision with the CBSS for the future? I think we will see an even closer practical cooperation between participating states.

An important aspect of CBSS today is that around the Baltic Sea all countries except Russia are members of the EU. The CBSS format today therefore presents an opportunity to have a dialogue with Russia about concrete everyday issues that concerns our citizens. I think we will also see a closer practical cooperation with CBSS observers Ukraine and Belarus as well as other states in the wider Baltic Sea area.

We need to work towards achieving an even closer integration in the Baltic Sea region and promote economically and socially prosperous societies, based on a market economy, freedom and democracy. Societies that share the same objectives, whether they concern protecting our environment or fighting organized crime and trafficking in human beings, are the best guarantee for stability, security, peace and prosperity. It also gives our economies new dynamism and serves the objective of maintaining the Baltic Sea region as one of Europe's strongest growth areas.

Carl Bildt

Minister for Foreign Affairs, Sweden

Kaliningrad region - a new development strategy

by Georgy Boos

The Kaliningrad region is a relatively small unit of the Russian Federation and a unique region according its geographical location. On the one hand the Kaliningrad region is a part of the Baltic region and it belongs to "the Baltic development belt" – one of the most dynamic zones of modern Europe, and this defines its strategic potential for Russia. On the other hand the region is a part of one of the most rapidly growing Russian regions for the last 5 – 7 years – the North-West federal district.

A specific location of the region defines its problems. Remaining a part of Russia after the Soviet Union disintegration, the Kaliningrad region found itself under the influence of the external factors, which included the additional barriers for the transit of people and goods.

The external factors affected the structural changes in economy and the break of the traditional economic relations. So the economic recession in the region was more significant than in Russia and in the adjoining Lithuania and Poland.

At present the economy development of the Kaliningrad region have higher rates of growth, then all Russia and other regions of the North-West Federal district.

The gross region product of the Kaliningrad region increased nearly by 156%, whereas the gross region product of the North-West district increased by 150%, but gross domestic product of Russia – just by 142.2%. Average annual rates of growth of the gross region product of the Kaliningrad region counted 12.4 pcts. And the potential of the growth has not been yet exhausted.

The region takes the 16th place among 89 regions of the country according to the solvency rate for the year of 2005. For comparison in 2004 it took 24th place. **The general situation is evidence of gradual reduction of the general characteristics gap between the Kaliningrad region and the Russian Federation, and also between Kaliningrad region and other Europe countries.**

A number of factories were created in the furniture industry, food industry and in the electronic engineering.

The Kaliningrad region specialization in the All-Russian division of labour has formed at present. The main goods, produced in the Kaliningrad region are the foodstuffs, electronics, vehicles, cellulose and paper, furniture. According some criterions the industry of the region takes leading positions in the Russian economy. So every third tin of canned-fish produces in our region. Two thirds of the general television sets output of Russia produced in Kaliningrad. About 9 % Russian furniture production concentrated in our region.

The development strategy of the Kaliningrad region for the average- and long-term outlook defines such priority lines of the Kaliningrad region development as:

• Development of the transport sector and its fusion in the Europe transport patterns due to new quality

The prerequisites for this are the presence of branched infrastructure. There is a non-freezing port on the Baltic Sea, which is the only one in Russia. The road density is ten times more then the average density in the main part of Russia. At the same time we modernize step by step the present infrastructure. So since 2006 the modern roads building program meeting the European requirements will be launched in the region. We plan extend consecutively the port and develop the air transportation.

Among the economic priorities of the regional government there is an organization of logistics, providing the development of the all modes of transport. This means a forming of HABs, which allow organizing of multimodal transportation system and a forming of integrated load processing. There are the railways of Russian and Europe standard in the region. Kaliningrad can be considered as the most western station of the Trans-Siberian Railway. Today there are all conditions for development of the transport relations between the Europe and Russian industrial centers through Kaliningrad.

• Development of the agroindustrial complex and fish industry

Due to the conditions of the Special Economic Zone the food industry in the Kaliningrad region is developing focused on the Russian markets. This industry uses basically import raw products. The task of the regional government will be to stimulate the development of own raw products base. At the same time we rely on the historical prevalent specialization of the region.

The climatic conditions in the Kaliningrad region are quite favorable for development of agriculture; moreover, at present there is a rise of investments in this field. Some pig-breeding and dairy animal projects are developed and begin to work. The legislative preferences for agricultural companies and the opportunities which are offered by the national priority project "Development of agrarian and industrial sector" being implemented in the Russian Federation are strongly supported this process.

• Development of the tourist-recreational complex

According to the World tourist organization, the potential of Russia allows to receive up to 40 million foreign tourists a year at a corresponding level of the infrastructure development, and the number of the international travellers will grow since 664 million up to more than 1 billion a year by 2020, and by 2020 it will reach 1,6 billion.

The historical objects, closed for visiting for a long time, beaches of the Baltic seaside and the development of new technologies all together allow predicting the increase of demand for trips to our region.

• Residential development

The important task is maintenance of modern quality living conditions. For 10 months of the current year it has been constructed about 370,6 thousand sq.m of habitation – it is 1,4 times more, than last year. The competition in sphere of housing construction is supported through the mechanism of sale of the land lots by the open auctions.

Plans in this branch are so grand that the Kaliningrad region need a lot of investments, modern technologies and building materials to implement them.

Setting and implementation of new strategic tasks open a new horizon for the development of the Kaliningrad region. The most important of them are the achievement of competitiveness of the Kaliningrad region at the macro-regional level and the assurance of the effective integration of the region into the general social and economic processes took place on the Baltic Sea region.

Georgy Boos

The Governor of the Kaliningrad region,

The Russian Federation

European Investment Bank's financing in the Baltic Rim Region

by Sauli Niinistö

The Bank in General

The European Investment Bank was established in 1958 as the European Union's long-term lending institution to finance projects furthering the economic and social integration of the EU Member States.

The Bank's Corporate Priority Objectives include:

- Economic and social cohesion in an enlarged EU
- Implementing of the Innovation 2010 Initiative (i2i)
- Development of Trans-European and Access networks (TENs)
- Support for Small & Medium Sized Enterprises (SMEs)
- Environmental Sustainability
- Support of EU Development and Cooperation Policies in Partner Countries

In 2005, the EIB lent a total of EUR 42 billion, some 90% of total lending, for projects furthering the EU's political objectives in the EU-25, of which EUR 6 billion went to the new EU Member States. The EIB also made available some EUR 5 billion, approximately 10% of its total lending, in non-EU countries in support of EU development and co-operation policies. Finally, the EIF, the EIB specialised venture capital arm and guarantee provider, invested EUR 368 million in venture capital funds and provided around EUR 1.7 billion in guarantees for SME portfolios.

Deepening the European Integration of Poland and the Baltic States

The EIB's lending in the Baltic States and in Poland is focused on four core areas: economic and social cohesion, the development of TENs, environmental protection and support for SMEs. EIB lending in these countries has reached some EUR 14 billion since 1990.

Economic and Social Cohesion: Economic and Social Cohesion is the main corporate priority objective for the EIB with the aim of supporting developments in the less favoured regions (Objective 1 regions) and, in particular, meeting the challenges of enlargement. The whole territory of Poland and the Baltic States consists of Objective 1 regions (where GDP per capita is lower than 75% of the EU average). As such, these are designated as areas qualifying for allocations from the EU Cohesion and Structural Funds.

Development of TENs: The TENs are large infrastructure networks of transport and energy underpinning EU's developmental and integration goals. TENs, notably transport corridors, are crucial for the development of the region's new EU Member States and for removing bottlenecks and barriers to the efficient movement of people and goods in the EU, for safety and for the environment. Since 1990, the EIB has granted loans of approximately EUR 4.5 billion (35% of the total lending in the mentioned four countries) in support of projects in the transport sector. Major projects in this area cover construction of motorways along TEN corridors (e.g. A1, A2 motorways in Poland, railways rehabilitation), modernisation of airports in the individual capitals and upgrading of ports.

Support for SMEs: Support for SMEs has become one of the EIB's corporate priority objectives. SMEs are financed by the EIB indirectly through credit lines in favour of EIB's partner banks. These financial intermediaries then on-lend EIB funds to their customers who meet the EIB's eligibility criteria. In this framework some EUR 2.4 billion, or 17% of total lending, has been provided in order to improve access to long-term loans for SMEs and municipalities in the Baltic States and Poland since 1990. List of EIB's partner banks can be found on the EIB's website (www.eib.org).

Environmental Protection: The EIB finances projects that protect and improve the environment and promote social well-being in the interests of sustainable development. EIB support to projects in the water, municipal environmental infrastructure and flood damage protection sectors has exceeded EUR 2 billion or 14% of the total lending in the mentioned four countries since 1990. An example of a major project financed in this area is the investment for environment improvement in the city of Poznan and the neighbouring municipalities, thus decreasing the contamination of the Odra River and subsequently the Baltic Sea. Other projects include the Warsaw sewage treatment plant and the Riga water and environmental loan.

Recently, the EIB has developed a new technical assistance facility in conjunction with the European Commission and the EBRD. This initiative is designed to improve the preparation of projects in order to help the new Member States use the grant finance provided by the Union in a more rapid and effective manner.

Fostering cooperation with Russia

The EIB operates in Russia on the basis of mandates provided by the European Council and the Bank's Board of Governors. The first mandate for Russia covered the financing of environmental investments in a total amount of EUR 100 million in the Baltic Sea basin of Russia. Subsequently, in December 2004, the European Council confirmed a further EIB mandate for Russia, Ukraine, Moldova and Belarus for an amount of EUR 500 million. This second mandate is for projects in the areas of environment, as well as transport, telecommunications and energy infrastructure on priority Trans-European Network (TEN) connections having cross-border implications for EU Member States. The Bank has financed environmental projects under the first mandate thus contributing to a higher quality of life, not only in Russia but in all countries surrounding the Baltic Sea. The Bank is currently identifying eligible projects that would be financed under the second mandate.

The EIB is also actively involved in and is the current chair of the Northern Dimension Environmental Partnership (NDEP), which co-ordinates and accelerates the implementation of important environmental and nuclear safety projects in the Northern Dimension region, especially in North West Russia and Kaliningrad. The environmental projects financed by the EIB in Russia have also benefited from NDEP resources.

Sauli Niinistö

Vice-President

European Investment Bank

The Role of Scientific Research and Higher Academic Education in the Baltic Sea Region

by Tapio Reponen

In this globalising world the particular role of regions is obviously strengthening. The Baltic Sea area has a great deal of potential to be a competitive player in the world economy. Some of the countries are very high in the world competitiveness rankings, and many are spending a high proportion of their GNP on research and development activities. Success needs, however, strong efforts in developing successful innovation systems to continuously generate new products and services.

Universities are regarded as key actors in promoting innovativeness. The expectations are very high and at the same time there are a lot of critics with regard to their operations. One of the main expectations is to reach and maintain top quality research and education in all the Baltic countries. In the present discussion there are, however, many doubts about the present performance of higher education units. Many diverse viewpoints give one reason to consider the situation and think of the actions needed to strengthen this sector. In the following there is a grass-root opinion put forth on how researchers and educators see the present strengths and weaknesses of the academic world.

According to the different University rankings, peer reviews and evaluation reports we have every reason to believe that in the Baltic countries we have academic fields which are, without a doubt, leading ones or near the top in the world. At the same time the overall development of the University sector has many problems, such as recruiting good students, recruiting the most talented faculty possible, the financing of research projects, increasing bureaucracy etc.

In our societies the demand for “efficiency” has increased, also in the research and education sectors. Market orientation has led in speaking of the “production” of academic degrees and research projects and increasing their productivity. The relationship between results (output) and resources (input) is consequently deteriorating. In academic research and education there is, however, a reverse connection between quality and productivity.

In business literature we can find research results that in the service sector we can increase productivity by redesigning processes, but only marginally. We can gain short term benefits, but by continuing this process re-engineering, the quality of services will, in the long run, suffer. In the University sector we are now living at this stage of development. We have improved productivity considerably by increasing the number of degrees produced, by starting numerous new, large research projects and by adding new forms of operating. The number of personnel has been growing less than the output, thus effectiveness has increased.

The critics of the University sector are correct in the way that we inside Universities have noticed signs of decreasing quality. Increased productivity means more mass education, less tuition, more routine work, longer working hours, less enthusiasm, poor motivation among personnel, more stress and thus exhausted people.

These problems should be tackled immediately. The main objective in University policy should be to increase the quality of research and education. Real quality improvement is a human process, where motivation and encouragement are the key factors. This can be supported, but not replaced, by quality assurance systems. The role of quality assurance may be important in taking care of an even quality. Controlling does not, however, help if the incentives are missing.

The Baltic Sea University sector has long traditions, high quality in many operations, diversity of actions and much hidden potential, but its global competitiveness needs to be improved. We need competitive research environments, which offer circumstances that are tempting to the young, talented scientist. At the moment we are losing our best candidates to industry, to better research environments and to other sectors. E.g. US Universities are able to offer much better environments for research and education. Consequently we are slowly losing our position, which in the longer run is a critical factor.

We need a career development programmes to recruit and keep the best researchers. The present situation, with many short engagements, does not meet this goal. We in the Universities understand that resources are scarce and there are limits to investing into higher education and research. Therefore it is important to guarantee that everything we do is of the highest possible quality. The resources we have should be deployed in an efficient way, but in all focal areas of research the balance between resources and objectives should be realistic. Every University cannot be good or best in all fields. We need prioritising, focusing, specialisation and networking to reach the best possible results.

We have already examples of well-functioning networks between Baltic Sea area Universities. This development should be strengthened to guarantee equal possibilities for our researchers, which those in other countries have. National policies on higher education and research definitely have an influence on our success. We in the Universities hope that these national policies follow the same direction so as to build a unified Baltic research area.

Tapio Reponen

Rector

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The Euro-rule for inflation is too strict for the Baltic economies

by Niels Mygind

It was an unnecessary rigid decision that Lithuania was not allowed into the Euro just because inflation was 0.1% higher than the Euro criterion. There would be no problem for the Euro or for the three Baltic economies if their inflation was considerably higher. We must expect a higher inflation in these countries during their catching up process.

After the fall of the command economies they needed deep restructuring from a system based on bureaucratic directives to the new market system where customers' demand and market based costs completely changed what and how firms should produce. Quite fast companies cut away unprofitable production, but it took several years to build up the new production structure with new technology, products and markets. Therefore, GDP fell in the first years of transition reaching the bottom around 1994 in the Baltic countries.

EU-accession accelerated the development of new market institutions meaning more efficient use of the highly educated labour, the quite advanced and improving infrastructure, and the good location close to some of the richest countries in the world. Therefore, the Baltic countries are in a fast catching up process with real growth since 2000 around 8%. Labour productivity is increasing at the same speed. This is the background for steeply growing wages and for increasing prices in the non-tradeable domestic sector. In Balassa-Samuelson terms we see a real appreciation mainly as an increase in the Baltic price-level in relation to EU15, but also nominal appreciations played a role for Latvia and Lithuania. Now, all three currencies are fixed to the Euro leaving only increasing prices as the adjustment mechanism for real appreciation.

In 1995 the price levels in three countries were only 25-36% of the level in EU15 (see table). There was room for steep increases. With the increase in productivity wages started to grow and this was reflected in an increasing domestic price level. By 2000 it was around 50% of the EU15 price level. In the first years of this millennium inflation was quite low probably as part of the policy to be ready for the Euro, but from 2004 inflation increased and it is now the main barrier for fulfilling the Euro-criteria. In 2006 the forecast is around 10% volume growth and Baltic inflation is about 3% higher than in EU15.

	Price levels			GDP/capita, EU15=100			GDP/capita PPS			GDP growth
	1995	2000	2005	1995	2000	2005	1995	2000	2005	2000-05
EU15	100	100	100	100	100	100	100	100	100	2.0
Estonia	36	50	56	11	19	31	30	38	56	8.7
Latvia	31	48	48	8	16	21	27	32	44	7.9
Lithuania	25	44	47	8	15	23	31	35	48	7.1
	2010	2015	2025	2010	2015	2025	2010	2015	2025	2006-25
EU15	100	100	100	100	100	100	100	100	100	2.0
Estonia	65	75	101	41	56	99	64	74	99	5.0
Latvia	56	65	87	28	38	68	50	58	77	5.0
Lithuania	55	64	86	31	41	73	56	64	85	5.0

1995-2005 based on Eurostat.

2006-25 volume growth difference 3%, inflation difference 3%

With the institutions in place, integration into EU, continuing high FDI, and strong restructuring the fast catching up is expected to continue. A difference in real growth rates between EU15 and the Baltics of 6% may not be unrealistic in the coming years. Later, when the economies converge technological spill-over effects will be smaller and growth will also converge to the lower EU15 level. Still, a 3% higher growth in Baltics is probably not too optimistic. Also the price level will catch up and converge to the level in EU15.

The table shows a simple calculation for a possible development for 2006-2025. Catching up is assumed to be 3% in volumes and on top of this is added a 3% price catching up. With fixed exchange rates this means 6% catching up per year measured in Euro. The result is that the Estonian GDP will reach the level of EU15 in about 20 years and Latvia and Lithuania a few years later. The prices will also catch up within this period and the Baltic inflation will thus be 3% higher than the EU15 inflation every year.

However, a 3% higher inflation is not within the Euro criterion. This shows that the inflation-measure is much too rigid for catching up countries with fixed exchange rates. Catching up with steeply growing productivity means higher inflation. Tough economic policy could keep inflation down at the Euro-level for a certain period when fulfilling the Euro-criterion, but the cost would be lower growth. Then, after Euro-entry the price levels should catch up at an even faster speed. The catching up process can be expected to be fastest in the first part of the period and it will be easier to fulfil the inflation criterion when the gap to EU15 has been narrowed considerably – the case for Slovenia with the highest GDP per capita of the new member states. However, it may take several years before it again will be relevant for the Baltic countries to fulfil the tough inflation criterion unless they run into a period of slower growth.

The advantage of joining the Euro may be exaggerated. Nobody claims that the Baltic part of the extended Euro area fulfil the conditions for an optimal currency area. However, with the currency boards in Estonia and Lithuania and the fixed exchange rate in Latvia the three Baltic countries have de facto had a sort of membership of the Euro for a long time. The Russian crisis hit the Baltics as an asymmetric chock compared to EU15 and still this chock was solved within the policy of strictly fixed exchange rates.

The costs of staying outside the Euro for a longer period are probably not high because the exchange rate uncertainty is already very low. It can be argued that interest rates at the Euro level combined with higher inflation mean very low, maybe, even negative real interest rates and this can cause overheating of the Baltic economies. However, already now a high proportion of Baltic loans are Euro-based with a very low real interest rate and very low exchange rate risk.

Niels Mygind

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Baltic Sea Energy Roulette: Is a Survival Kit on Civil Protection Needed?

by Timo Hellenberg

Throughout its turbulent history the Baltic Sea has played a trivial role being that of a bridge and a barrier between Eastern and Western Hemispheres. The Sea has carried hopes and spread destruction, whilst always harboring some hidden dimensions unpredictable for the governing regimes. After recent waves of eastern enlargement the European Union has finally generated the borderless socio-economic maritime region, gearing its growth from mounting energy transportations and logistical highways. But as in all historical success stories, there is always the less glorious side of a coin to be tackled.

The greatest potential risks within the Baltic Sea Region are derived from growing energy transportations, namely natural gas and oil. The EU's external dependence and, at the same time, vulnerability for energy is rapidly increasing. Though the Union has very limited scope to influence energy supply conditions, it can effectively manage the risks related to the energy transports, particularly at sea corridors. Regardless of the usage of high-end technology and a stable business environment, the European Union energy transits at the Baltic Sea is facing physical risks (transfer of demand, geopolitical crisis, natural disaster), economic risks (price fluctuations), social risks (social disruptions), environmental risks (global warming) and terrorism. The terrorism risk related to sea transport is clearly evident within the Baltic Sea Region but it has yet to be studied properly.

This is particularly true of some sub-regions of the Baltic Sea, e.g. the Baltic Proper and the Sound, where the narrow and shallow straits cause additional risks. In upcoming years the maritime traffic, for instance the amount of transported oil, is forecast to increase substantially. The oil transit by shipping within the Gulf of Finland is 7 times greater than 10 years earlier. In 2000, the oil cargo through the Gulf of Finland was 40M tons, in 2006, 140M tons and by the end of the decade it is estimated to reach the level of 190-200M tons. Sea transportation essentially uses larger vessels and, although this means less traffic, the risk potential for a large scale accident will grow.

The narrow ship lanes and shallow waters increase the probability for collisions and groundings. Particular risk areas at the Baltic Sea are the Gulf of Finland, the Archipelago Sea and the Quark; the threshold between the Bothnian Sea and the Bothnian Bay, both of which have specific ecological value, but also serve as crossing paths for heavy maritime traffic, particularly between Helsinki and Tallinn. These characteristics together with other kinds of risks, for instance, terrorist attacks on vessels carrying Russian black gold, would have severe consequences for people, property and environment in the region for decades to come.

According to a recent Council of the Baltic Sea States Eurobaltic Report on Cross-Border Risks at the Baltic Sea Region (Hellenberg & Hedin, 2006), there are several advantages within the area currently. On the plus side, the fleet sailing in the Baltic Sea is generally modern. Additionally, transportation by way of single hull vessels will be a thing of the past by 2010 and, importantly, the legislation around transportation is strict. Finally, there is better information flow and possibilities of identification of ships and oil spills. Satellite pictures and the monitoring by aircraft and vessels have, for instance, improved the control of the Baltic Sea traffic. However, apart from the risk of oil spills, the Baltic Sea will face new intergovernmental challenges – with far reaching economic, political and military dimensions – as a result of the North European Gas Pipeline. The risk of disrupted gas outflow would have not only environmental, but also disastrous economic and political dimensions.

Acknowledging that national measures alone are not sufficient to prevent environmental disasters at the Baltic Sea, the Baltic Sea States signed the Helsinki Convention in 1974 which came into force in 1980. Finally, regional cooperation for environmental protection (HELCOM) was initiated. There are also numerous bilateral agreements between BSR countries to tackle oil spills. In 1971, the Copenhagen agreement was established between the Nordic countries to develop multinational cooperation, obligate the countries to arrange annual exercises and man the oil spill capacity. However, where there are arguably too many agreements in place to tackle the oil spill on seawaters, no such agreements exist today for multilateral assistance to tackle oil spills on land or inland waters.

Another obstacle comes from the fact there are too many authorities to deal with oil spill prevention at the national level. For instance in Finland, the Finnish Environment Institute under the Ministry of Interior is responsible for oil spill prevention on seawaters. However, when the oil reaches the shorelines the responsibility shifts to the regional rescue services under the Ministry of Interior. Somewhere between these two agencies lays the capacity and knowledge of the Defence Staff and Ministry of Defence, which may be mobilized if needed. The decision making is at least as complex in neighbouring Sweden where the private sector has an essential role in oil collection from the shorelines.

So what is to be done at the Baltic Sea Region in order to manage these emerging risks around energy transportations? A new model for the regional approach could be derived from the Mediterranean Sea where the United Nations and the EU are co-financing a Regional Marine Pollution Emergency Response Centre for the Mediterranean Sea (REMPEC) to tackle cross border risks, mainly oil spill prevention. Rather than lose time and scarce resources on overlapping national monitoring, training and decision support systems, the Baltic Sea Countries should promote the region as a piloting area within the European Union and worldwide in the field of cross-border risks prevention. This would provide citizens of the region comprehensive safety across their borders and enhance the mutual trust towards our common survival kit targeted to respond to the greatest megatrend of the 21st century; the balancing of domestic safety risks and external security threats. Something which the Baltic Sea has witnessed over centuries but which could prove lethal if not recognized and faced with proper survival strategy and power.

Timo Hellenberg

Dr (Int.Rel), Chairman of the BSR Research Network on Civil Protection

Will tourism become " pole of growth" of the Kaliningrad economy?

by Elena Kropinova

During the last 15 years the Kaliningrad oblast has been regarded a perspective region for tourism development. Global changes both in the world and in the immediate surroundings of the territory have taken place within this period of time. How has it affected tourism business? Can we consider this sphere "pole of growth" of the Kaliningrad economy?

In 1991 the Kaliningrad oblast counted 90 sanatorium-and-spa and resort institutions (capacity 9921 beds) which had served 250 thousand people. The average accommodation price for foreign tourists amounted to 25-30 US dollars. The main kind of international tourism was nostalgic tourism, which could be proved by increasing flow of German tourists and their dominance in the share of foreign tourists.

According to the 1990s territory development forecast done by SPb experts capacity of accommodation facilities should have grown up to 60 thousand beds in wintertime and 170 thousand beds in summertime[1]. However tourism business growth and restructuring have flown slower than expected and these results were not achieved. In 2005 over 125 accommodation objects (capacity about 15-20 thousand beds), 147 museums, 47 leisure entertainment centres and around 300 restaurants, cafes and bars were at tourists' service. The number of Russian and foreign tourists visited the Kaliningrad oblast in 2005 was 256,6 thousand and 76,4 thousand respectively[2].

Among the problems of tourism development since 1990-s remain visa regime (with expected complication of the situation resulting form inclusion of Lithuania and Poland in Schengen Agreement in the nearest future), poor transport connection (direct regular international flights only to Warsaw- once a day, Copenhagen –four times, to Berlin – three times a week), railroad connection with Gdansk-Berlin (trailing car; 600 km distance is covered in 15 hours), Vilnius (Moscow and St. Petersburg trains), underdeveloped infrastructure, poor condition of landmarks and historic monuments (some improvements, connected to celebrating of the 750th anniversary of the city, should be noted).

The most evident improvements have been achieved in accommodation sector. Among the measures taken are thorough repair of existing and construction of new hotels meeting European requirements. At the same time the price-rate has increased to average 50-100 US dollars per day. The quality of professional training has improved (at present five educational institutions provide the region with specialists in services and tourism). The ecological situation has as well improved due to more strict environmental requirements and utilization of modern technologies.

Besides permanently existing problems which are taken for granted, two comparatively new have risen. One of them results from the new conditions of the Russian Federation tourism enterprises operation in view of the planned introduction of amendments to the Federal Law "On the Essential Principles of Tourism Activity in the RF". If they will be approved financial guarantees will be introduced accordingly. These guarantees will account for 10 million rubles for the tour operators, specialized in external tourism (according to experts' opinion this amount is sufficient to cover, for example, the costs of the costumers flight from abroad in case of bankruptcy) and 1 million rubles for the tour operators specializing on incoming tourism.

However this amount is too large for the regional tour operators who see these innovations supportive of larger Moscow companies (there are about 30) interested in displacement of smaller companies. Hence, we will have the following situation on the Kaliningrad tourism market – around 10 regional operators, Moscow branches (the most active at the time is "Neva" (airplanes), "BonVoyage" (busses), "Infinity", "Rus.Adventure" etc.) and, possibly, foreign tour operators (Turkish, Greek, Spanish, Egyptian) (apparently international partners' guarantee can become rescue for the smaller firms). Other firms will have to extend or merge with the survived ones (including Moscow and foreign companies).

Another problem is faced by the regional government, the administration of municipal formation "Zelenogradskij district" and the administration of the "Curonian spit" national park. It is a consequence of the decision by the Ministry for Trade and Economic Development of the RF Government on creation of tourist-recreational area "Curonian spit" on the territory of the Kaliningrad region taken in November 2006. This territory together with six more regions has won the tender for investment. The planned amount of state financing is 1,8 billion rubles[3]. 1,5 rubles of this amount will be allowed by federal centre within the framework of recreational areas development programme. The advantage is that the funds will cover modernization and infrastructure development. Obviously, the territory with sufficient infrastructure will become attractive for construction of tourism and recreation objects (according to the regional government forecast it will draw at least 9-10 billion rubles private funds). However, the project raises doubts from both economic and ecological perspectives, as the territory is occupied by the "Curonian spit" national park and economical activity, therefore, is significantly restricted. The amount of the requested investment is groundlessly low – 1.5 billion rubles (43 million Euro) (construction of bicycle lanes, promenades etc. is planned) while the time constraints of assignation are wide - till 2026.

To compare, 6,9 billion rubles are allowed for tourism-recreational area development in Altayskiy krai, 4,8 billion rubles for the republic of Altai, 2,56 billion rubles for the Irkutskaya oblast, 10 billion rubles for Buryatiya, 12,9 billion rubles for Krasnodarskiy krai, 2,5 billion rubles for Stavropolskiy krai. One has also take into account that infrastructure development will be carried out in the area with complex geology, which involves complex coast-protecting measures. More than that, the project has to undergo ecological examination which sets specific, more strict requirements for the area within the National park. Not less interesting is the international community opinion, considering that the territory is included into UNESCO World Heritage List. Therefore, those elaborating the project bear greater responsibility, both ecological and financial.

The Kaliningrad oblast authorities face a complicated task – to transform the oblast into a tourist centre, capable of competing with neighboring areas and at the same time attractive and accessible (in respect of visa and transportation) to be included into international tourist routs in the Baltic Sea region. Mere adequate solution of the indicated problems will make tourism profitable business and "pole of growth" of the Kaliningrad economy.

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[1] The Kaliningrad Oblast Recreational Complex Development Programme, 1993 r.

[2] Kaliningrad Oblast v zyphrakh. State Commettee for statistics in Kaliningrad Oblast, 2006

[3] Russia. Federal Internet Channel. 6.12.06 , http://www.rfn.ru/cnews.html?id=116274

Finnish - Baltic Trade Associations
Case: Finnish-Latvian Trade Association

by Tapio Aho

As soon as the Soviet occupation was over in the Baltic States, Finnish companies started to investigate business opportunities especially in Estonia, but also in Latvia and Lithuania. Estonia issued as the first former Soviet republic its own currency in June 1992. This successful operation supported Estonian economy by cutting it away from Rouble economy. It also caused a new wave of Finnish companies entering to Estonia. At that time most of the official contacts between Finland and Estonia were missing. One of the reasons was the lack of institutions in Estonia. Sufficient information about development was not available in Finland. To cover these needs Finnish – Estonian Trade Association www.seky.fi was established 1992. Finnish-Lithuanian Trade Association www.suli.fi saw day light 1994. Finnish-Latvian Trade Association www.laky.fi was registered in Finland 1997. The main task of associations is to develop trade between the countries and also to support the Baltic institutions and organisations with information and training.

Total number of Finnish investors in Latvia is 290. The number of members in Finnish-Latvian Trade Association is growing every year and has now reached the highest level so far and is almost 90. The first members were retail chains or companies offering Finnish products to consumers, farmers, etc. This group was followed by service sector; like banks, law offices and advertisement companies, who were forced to follow their customers to new market areas, in order for not to loose the customer relations also in Finland. Today we see more and more manufacturers looking for possibilities to produce components in cheaper labour area like in Latvia. Real estate developers have started to move to the Baltic countries already some years ago. It has been most important for association to keep close contacts and strong co-operation with Latvian embassy in Finland and also Finland's embassy in Latvia. Among partners of Finnish-Latvian Trade Association there are also high schools, central banks and ministries. Through the members association owns a huge amount of know-how from all fields of business.

Association has organised annual seminars, meetings and trips to Latvia. Today the need of information is not as important as it was some 10 years ago. Information is available from many sources like law offices, banks and research units. In spite of that it is possible to cover special areas, which may have impact on most of the members. At the moment Association follows infrastructure investments in Latvia and transparency of projects. Naturally Association also keeps individual contact with as many members as possible.

We still believe in strong integration between the economies of Baltic countries and Finland. Estonia is leading this process. The number of Finnish direct investors in Estonia is 570, in Latvia 290 and in Lithuania 180. More and more medium sized companies are also looking for trade possibilities. Many of them seek producers of components. Especially Finnish metal companies contact rather often Association for information of potential counterparties.

A new phenomenon is Baltic investment activity in Finland. Estonians' are leading also this process with names like Tallink, Teho and Alta Capital. Latvian investors are still missing, but finally new Latvian products have entered Finnish markets.

Because most of the members have activities in each Baltic country, Baltic Trade Associations also co operate and arrange joint meetings. However we still feel that separate associations are needed. There is much in common, but the Baltic States are different. Their history, economy, language and culture differ from each others.

Tapio Aho

Chairman

Finnish-Latvian Trade Association

Threats and opportunities regarding Latvia's economy

by Raita Karnite

On the surface, Latvia and other Baltic States, have demonstrated surprising progress in developing their economies. Growth rates have been high for several consecutive years in all the Baltic States with varying degrees of success for each country. Estonia attains better positions in all international comparisons and evaluations, whereas Latvia and Lithuania occupy lower positions, yet in the middle of the list, usually next to each other.

Economists know that a high growth rate does not necessarily provide good economic development, or, that quantitative achievement not always transforms itself into adequate qualitative achievement. The adequacy of qualitative and quantitative improvements depends on the growth engines.

Taking Latvia as an example, high economic growth is supported by strong domestic demand; besides a low starting level helps to see high growth rate figures. The average annual GDP growth rate has been more than 9% for five consecutive years, and the steep rise (more than 10%) continues since 2005[1]. The domestic demand is fueled by higher real income, resulting from the dynamic expansion of lending, FDI, financing from EU structural funds and other factors.

It is expected that the present pace of Latvia's economic development will remain unchanged for some years. The Bank of Latvia reports[2] that the annual lending growth rate was 59.5% in QII 2006. However, the positive effect of loans availability is deteriorative as lending activities are focusing on consumption financing. More than half of all the credit issued goes to households, primarily for house purchase. Two-thirds of the corporate loan portfolio is allocated towards real estate, renting and business companies. The third larger borrower is the banking sector itself. Through this disproportional financial provision, banks have encouraged structural changes in the Latvian economy within a short time period. In 2004, the increase in the gross value added was equal in the goods-producing and services sector, while in 2005 growth in the service sector (by 11.2% on y/y basis) surpassed that of the goods-producing sector (7,9%)[3].

The high increase in money supply continues (about 40% in QII 2006), and also domestic deposits grew by more than 40%[4]. The lending activities of foreign-owned banks surpass borrowing; essentially meaning that banks no longer primarily transport money within the Latvian economy, giving earnings to lenders in Latvia, but they allocate deposits accumulated in their parents into Latvian economy thus increasing external debt. The banks focus on the high profit and liquidity sectors – currently the real estate sector, on the basis of mortgage crediting. This business is attractive, and several other foreign-owned banks have entered the Latvian financial market in 2006.

Due to the substantial structural changes, the picture seems less sunny from the supply side of Latvian economy. The Bank of Latvia states[5], that the upward trend in GDP is strongly supported by a steady rise in retail trade turnover, while the progress in manufacturing is considerably less, associated with internal demand. The demand for exports has slowed in the main exporting sectors in QII 2006. The growth was also moderate in the transport, storages and communication sectors due to problems of oil and mineral fertiliser transit.

On other hand, imports grew at the high average pace. The deterioration of the goods balance persisted and the current account deficit jumped to 17.9% of GDP in QII 2006. The deficit was covered by long term capital, of which FDI comprised almost half[6].

The economy faces some other structural problems – tight labour market conditions, emigration, and fast-growing labour costs and salaries, as well as high inflation on the basis of price rises for energy, increasing material and labour costs. The bubble of the real estate market has reached considerable amounts, yet prices continue their growth. It is clear that the current situation can not remain forever and there should be changes. What changes would we like to see?

They must turn the economy from the dangerous "only consumption" oriented path to a more sustainable one, by forwarding a part of the lending to the producing sectors – no matter to the material production or service sectors. It is likely that foreign-owned banks are not going to cut their lending activities and prefer consumption credits unless other sectors show better productivity. The first comers' preferences in using unbelievably cheap labour are almost exhausted. Investors have not yet understood profit from that of investing in productive sectors, and clearly demonstrate their short-term interests in Latvia. In this moment, the winner will be the one who finds new paradigms of competitiveness in Latvia. The external situation also supports investment in NMS in general and Latvia in particular. Economic development in the "core" EU countries remains uncertain – good in projections but moderate in real figures whilst growth rates in NMS remain high.

What are the new paradigms of competitiveness in Latvia? From the current point of development, it is the implementation of the Lisbon pattern in an easy way. The share of industry in Latvia's GDP is only slightly more than 12%, and it is segmented into a large number of small production units. The development of knowledge-intensive service sectors is also moderate, so the market is free and competition stays away. On the other hand, the availability of the highly-skilled workforce is still substantial. At the time being labour resources are used and paid inadequately with regard to their qualifications, labour productivity may be raised several times. Besides, the government has declared support for the knowledge-intensive model of Latvian economy in the National Development Plan that governs investment priorities in forthcoming years.

We may conclude that the development reserves of the Latvian economy remain high. Despite the dual situation at the current moment, and probably because of it, the country is at the beginning of a new development wave.

Raita Karnite

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[1] Monthly Bulletin of Latvian Statistics, 9(148) 2006, CSB, October 2006, p.4

[2] Monetary Review 2/2006. Latvijas Banka, 2006, p.31.

[3] Bank of Latvia: Annual Report 2005, p. 14

[4] Monetary Review 2/2006. Latvijas Banka, 2006, p.31.

[5] Monetary Review 2/2006. Latvijas Banka, 2006, p.31.

[6] The same.

The role of the Northern Dimension in the Baltic Sea cooperation

by Erkki Tuomioja

The Northern Dimension became an EU policy in 1999. The new EU Member States in the north, Finland and Sweden, wanted to make the rest of the European Union aware of the challenges and opportunities of the region comprising the Baltic Sea, Kaliningrad, North-West Russia and the Arctic areas. Many of the challenges were too big for individual countries to handle alone. Seizing the opportunities opening up in the Northern Dimension region in such fields as trade, investments, transport and energy would benefit not only the northern areas but the economy and well-being of the whole of Europe. The original ideas behind the policy continue to be valid even today.

The Baltic Sea plays an important role in the Northern Dimension cooperation. Without underestimating the impacts of the EU's internal policies in the Baltic Sea region, we have reason to say that many aspects of the Baltic Sea cooperation require close cooperation with Russia. The marine environment, transport safety, cross-border crime, communicable diseases, transport and logistics cooperation are examples of issues in which exchange of views with Russia is necessary.

The cooperation in the framework of the Northern Dimension has led to the establishment of two practical partnerships, the Environmental Partnership (NDEP) and the Partnership in Public Health and Social Well-being (NDPHS). These partnerships work for increased well-being in the Baltic Sea region.

The Environmental partnership aims at solving problems related to waste water, solid waste, air pollution and nuclear waste. The NDEP Support Fund has now collected 225 million euros as donations from the EU Member States, the Commission, Russia, Norway and Canada.

The Support Fund gives only the seed money to the projects carried out within the partnership, and the main bulk of financing comes from loans that chiefly Russian actors take out from international financial institutions. The total value of projects in the pipeline exceeds 2 billion euros. This is an enormous achievement.

The ecological state of the Baltic Sea is of importance to all bordering countries of the sea. The first major partnership project, the St Petersburg Southwest Wastewater Treatment plant, was inaugurated last September. Several other projects are under way or at the planning stage in Kaliningrad, St Petersburg and in other parts of North-West Russia.

The other partnership, **the Partnership in Public Health and Social Well-being**, focuses on the prevention of communicable diseases, such as HIV/AIDS and tuberculosis. It also focuses on lifestyle-related health and social problems. The cross-border nature and social and economic repercussions of these problems make the issues covered by this Partnership a common interest of us all.

The Northern Dimension policy is going through some significant changes. The Northern Dimension Ministerial Meeting in November 2005 agreed on the guidelines for the renewal of the policy, taking into consideration the changes in its operational environment.

A strong and active Northern Dimension policy in the future calls for the joint efforts of all the countries in the region. The future Northern Dimension will be a common policy between the EU, Russia, Norway and Iceland.

Another important decision of the Ministerial Meeting last year was to accommodate the Northern Dimension to the EU-Russia cooperation framework. The Northern Dimension will be seen as a regional expression of the implementation of the Four Common Spaces. The road map, agreed in May 2005 between the EU and Russia, includes steps that should be taken to enhance cooperation in the following four fields: economy; freedom, security and justice; external security; and research, education and culture. Also other issues of special relevance to the northern regions will be held high on the Northern Dimension agenda.

Negotiations between the EU, Russia, Norway and Iceland on the new common Northern Dimension policy document (the so-called Framework Document) are well under way. The finalization and adoption of the new document is due to take place during Finland's Presidency of the EU in the autumn of 2006. One of the priorities of the EU Presidency is to strengthen the Northern Dimension in the external and cross-border policies of the EU.

The Northern Dimension partnerships have proved their strength and value. We hope that the new common policy will give impetus to further strengthening and development of the current partnerships. Financial resources need to be ensured to make possible the implementation of the projects planned to take place under the Environmental Partnership. In addition to large environmental investments, there is also demand for small and medium-sized environmental and energy efficiency projects in North-West Russia, particularly in the municipal services sector. The Environmental Partnership could provide a well-functioning cooperation structure also for the implementation of these projects.

Finland would also like to see the establishment of new partnerships. The next one could be in the field of transport and logistics. Such a partnership could focus on the northern main axes and cross-border infrastructure, on the motorways of the Baltic region and the development of requisite ports and inland navigation, on efficient logistical chains and on trade facilitation and customs procedures. Also, security in transport as well as interoperability of railways could be themes for such a partnership. Kaliningrad could be a geographical priority.

If we think about the future of the Baltic Sea region, the key word is competitiveness. In order to keep our societies on the right track, we need well-functioning educational and research structures. This could also be an issue to be addressed in the framework of the Northern Dimension.

The Northern Dimension should also facilitate cooperation at the level of sub-regional and local actors, universities, the private sector, NGOs and other non-governmental actors. They all play a significant role in the practical regional and cross-border cooperation and in the enhancement of people-to-people contacts. This is a matter that deserves closer attention in the future Northern Dimension policy.

Erkki Tuomioja

Minister for Foreign Affairs, Finland

Norway's Role in the Development of the Baltic Sea Region

by Jonas Gahr Støre

Norway has been a member of the Council of the Baltic Sea States since its establishment in 1992, and is an active participant in the Council's regional cooperation efforts. Norway may not be a part of the Baltic Sea region in strictly geographical terms, but both trade and shipping links and people-to-people contacts can be traced back to Viking times.

Parts of the Baltic Sea region have experienced radical political, economic and social change since the early 1990s. Norway has engaged in this process, not only through investment by Norwegian companies and closer and more comprehensive trade relations, but also by providing democratic institution-building assistance to Estonia, Latvia and Lithuania.

Norway has also helped to prepare the way for four Baltic Sea countries to join NATO and the European Union/the European Economic Area (EEA). Assisting in this way benefits Norway's security and trade. While some may argue that the expansion of NATO and the EU is creating new borders within Europe, Norway is focusing on the new opportunities this expansion is creating for the consolidation of peace and security in the European region. Moreover, the expansion opens the way for neighbouring countries, including the Russian Federation, to participate in the dynamic economic developments of the expanded common market.

Developing relations with the Russian Federation is one of the cornerstones of Norwegian policy, and not least Norway's Baltic Sea policy. The close and friendly relations between the Russian Federation and Norway have made a real contribution to peace and stability in Northern Europe, and I believe that they will continue to do so.

The Baltic Sea region is emerging as one of Europe's most promising areas. Economic development is bringing social and material benefits for its population, and the region is becoming a strong, competitive participant in regional markets. The State of the Region Report 2005 concluded that the Baltic Sea region is continuing to register strong prosperity growth, outpacing growth in the Central European Region and the EU-25. The Baltic Sea region also has a higher level of employment than the European average. It is in Norway's best interests not merely to follow these developments, but to participate actively in them.

Through the EEA Financial Mechanisms, Norway is contributing to the reduction of social and economic disparities in Europe, and providing support for new EU member states in their efforts to participate fully in the enlarged internal market. A large proportion of the funds allocated through the Financial Mechanisms are earmarked for states in the Baltic Sea region, particularly Poland.

As an important producer of oil, gas and hydroelectric power, Norway values its energy dialogue with the countries of the Baltic Sea region. The region covers a large part of northern Europe, and features a wide range of resources and actors in the energy field. Norway is an active member of BASREC, the Baltic Sea Region Energy Cooperation, one of the most important bodies dealing with energy issues in the region. This intergovernmental cooperation platform provides a forum for energy dialogue between the 11 countries of the region and the European Commission.

Discussion in forums such as BASREC must focus not only on energy issues, but also on environmental considerations. Norway has been following this approach in relation to the High North, an area rich in both energy resources and fish stocks. The collapse of fish stocks in other areas is a constant reminder of the importance of international cooperation to ensure that living marine resources are managed in a wise, sustainable manner. Norway's recently-adopted integrated management plan for the Barents Sea–Lofoten area is a key instrument in the responsible management of resources in that area. The plan sets out standards for the oil and gas industry, maritime transport and the fisheries industry, and I believe that it could serve as a model for the Baltic Sea region.

The great political changes that took place in many of the countries surrounding the Baltic Sea in the last decade of the 20th century paved the way for extensive people-to-people contacts, the development of NGOs and civil society groups, cooperation in higher education, and youth and cultural exchanges. The Council of the Baltic Sea States, of which Norway is a member, has actively promoted development in these important areas. Norway considers cooperation at grassroots level to be vital, and has been supporting the annual NGO forum for the region and the EuroFaculty academic programme for several years.

We cannot ignore the challenges that have emerged in the Baltic Sea region in recent years in relation to human trafficking and cross-border organised crime. Meeting these challenges must be given priority at political level. Human trafficking is a transnational crime, affecting all countries in the region, whether as countries of origin or transit, or as recipient countries. It is also a gross violation of human rights. Destination, transit and origin countries need to combat the problem jointly, to send a clear message that human beings are not for sale.

Dealing with these issues requires a wider perspective, and this is exactly what the EU's Northern Dimension provides. It is a political framework for the broader cooperation needed, not only on environmental and energy issues, but also on issues such as human trafficking and cross-border organised crime.

The Northern Dimension cooperation will take a significant step forward in 2007, when it will become a common endeavour involving the EU, Iceland, Norway and the Russian Federation as equal partners. Norway has given high priority to the inclusion of the environment, nuclear safety, natural resources, social welfare and health care among the priority sectors, and is therefore pleased that these form part of the policy framework document for the new endeavour.

Norway is a member of the four regional councils dealing with the Barents Euro-Arctic, the Arctic, the Baltic and the Nordic regions, and will continue its close cooperation with its partner countries in this vast region.

Jonas Gahr Støre

Minister of Foreign Affairs, Norway

Latvia: new transformation challenges ahead

by Ilmārs Rimš ēvičs

As a result of the economic reforms of early 1990ies Latvia has defined itself as a small, open and liberal economy. There is another transformation process still ahead. Namely, reaching full convergence, both nominal and real, with the advanced EU countries.

A few years ago it was argued that the EU accession for most of the new member states would lead to increased flows of foreign trade and at the same time provide access to more liquid and deeper financial markets. All that – in combination with a lower risk premium associated with the EU membership – was expected to result in falling interest rates and increased inflow of funds, both in the form of domestic and foreign investment. As a result, the rates of economic growth were expected to accelerate.

All this appeared to be more than true, in particular, for Latvia. As positive as these developments are, they have put new questions and produced new challenges to our policy makers, as well as to the central bank: is convergence with the EU fast or too fast? In other words – is high GDP growth sustainable? Is the excessively high inflation threatening to transform itself into a stubborn wage-price spiral? Should the rapid credit growth be seen as a cause for worry?

The arrival of lower rates and the boost they gave to the domestic consumption and investment in the case of Latvia coincided with a cyclical upturn in the economy, which was already in high gear and growing fast. This certainly gives us a cause for concern, as the current phase of economic expansion will obviously not last forever. Even if there are no distinctive shocks to the economy, economic logic still suggest that the current growth rates cannot be sustained over a long time. We are already noticing a shortage of labour force in several branches of the economy that pushes up wage demands and creates additional inflationary pressures. The result of high economic growth – seen slightly above 10% for 2006 – in combination with declining interest rates has been a considerable pick-up in the inflation rate since 2004 – from 2-3% levels to an annual average of 6-7%.

It is true that inflation in Latvia has been affected by several supply factors, such as oil price shocks, increasing tax rates on selected commodities and higher prices for un-processed food. In the case of Latvia, it should also be noted that many local producers and merchants had been quite successful in anchoring higher inflation expectations among the general public, as related to the EU accession. These expectations are now self-fulfilling.

However, the supply side factors do not show a complete picture of the driving forces behind the recent pick-up of inflation in Latvia. High and robust domestic demand is also an increasingly important factor.

The most significant development in Latvia in the past couple of years has probably been the rapid growth and significant deepening of the banking sector. It has enabled many households to transfer their future consumption into present, against the projected stream of future income. A considerable growth in lending has thus been behind the developing pattern of inflation as well. While such important indicator as the credit to GDP ratio in Latvia is still considerably lower than the EU average, the fast growth in lending, in recent years between 40%-50% and even more, is definitely a cause for major concern.

It is obvious that containing inflation and adjusting growth figures to sustainable levels are the two main challenges the Latvian authorities have been facing in after the EU accession. What tools do we have to manage this type of problems?

As of January 1, 2005, the Bank of Latvia changed the peg of the lats from the SDR basket to the euro. Four months later, as a consecutive step towards the introduction of the euro, Latvia joined the ERM II, unilaterally retaining the previous +/– 1% fluctuation band around the central rate. As the domestic and euro-denominated assets have become close substitutes in Latvia and around two thirds of all loans to households and domestic enterprises have been issued in foreign currencies, mainly euros, one of the main monetary policy instruments, namely, interest rates, has lost its importance for adjusting economic trends, when necessary. This also means that the power and efficiency of the traditional central bank instruments of monetary policy has weakened significantly.

Against this background, the government should demonstrate a clear commitment towards containing inflation and inflationary expectations by providing the necessary impulse and direct the economy towards a balanced development. This would best be done by pursuing a fiscal policy aimed at achieving a budget surplus or at least a clear tendency towards a minimal deficit. Promoting greater competition in all sectors of economy would also help to expand the supply side of the economy and thus enhance long-term stability. It is also necessary to find measures that would stimulate the banks, businesses and private individuals to develop behaviour that would foster stable and sustainable economic development.

Latvia has set the objective to become a full-fledged member of the Economic and Monetary Union and introduce the euro at an early stage of its EU membership. We see the introduction of the euro not only as an obligation defined in the EU Accession Treaty, but as a potentially beneficial development for our economy. Becoming a part of a large currency area, in our opinion, would ensure long-term stability, as well as a preferential trade environment for a small and open economy such as ours. Maastricht criteria and the introduction of the euro remains a challenge ahead: Latvia has easily complied with all nominal convergence criteria, except inflation. And it is indeed clear that decisive and, possibly, painful measures have to be taken by our authorities to meet the inflation target in the coming years.

Ilmārs Rimšēvičs

Governor of the Bank of Latvia

The Baltic Tigers - An end in sight for the growth story?

by Christian Ketels

Over the last few years Estonia, Latvia, and Lithuania have firmly established themselves on the top of the European growth rankings. While still lagging their European peers on absolute prosperity, this is an achievement that many would have thought impossible to achieve for small countries at the northern periphery of Europe with a legacy in the Soviet Union. But can the growth story last, or will it soon be forgotten as an episode spurred by low taxes and luck? And what can the Baltic countries do themselves to ensure a positive answer to that question?

To understand the trajectory for the future, it is important to understand the present: The Baltic countries have been successful following a unique economic model based on the combination of four factors:

- Decisive opening of the economies for competition and investment
- Leveraging the proximity to the Nordic and other EU countries
- Legacy of solid skills and key infrastructure
- Low wages and attractive tax environments

This model has proven tremendously successful but will over time lose traction: Economic growth already is increasing wage pressure, leads to shortages of skilled labor, and creates social divisions between those that are well prepared to take advantage of these new opportunities (young, urban, well educated) and those that can't. And there is a danger that the legacy infrastructure (physical, skills, research institutions) will deteriorate without meaningful investments, reducing the productivity that companies can reach. These two trends can over time easily slow down growth unless the Baltic countries move towards a new model for upgrading competitiveness.

Productivity increase clearly needs to be the mantra of new initiatives for the Baltic countries to remain economically attractive while wages are rising. But what might some of the key elements of this new growth model look like?

First, **government** policies will gradually need to shift from a "zero interference" mode to a "positive contribution" mode. Investments in skills, infrastructure, and effective government services are critical to enable companies to move to higher value-added activities. The challenge is to make this transition without introducing either large fiscal burdens or a lot of bureaucracy. The experience shows that the fiscal dimension might actually be easier to manage – EU structural funds are available and with increasing productivity and prosperity higher tax revenues will become available. The real test will be on the investment side – it is much easier for government to "get out off the way" than to "make a positive contribution". Frequent changes in governments add to the potential for mistakes to be made.

Second, **companies**, both domestic and foreign, can play an important role to make sure that this difficult transition of upgrading the business environment will be successful. They can get involved in competitiveness and cluster initiatives, launch industry associations that are more than mere lobbying efforts, and they can take own steps to upgrade the business environment they are part of. This does not relieve government's responsibility from stepping up to do its part. But it will require companies to see the long-term advantage in relying not only on low taxes but instead taking an active role in working with government to create the conditions for innovation, higher productivity, and sustained economic success.

Third, each of the Baltic countries will need to develop a clear **economic strategy** that outlines the value it aims to offer as a business location in global competition. In the past, attractive cost levels, a good location, and good general policies were all it took. In the future, more distinguished combinations of unique strengths and positions in specific clusters will be required to achieve and sustain higher levels of prosperity. Benchmarking best practices from abroad are not enough. The cooperation of public and private sector will be critical to define and implement these economic strategies.

Fourth, the Baltic countries will need a more systematic approach to **cluster mobilization**. Future growth will depend on a mix of old and new clusters; only such specialization can sustain high productivity. To get there, a combination of efforts is needed: First, support existing clusters in upgrading competitiveness; don't discard them even if they are "traditional". Second, pursue opportunities in new areas that are either close to (use similar know-how, technology, skills …) or at the intersection of existing clusters. Third, continue to upgrade the general business environment to increase the likelihood that entrepreneurs will launch something entirely new that over time can become a cluster.

Finally, the Baltic countries will need to combine their tight relations to the West with a clear policy towards the East. For many economic reasons relations to **Russia** provides huge potential for the future. But for many politically reasons these relations are challenging: The Russian government is oscillating between developing mutually beneficial economic ties and using these ties as a political tool (energy!). Whether other EU partners with their own bilateral interests towards Russia will be helpful remains to be seen; in any case, the Baltic countries need a plan on how to deal with this situation in different contingencies.

At the moment the Baltics are still enjoying the benefits of the economic model outlined above; in fact, EU membership has provided even better access to EU markets so there is no immediate erosion of attractiveness. But there is a danger that the Baltics will become over time much less of a "good deal" if wages continue to rise while the opportunities for productivity growth become smaller. It is in the hands of the Baltics to devise economic policies that will avoid this scenario. Countries like Singapore and Ireland have shown that it is possible to move from competitiveness based on low wages to competitiveness based on productivity.

Dr. Christian Ketels

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Experiences of Finnish firms in Poland

by Ville Kaitila* and Maarit Lindström**

Finnish trade and FDI in Poland

The share of Poland in the total goods exports of Finland was 2.0 per cent last year, while the share in Finnish imports was 1.3 per cent. Taking into account Polish purchasing power, Finnish exports are at a relatively good level. After Estonia, Poland is Finland's second-largest trading partner among the new EU countries. Trade between Finland and Poland is largely based on comparative advantage as the share of intra-industry trade in total trade is rather small. The main Finnish export products are electrical machinery and equipment and paper products. In Finnish imports, coal remains the most important article.

According to statistics by the Bank of Finland, the Finnish foreign direct investment (FDI) stock in Poland was 437 million euros at the end of 2004. This is 0.7 per cent of the total FDI stock of Finnish firms. Taking into account Poland's large size and its relative proximity, Finnish firms have not been very active in the Polish market in terms of FDI. Finland's share in the total FDI stock in Poland is also just 0.7 per cent. Finnish firms have thus not linked Poland in their business strategies as a location for the production of lower value added goods in the same way as has happened with Estonia. Indeed, integration has largely taken place at the level of trade.

Results from a firm survey

However, it is important to analyse the experience of Finnish firms in the Polish market, which is one of the largest in the Baltic Sea region. As a part of the study, Kaitila – Lindström – Balcerowicz: "Puolan liiketoimintaympäristö ja suomalaisten yritysten kokemukset", ETLA Discussion Papers No. 994/2005, a survey targeted Finnish firms operating in Poland regarding their experiences in the Polish market.

Of the firms that responded to the survey, almost two-fifths say that the Polish market is at least moderately important for their firm's turnover and profitability. Furthermore, the importance of Poland for these firms is increasing. Almost three-quarters of the firms will continue to expand their activities in Poland, while the remaining quarter did not respond to this question.

Up to 70 per cent of those companies that expect to expand their business activities in Poland anticipate that the expansion is in production, including R&D and customer services. One-fifth of the firms expect to transfer some of their business activities to Poland in coming years. This will mostly involve the transfer of production, not services.

Furthermore, up to three-quarters of all firms that answered the survey will increase their exports to Poland in the near future and almost one-third will increase their imports. Almost three-fifths of all firms will increase their direct investments in Poland, while none will disinvest.

Growth and future growth prospects of the local markets have been the main factor attracting the Finnish firms into Poland. Firms also say that their presence in Poland is important from the perspective of enlarging their markets. In addition, the country's location in relation to other markets is an important motivating factor.

Also low labour costs favour Poland as a location for business operations. However, this factor is less important than those previously mentioned. Still, labour costs are important especially for Finnish manufacturing companies.

Finnish companies' production in Poland is primarily targeted to the local markets and secondarily to third markets. The firms that answered the survey do not import much from Poland. Instead, Polish markets seem to be a natural continuum in Finnish companies' internationalisation in the Eastern Baltic Sea region after the Baltic countries.

During Poland's EU membership, the investment climate, corporate culture, infra-structure, the operation of customs, bureaucracy and legislation have improved to some extent according to the firm survey. On the other hand, the state of the judiciary and corruption have not improved.

There is growth potential in Poland for good product and service concepts for Finnish firms, even if competition is already relatively fierce in many industries. Company managers underline careful preparation before entering the Polish markets. Also the significance of local managers and experts is deemed essential in order to secure the company's success. In general, companies' managers see their Polish staff as entrepreneurial and willing to develop their country.

Structural weaknesses in the Polish economy

Regardless of the largely positive image revealed in the firm survey, we also identify some critical points in the economy. Economic growth has not been particularly fast during this decade especially if taking into account the low income level (GDP per capita). However, this is partly due to strict monetary policy, which has brought inflation down, but also constrained economic growth in the short term.

There are also structural problems in the economy. Public sector finances and its increasing indebtedness have been alarming for quite some time. In addition to this, investment activity has been low, the level of taxation is relatively high, and the size of the public sector is large. Also bureaucracy and corruption are troublesome. Unemployment is high and the employment rate is low. Furthermore, inefficient agriculture still employs one sixth of the employed.

Another aspect is the low population growth rate, which is a problem in the other new EU countries also. This will restrain growth prospects in the future. Furthermore, the functioning of the labour, commodity and capital markets should be improved in Poland. According to various studies, their functioning in Poland is among the weakest in the EU. Poland's competitiveness and its potential economic growth will increase if reforms and market liberalisation continue. This would most likely encourage also Finnish companies to invest in a larger scale in Poland.

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The Baltic Sea - The Most Polluted Sea Area in the World

by Juha Beurling

The health of the Baltic Sea has been seriously damaged since the 1960s due to excessive pollution from the countries in its catchment area. The pollution, such as untreated human waste, toxic materials, and metal (e.g. lead), have resulted in stratification and water pollution of the Baltic Sea. The Baltic Sea, when it is stable, is a mix of freshwater from the rivers of Europe, and saltwater from the North Sea which flows through the straits around Denmark. The source of much of the pollution was is from the countries of the former Soviet Union and East Bloc. This pollution, in turn, harms a variety of industries.

Because of unrestricted and (environmentally) unregulated industry in the past, factory waste was, and in some cases still is, disposed directly into the Baltic Sea or into rivers which feed it. A second problem is agricultural run-off. These chemicals run off land and into the water supply, eventually ending up in the Baltic Sea. With the fall of the communist states, central, eastern and northern Europe are moving towards a collective plan to clean up the Baltic Sea. Many positive steps are being taken by the countries which either border on the sea. The European Union has given an excellent framework for the development of the protection of the Baltic Sea in the Baltic countries and Poland that joined the Union after gaining their independence.

The Baltic Sea's rich biodiversity is threatened by environmental pollution that could cause irreversible damage to a sea that is an important source of economy and recreation for more than 80 million people who live along its coast and within its catchment area. The sea is very important to the tourism and fishing industries of the Baltic countries.

The goal of the Baltic Sea nations is to reduce the amount of pollution which reaches the Baltic Sea in order to preserve the precious fishing and tourism trade in each country. The waste includes industrial emissions, agricultural run-off (fertilizers), urban pollution, untreated sewage, wastewater from pulp-and-paper and other industries, toxic substances and heavy metals. Many different species are threatened in the Baltic Sea, but the most often mentioned are herring, salmon, and cod.

The countries around the Baltic Sea have agreed on a Baltic Sea Joint Comprehensive Environmental Action Program. It was approved by the Diplomatic Conference of Ministers of the Environment in Helsinki, Finland in April, 1992.

The program has six components:

1) A set of policy, legal, and regulatory reforms that establish a long-term environmental management framework in each country.
2) Institutional strengthening and human resource development.
3) A program for infrastructure investment in specific measures to control point and non-point sources of pollution and to minimize and dispose of wastes.
4) To aid in the management of coastal lagoons and wetlands.
5) Supporting applied research to build the knowledge base needed to develop solutions, transfer technology, and broaden understanding of critical problems.
6) Encourage public awareness and environmental education to develop a broad and sustainable base of support for implementation of the other components.

The Baltic Sea, the largest body of brackish water (i.e. slightly salty water) on Earth, was considered healthy as late as the 1950s. Since then, the Baltic Sea's health has seriously deteriorated due to the waste mentioned above. The fishing and recreation industries have already been affected by the pollution and more action is needed to prevent permanent damage.

Recent steps to clean up the Baltic have been made possible with the end of the East-West divide. The 14 countries of the catchment area are now on schedule to carry out the comprehensive program to improve the environment in and around the Baltic Sea. The Baltic Sea is important to these countries for many reasons.

Economically, the Baltic Sea is a vacation area for many Europeans. This provides service jobs in tourism and recreation. The coastal areas also serve as spawning, nursery, and feeding grounds for several species of marine and freshwater fish. The value of the catches, which amounts today to hundreds of millions of euros per year, is an indication of the considerable economic importance of the Baltic fishery.

While the threat to the Baltic Sea is very serious, it appears that the problem has been realized in time to prevent an environmental disaster if the measures taken now are effective enough. Now that the countries which surround the Baltic Sea (and contribute water to it) realize there is a problem and are doing something about it. One note of caution about being overly optimistic on the program to clean-up the Baltic Sea working should be offered. If the economies of the former Soviet republics and the former East Bloc begin to have greater economic difficulties, they will be less inclined to follow environmental regulations. To prevent this from happening we have to create even stricter legislation on the level of the European Union.

Clearly, not all of the work will be done on the international or not even on the national level. Although much of the policymaking necessary to restore the Baltic Sea is the responsibility of officials at the national and international levels, such matters as improved sewage treatment, district heating systems, and handling of refuse are usually dealt with by individual cities. Sub-national factors in the Baltic Sea will definitely have an impact on the environment improvement of the area and on promoting trade.

Juha Beurling

President of the Socialdemocratic Environmental League in Finland

Head of the Socialdemocratic group of the environmental committee in Helsinki

The Baltic Sea region a forerunner towards sustainability!

by Lars Rydén

The dilemma spelled out

Sustainable Development is becoming the key phrase of our days. Still it there are many different ideas what it is and what it requires of policy changes. Below I will argue that the Baltic Sea region has a unique possibility to become a leader in the path towards a sustainable future and give some proposals on what is needed to do that. But first a few words on why sustainability is so crucial.

History tells us. The American historian John MacNeill, who in his book Something New under the Sun reviewed the entire century with the environment in focus, summed up his finding as list of 20th century global changes. An extract include the following:

- population increased 4 times
- economy (global GDP) increased 14 times
- industrial production increased 40 times
- energy use 16 times
- carbon dioxide emissions 17 times
- sulphur dioxide emissions 13 times
- ocean fish catches 35 times

In short this means that the resource use on our planet increased first due to a of four fold global population increased, from 1.5 to 6 billion inhabitants, but also due to an approximate four fold resource use per capita to a total 16-fold over-all increase.

Obviously such a development cannot continue forever. The planet is after all limited. We have today an "overshoot", that is, use of capital resources. This capital includes fossils, forests, fish etc, used up faster then they are regenerated. The estimate of this overshoot in many reports is about 25-30 % (See e.g. global footprint network). When the consumption is faster than renewal there will be a "peak" when production is at its maximum. For fossils – where "renewal" means discovery of new sources – the peak, "peak oil", is calculated to happen in about 2010. For ocean fish the peak is said to have occurred in 1996.

The challenge of sustainable development

Sustainable development is to create a welfare society without using too much resource. The Baltic Sea region has a good position to do that. From an environmental point of view we are doing comparatively well. In the global overview of "ecological sustainability" conducted by Colombia and Yale Universities in the US) the Nordic countries (together with Canada) are ranked in the top 5. The Baltic States are found around position 15 in the list, while Poland and even more so Russia is much further down. At the same time the Nordic welfare societies are doing well in a global over view. For example in the Estes WISP indicators the Nordic countries are in the top four.

Of course economy is important here. Can we have a vital economy without using too much resources? In early industrialisation economy was tightly linked to resource use, e.g. energy. Later in industrialisation (for western countries about after 1970) it is typical that GDP per resource use in increasing. However this has been for all western countries offset by a total increase of resource use and thus sustainability still decreases. Services may be quite decoupled from material use (although not always). Service economy is one answer to the question if a vital economy is compatible with sustainability.

Policy priorities

MacNeill in his book discusses the policy priorities needed to turn a society – or the world for that matter – towards sustainable development. He lists a *new energy regime*, and a *stabilised population*. I would like to add *developing democracy*. These priorities should be compared to those dominating the last century, and still having the upper hand: national security, and economic growth. National security is today less urgent after the end of the Cold War. The situation in the Baltic Sea region is dramatically better from what is was only few years back, with European Union and Nato enlargements.

Then, what about economic growth? It will end up on a second place. According to research at e.g. Prio at Oslo University (Lafferty et al) or at SERI in Germany/Austria (Spangenberg et al) sustainable development in a society requires that sustainability becomes priority. Economic growth in the end will depend on sustainability policies.

For energy, sustainability requires phasing out fossils. It is possible and Sweden may serve as example. Decreased oil dependency has since long been policy but it became much stronger in 2005, when the Prime Minister appointed a commission with the task to tell how the country could be independent of fossil fuel in 2020. Renewable energy, such as wind and biomass, gets a big place. Smarter use of energy, and therefore less energy, is not as central as it should be. Sweden has the capacity to be completely oil free if these possibilities are used. The rest of the countries in the Baltic Sea region also have good opportunities to improve their energy situation. Finland and Norway are similar. In contrast eastern shore is much dependent on Russian gas and oil.

Demography also presents difficulties. Population numbers in the western Baltic Sea region is since some time almost stable, and the eastern countries in particular Russia is decreasing. In the Baltic States a considerable out migration occurred during the 1990s. A result of the demographic changes is an ageing population. It should be recognised that this is a necessary consequence of the path towards sustainability: With a stable population we will have a smaller proportion of young. This however leads to much higher costs for elderly care. The demographic changes will necessary lead to some reorganisation of our societies.

Democracy is necessary for sustainability. Human rights issues are in focus, but not only. Experience tells us that non-democratic societies have less welfare and less environmental concerns. The dramatic changes towards democracy on the eastern side of the Baltic Sea has coincided with a remarkable improvement of their environmental policies. What we see today is the slow development of democracy in Ukraine, a status quo in Belarus, and a de-democratisation in Russia. In perspective, however, the development is positive. We should not forget that only ten years back tanks were openly threatening at the White House (parliament or Duma) in Moscow.

The actors – cities, companies and educators

Who should act to achieve sustainability? Some argue that individuals have to change life style; others that global actors, perhaps WTO, need to set the proper rules. In an overview of actors my conclusion is that all have their role to play, but the middle ground – local authorities and companies – are key actors: Municipalities because they have a planning monopoly, a responsibility for their inhabitants and the

material resources. Companies because they can change much more efficiently than anyone, and since they gain from the change towards sustainability. Today many companies adopt to environmental management systems, and also towards social responsibility, because it is good for them. Municipalities adopt policies of sustainability. Collectively this is the strongest force we see right now.

In the Johannesburg meeting in 2002, the importance of education to achieve sustainability was underlined. The United Nations later in the year announced the Decade for Education for Sustainable Development, DESD. The organisation I work with, the Baltic *University Programme*, introduced education for sustainable development on a large scale from 1997. It has been the most attractive section in our Programme since then. Today about 4,000 students yearly register for courses in Sustainable Development at close to 100 universities in the Baltic Sea region. Since 2001 we have developed master and special course in Sustainability, such as water management, urban management and environmental management in industry. These are offered at some 25 universities each.

Recently the decade is introduced in many countries. ESD is required content in schools in many countries and Sweden even introduced it into the law for higher education. If all the knowledge and skills available would be applied the situation in our societies would change rapidly. We have an implementation gap. The Baltic University programme works since some year with a network of cities and towns in the Baltic Sea region to see how sustainability strategies can be implemented. We hope to have a similar cooperation with industry.

The Baltic Sea region with its well educated population, mostly democratic regimes and good natural resources should be able to be a leader in the path towards sustainable development. Many good forces already started this.

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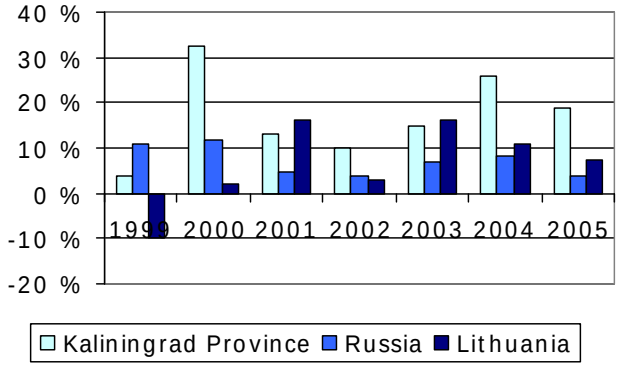
Kaliningrad's Industry - a Double-Headed Bird: Will It Fly?

by Artur Usanov

Last few years have seen a spectacular growth of the Kaliningrad's industry. Since 2000 growth rates of the region's industrial production have never been below double figures. Total industrial output in 2005 was almost 3 times higher then in 1998 when it touched its lowest point. It seems that industrial output in 2006 will exceed its pre-transition level. Productivity



grew rapidly as well during 2000s – the number of industrial workers is now well below its level in 1990

Growth rate of industrial production

However, a detailed look at statistical data reveals some interesting facts. For example, if one compares lists of the largest exporters and importers in the region he/she will see that these lists do not have much in common. It indicates that Kaliningrad's industry consists of two main and largely independent sectors: one is export-oriented and the other is focused on the Russian market but relies heavily on imported raw materials and components – I will call it the import-oriented sector. Kaliningrad's industry in this respect can be compared to a double-headed bird[1] with one head looking to the West and the other to the East.

The backbone of the export-oriented sector is formed by companies from the oil industry and the pulp and paper industry – they account for most of the exports. Other manufacturing sectors where one can find export-oriented companies include: alcoholic beverages and food processing, shipbuilding, machinery, clothing. What is common for almost all export-oriented companies is that they are former state-owned enterprises that have been privatized in 1990s. Most of them still have birthmarks of the Soviet assets, technology, organizational structure, etc. They produce mainly either raw materials or goods with low level of processing (oil, cellulose, paper, ship hulls, etc).

Unlike the situation in Central and Eastern Europe, FDI has not played any significant role in the Kaliningrad's export-oriented sector. FDI inflows per capita in the Kaliningrad province have been tiny compared with that of the Baltic countries and remained below average Russian figures. Still, it has been service sectors – such as trade, telecommunication and transport – not manufacturing that attracted most of FDI.

The import-oriented sector is very different. It was created by the special economic zone (SEZ)[2] regime literally from scratch. All largest companies in the import-oriented sector were established after 1990. Peculiarities of customs and tax benefits of the SEZ regulation have determined many characteristics common for the import-oriented companies. Most of the companies were established to serve markets with high import tariff protection but with weak domestic Russian competitors – motor vehicles, food products, home appliances, furniture, etc. Import-oriented companies do not have much of the Soviet legacy in terms of overstaffing, large social infrastructure and vertically integrated operations. The SEZ incentives for imports made them rely heavily on imported raw materials and components. The SEZ rules of origin (low level of requirements to value-added in manufacturing processes) ensured that investments of these companies were usually small – a bare minimum to get a duty free access to the Russian market. But production equipment they employ is relatively modern. Although FDI has been small it played more significant role in the import-oriented sector, especially in the food manufacturing.

The difference between the export-oriented and import-oriented sectors is evident when one compares tax payments and fixed investment of companies in these sectors. Although 'exports' of Kaliningrad companies to Russia exceed exports to other countries by more than factor of 3, tax payments and investment of export-oriented companies dwarf that of their import-oriented counterparts[3]: in some years fixed investment made by the local subsidiary of the Russian oil giant *Lukoil* exceeded investment of all import-oriented manufacturing companies.

What are the factors that caused the Kaliningrad's industry to split into two sectors? They are fairly obvious: market reforms, exclave location of the province and the SEZ regime. Market reforms caused sharp decline in the industrial output in almost all transition countries including Russia. For the Kaliningrad province difficulties of the transition stage were complicated by the facts that: (1) the SEZ regime essentially provided a subsidy to foreign goods, and (2) enclave location of the region led to an increased transportation cost and time required for moving goods to/from the region. Additional transportation cost put Kaliningrad's manufacturing firms at disadvantage in the competition for the mainland Russian market and the SEZ made it difficult for them to compete with the direct imports even on the province's market. It drove many manufacturing firms out of business. Industrial output in the province in 1998 dropped to 27% of the 1990 level.

In these conditions companies had to export something in order to survive. But only exportable goods were raw materials and semi-finished goods that were produced by former state-owned companies. When the SEZ rules became more or less stable after 1996 (by the Russian standards) Russian companies began to make investments to exploit its incentives and get a duty-free access to the Russian market using imported components and raw materials. Very quickly advantages of using the SEZ benefits become apparent. Growth of the import-oriented manufacturing sector has been astonishing and until recently it was the main engine of the province's

[1]Calling this bird an eagle will be too bold a statement at the current stage.
[2]Kaliningrad province has been a special (free) economic zone with some interruptions since 1991. Although the meaning of SEZ has been changing over time but the free customs regime remained its cornerstone.
[3]Apparently new, i.e. import-oriented companies much more in love with tax optimization than former state (export-oriented) companies with large assets and staff.

goods produced under the SEZ rules for the Russian market grew at compounded rate of 40% (in US dollars). In industrial expansion[4]: in 2000-2005 some sectors (TVs and other home appliances) Kaliningrad's import-oriented companies now dominate the Russian market and even companies that were vocal opponents of the SEZ are building plants in Kaliningrad.

Of course, the classification of the Kaliningrad's industry into the export- and import-oriented sectors does not tell the whole story and is a major simplification. There is a significant sector that serves the local market: utilities, many SMEs, etc. For many exporting companies Russian market might be more important than the foreign ones. Not all exports confine to low tech products: there are companies that export high-tech and unique products: for example, state-owned Fakel that designs and produces electric propulsion systems for Russian and foreign spacecrafts. However, I believe that this simplification is useful for understanding major trends in the Kaliningrad's industry and for speculating about its future.

New SEZ law that came into force on April 1, 2006 abolishes customs benefits for new companies and provides a 10-year transition period for the existing ones. This creates a dilemma for the import-oriented sector: companies in this sector must develop new competitive advantages (besides their use of SEZ customs benefits) or die.

[4]Growth of the import-oriented sector slowed down in 2005 at the same time when development of the new offshore oil field and rise of oil prices have given a boost to the oil sector.

Concentration of import-oriented companies in a few manufacturing sectors gives hope that a critical mass of the producers, suppliers, skills, employees, etc in these sectors can develop into viable, modern and competitive industrial clusters. Potential candidates include: fishery and fish processing, home appliances and electronics, food manufacturing, wood processing. In these respect the 10-year transition period, on the one hand, provides ample time to prepare for the new conditions but, on the other hand, gives an opportunity to repay all investment made and shut down plants after the transition period expires.

There are some indications that some leading foreign companies in home electronics are interested in Kaliningrad as a location for their manufacturing sites. Russian companies started to make manufacturing investment in Kaliningrad to target export markets. New SEZ law by providing tax breaks for significant manufacturing investments rather then simply for imports is also more favourable for long-term investors then the previous law. These are positive signs. However, the ultimate success is not pre-determined and calls for well-thought economic policy on behalf of the regional and federal authorities, for example, attracting long-term foreign investors that can bring world-class technologies, management know-how and their suppliers to the region.

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The City and the State Foreign Policy. St. Petersburg after G8

by Filipp Kazin

After the celebrations of the 300th anniversary of St. Petersburg and its hosting of the G8 summit, the question of St. Petersburg's role in the foreign policy of Russia seems only natural. On the one hand, the answer is obvious: St. Petersburg is the "window on Europe," the largest city on the Baltic Sea. It's a city with an eventful history, rich culture, and significant economic potential. On the other hand, however, the question is: how should we evaluate its role in foreign policy? What should be the criterion? What do we access – the role of the city, the citizens or the municipal government? What part does history or modern times play in determining this role? In this paper, I will attempt to answer these questions.

Potential and Contribution

Firstly, one has to determine the approach to "counting" the role of the city in the country's foreign policy and to assessing the correlation between its potential and actual contribution.

The realistic approach to foreign policy analysis does not view a city as an acting subject. It plays the role of a strategic outpost of a country in a region and has no specific foreign policy identity. Its contribution is viewed as that of a subdivision to the whole power of an army.

The liberal approach views a modern city as an equal player in a foreign policy, which has its own interests that might not be exactly the same as those of the country. There exist special procedures that allow for compromise. The country's foreign policy is a result of an agreement between the interests of cities, companies, public organizations, political groups, etc., the role of which in foreign policy is evaluated by their ability to influence the general trend.

The constructive approach sees the role of a city in foreign policy not as a role determined by objective factors (foreign trade volume, geographic location, number of summits held, and so on), but by a subjective perception thereof. The constructive approach values the interpretation before the fact, the attitude of a viewer toward the subject before the subject itself. According to this approach, the role of a city in foreign policy is determined not by its physical or legal status, but its symbolic significance in the history of a country.

City Diplomacy

The role of megalopolises in the modern world is growing rapidly, and the term "city diplomacy" is gaining popularity. Its meaning lies in using city's potential for addressing country-wide problems. St. Petersburg also participates in this process. Here are a few interesting facts[1]:

1. St. Petersburg is the third most populated city in Europe (after Moscow and London), and the twenty-seventh in the world. It is the largest city in the Baltic region!
2. Out of the 100 largest cities in the world, 56 are in Asia and only twelve in Europe.
3. Out of the 100 largest cities in Europe, 44 are in Russia and the CIS countries and 21 in the Baltic region.

This gives St. Petersburg some unique competitive advantages, allowing it to use the status of one of the world's megalopolis to promote its own and Russia's national interests in the global politics and economics.

First, as noted above, the main problems of globalization assume concentrated form in cities. Therefore, cities are capable of making the greatest contribution to finding solutions for such problems as inequality, poverty, illegal migration, and others at a global political level. Expressing this interest can and should result in corrected agendas of international summits and negotiations between heads of governments and countries.

Besides St. Petersburg there are only six cities in the world with populations of four to five million people: Sydney (Australia), Wuhan (China), Calcutta (India), Shenjian (China), Santiago (Chile), and Bogor (Indonesia). This list is virtually a call for dialog between civilizations to be developed on the city level. This will facilitate the realization of the priority of Russian foreign policy: to form a multi-polar world.

St. Petersburg is the largest city in the Baltic region. This means that the European vector of Russian foreign policy may be reinforced by focusing its efforts on St. Petersburg. What do I mean by this? Primarily, that St. Petersburg should propose its own initiatives. I think it is necessary to prepare a Russian program for regional cooperation, which would reflect the priorities of the federal center, Northwest Russia, and St. Petersburg. The city should come up with an agenda and present it to its partners, thus making its "foreign policy" more active and targeted.

The Russian Detroit or the Window on Europe

I believe that the main contribution of St. Petersburg to the foreign policy of Russia is its symbolic capital. According to sociologists, when talking about St. Petersburg Russians tend to associate it with history, culture, and politics: the city of Peter the Great, the capital of the Empire, a city with a special historical significance for Russia, the Decembrists, the October Revolution, the Blockade of Leningrad, hometown of President Putin, and the source of personnel for the government[2]. This list demonstrates that the role of St. Petersburg in the foreign policy of Russia derives from its history and spiritual tradition

Therefore, St. Petersburg is symbolically a very good location for conducting negotiations with representatives of the western world. The magnificence of Russia expressed in European forms is present here. Essentially a Russian city in a European form, St. Petersburg is an intermediary between Russia and the West. This is the difference between Moscow and St. Petersburg: Moscow is the heart of the Russian civilization; St. Petersburg is its European façade.

Conclusion

Below I outline the main trends that I believe should be strengthened in order to increase the significance of St. Petersburg's role in the foreign policy of Russia.

1. Expanding the participation of St. Petersburg in the interaction of global megalopolises with a special emphasis on the problem of the dialog of civilizations at the city level, and addressing the issues of inequality, poverty, and illegal migration.
2. Promoting, on the initiative of St. Petersburg, Russia's initiatives in the area of cooperation in the Baltic Sea region, aimed at developing the city's infrastructure and increasing the standard of living in St. Petersburg.
3. Strengthening of the conceptual component of the city's public relations as part of the foreign policy of Russia, taking into account the historical experience, traditions, and image of St. Petersburg in the public mind.
4. Reinforcing the expertise-gathering and the analytical component of the city's public relations, and establishing a permanent dialog on this subject between scientific circles and the city authorities.

All this will allow St. Petersburg to make an even greater contribution to the foreign policy of Russia, which will be in agreement with the historic mission of St. Petersburg.

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[1] Source: www.citymayors.com

[2] According to the poll of the Public Opinion Foundation, May 12, 2003. "The Second Capital through the Eyes of the Provincial Elite."

Nordic manufacturing companies in the Baltic States - are they diffusing or evading the Nordic industrial relations practices?

by Markku Sippola

Baltic Sea Region undergoes economic and institutional integration owing to the flexible labour market and tax incentives on the part of Estonia, Latvia, Lithuania and Poland. So far, the gap between Nordic and Baltic countries with respect to labour costs has remained wide: the expenses in Sweden are seven times bigger than in Estonia, and about ten times bigger than in Latvia. Appearance of Baltic workers in Nordic countries caused by either individual labour migration or service provision will further the convergence. Nor less effect will have the foreign direct investment and outsourcing to the Baltic States. The impact of Nordic foreign direct investment is really strong: it is estimated that a half of the aggregate FDI stock in the Baltic States originates from Nordic countries. Nordic companies have been capable of providing employees with better wages and labour standards in their subsidiary companies compared to local enterprises. But, will Nordic companies in the Baltic States follow suit of their mother companies by instituting industrial relations systems peculiar to their home countries?

When entering the Baltic market, Nordic companies face besides the challenge of rapidly growing wages also high levels of labour turnover. Large-scale emigration of workers to abroad has resulted in tightening labour market which might provide workers with better positions and possibilities to stand up for their rights. Both Nordic and Baltic employers are increasingly looking to FSU labour to fill gaps emerging in their workforces as a remedy for the shortage of workforce.

Nordic and Baltic trade union federations have felt concern about the future of the labour relations in the Baltic Sea Region. Bilateral campaigns have been launched by Nordic unions in order to help the sister unions across the Baltic Sea already for 15 years, since the Baltic States regained their independence. While unionisation rates in Denmark, Finland and Sweden are around 80%, the average unionisation rate in the Baltic States is slightly above 10%. Collective agreements, in turn, cover 80-90% of workforce in Nordic countries, whereas in the Baltic countries the coverage is about 25%.

It seems that Nordic companies are not at the head of promoting Nordic social dialogue model in the Baltic States. In a case study research conducted in twelve manufacturing enterprises in 2004-05, dilatory introduction of Nordic industrial relations systems in the Baltic daughter companies was noticed. The case study comprised three textile factories, two construction material producers, three metalworking plants, three food processing plants and one pharmaceutical factory. Information of employees on the current state or changes in employment and business situation was satisfactorily carried out, whereas the level of consultation of employees on these issues was poor. Collective agreement was concluded only in those three companies (out of the sample of 12), where trade unions created prior to the fall of the Soviet Union. The three companies with newly established trade unions had no collective agreements because of the resistance by the employer. Six companies had no trade unions at the moment, although one of them used to have it for a short period and another had instituted a worker council. There was a clear correlation between high levels of consultation and the progress in collective agreements.

The unionisation rates in the companies with unions were 25-50%, which means that they were quite low. Interviews of managers in the researched companies disclosed some reasons for the situation. Typical arguments were, for instance, that there is no tradition of trade unionism in the Baltic States (although it was taken for granted that there will be some day a stronger trade union alike in Nordic countries), Nordic companies offer so good working and labour conditions for workers that trade unions are not needed, and that workers prefer agreeing on wages on individual basis to agreeing upon them collectively. All three arguments have counter-arguments, though. Baltic trade unions have their roots in the Soviet system – albeit their functions were a bit different – and the modern trade unions have yet proved to be needed also in Baltic societies. The claim that Nordic manufacturing companies pay better salaries compared to local ones is not true any more where the case study companies are concerned. And the individualistic wage bargaining seemed to meet more often with the needs of Nordic management than it was desired by workers.

European Works Councils had been hesitantly introduced in the Nordic subsidiaries. Although six case study companies were supposed to have an EWC representative, only two of them had organised the election. Various reasons were mentioned why the election was not held, such as there was no employee representation in action in the Baltic subsidiary and therefore the election of EWC representative was not a question of the day, and that they "will wait" for the moment the practice will be more widespread in the Baltic countries. Instead, corporate HRM practices, introduced by Nordic mother companies, were actively carried out in five companies. HRM seems to have a strong effect in company social dialogue.

Nordic manufacturing companies tend to follow rather host country practices in the Baltic States than to introduce the practices of consultation, co-determination or trade union representation peculiar to their home countries. Direct consultation through intermediary management is more typical than indirect consultation through employees' representatives. The latter way of consultation would, however, correspond better with the Nordic ideals as well as the ideal of the directive 2002/14/EC on information and consultation. Introduction of substituting forms of employee representation for trade union is not any philosopher's stone in order to achieve the EU norm. It seems that consultation is easier to be carried out in the framework of trade unions, for they form an existing participatory body for workers. Other representation forms, initiated by employers, remain obscure for employees, and management may draw on them just "when some documents need to be signed." Employers would better foster consultation necessitated by the EC directive and national legislation by permitting trade unions freely to take charge of the negotiation and consultation.

It is advisable to take on global corporate responsibility initiatives. In two researched companies this sort of initiative (Global Reporting Initiative, Global Compact) facilitated company-level social dialogue. Besides these initiatives can become a competitive advantage, they really may have positive effect upon industrial relations at the workplace.

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Creating an innovative Europe

by Günter Gloser

With the Lisbon Strategy the EU is aiming to become in the medium term the world's most competitive economy. At present it is lagging well behind notably the United States and Japan. Germany is already spending 2.5% of GDP on research and development (R&D). By 2010, however, we want to increase R&D spending by government and industry to 3% of GDP both at the national level and EU-wide. Countries that in recent decades have invested in education, R&D and getting the framework conditions right are all well ahead today also in designing successful products. Finland in particular, which spends 3.46% of GDP on R&D – one of the highest levels in the EU – is a prime example of how closely R&D and innovation are linked to economic growth.

Following the EU's Hampton Court summit in October 2005, the European Commission sought to set the ball rolling on innovation by appointing an Independent Expert Group headed by former Finnish Prime Minister Esko Aho to identify what new efforts are needed in the field of research and innovation to achieve the Lisbon goals. The Group's report recommends the accelerated implementation of initiatives at EU and national level to boost research and innovation along the lines proposed under the revised Lisbon Strategy, including a Pact for Research and Innovation and the creation of an innovation-friendly market. It also called for greater mobility of human resources, an efficient venture capital sector and the use of European technology platforms and clusters to create new linkages favouring mobility in organization and knowledge.

The Finnish Council Presidency sees innovation in all sectors of the economy as crucial and the key concept in the creative process it plans to initiate. The German Council Presidency will build on the concrete ideas emerging from this process. Germany broadly agrees with the Report's basic analysis and is keen notably for the Structural Funds to play a more prominent role also in boosting innovation and developing R&D infrastructure in the new member states.

At national level Germany has already acted to realize many of the Report's proposals. Some have been listed as goals in our National Reform Programme, others have even been fully implemented. In Germany the private sector already accounts, for example, for two thirds of R&D spending. With its Excellence Initiative the Federal Government hopes to make its research promotion efforts still more effective. Under this Initiative designed to foster centres of excellence with a world reputation, universities will bid for an additional 1.9 billion euro available up to 2011, which will be allocated to those deemed to have submitted the best research strategies.

The Federal Government has long been a major sponsor of research in key fields. It works closely with the academic community and business to identify new innovation strategies for cutting-edge technologies such as microsystems technology, nanotechnologies, optical technologies, information and communication technology (ICT), transport and aerospace, health, biotechnology, energy and sustainability as well as services. Priority is also given to innovations that will benefit smaller businesses as well as the transfer of knowledge and technology, the development of regional clusters and international networking. All this, we hope, will help to improve the process of translating research into successful market products.

Under the Finnish Council Presidency general political agreement was reached on 24 July on the Seventh Research Framework Programme (2007 – 2013). Over the months ahead the details of the various specific programmes will need to be settled so as to ensure a smooth transition from the Sixth Framework Programme, which is due to expire shortly. For the implementation of these programmes a total of 50.521 billion euro has been earmarked which will clearly go a long way towards ensuring first-class research in Europe. The start of the German Council Presidency in January 2007 will also coincide with the establishment of the European Research Council, whose main brief is to promote basic research. Taken together, the Finnish Presidency's focus on applications-oriented research and our Presidency's focus on basic research address all the main links in the chain that leads from new ideas to innovative products. With this combined approach, our efforts are geared to giving direct practical effect to the revised Lisbon Strategy, which views action to revitalize Europe's economy and boost competitiveness, growth and employment as essential if Europe is to rise to the challenges of a globalized world.

Günter Gloser

Minister of State for Europe in the Federal Foreign Office

Federal Republic of Germany

Post accession developments in economic relations between Poland and Finland: Challenges ahead

by Andrzej Szynka

Speaking about the lessons from the recent enlargement of the European Union to the Polish economy and the Polish-Finnish relations one has to be aware that not all what happened after May 2004 may be attributed to the very moment of our formal membership and it is not always possible to distinguish between causative and coincidence developments. Poland's way to the European Union started in the early 1990s. Poland undertook extensive reforms to modernise and is now a dynamic market economy. The stability provided by accession has helped us to boom the economic growth and to multiply trade and investments. The economic growth in recent two years has been on average faster (4,2%) than in the old EU member countries (1,9%). The favourable economic expectations connected with the EU-accession have been fulfilled. In two post accession years the export dynamics to the EU exceeded the import growth rate. Today more than two third of our trade is related to EU zone. Exports growing at higher pace than imports tell us that the Polish businesses were well prepared for the accession and their products proved to be competitive on the single market. Anticipated exposure to fierce competition and stringent EU regulations sped up adjustment processes in Poland's economy.

Figures related to the Polish-Finnish trade seem to follow the general trend. Exports to Finland grew from Euro 316 million in 2003 to Euro 559 million in 2005 that is by 77% whereas imports increased by 17%. Moreover, the exports increased significantly also for the goods which exports had given rise to the most serious – as it seemed – anxieties, i.e. food products such as dairy and fruits. In general, deliveries from Poland to Finland grew faster than Polish export to EU and similarly Finland's trade with Poland developed more dynamically than that one with the EU.

It is also worthwhile stressing that the positive quantitative changes in trade were accompanied by qualitative and structural ones. An important tendency in bilateral relations is the gradual change in the commodity structure of trade and in particular growing share in our exports of more value added content goods such as machinery, mechanical, electrical and optical appliances and instruments, pharmaceuticals. One should also note an increase in export of Polish services in such sectors as building and construction.

Perhaps the most far-reaching and weighty consequences of intensified Polish Finnish economic relations after May 1st 2004 derive from the transfer of Finnish know how in innovation policy and its implementation at national and EU levels.

These issues were discussed during the Polish Lisbon Strategy Forum in December 2005 with the participation of Prime Minister M. Vanhanen and during subsequent experts meeting. Joint efforts in this field, apart from their beneficial impact on Poland's economy, may and no doubt should lead to a closer cooperation in shaping of the Baltic Sea region as a more competitive, innovative and cohesive entity. In this context it is also worth mentioning that endeavours have been undertaken to implement ideas laid down in the Memorandum of Understanding on Motorways of the Baltic Sea between Polish and Finnish ports.

It needs to be stressed, however, that positive phenomena and trends in the economic relations between our two countries sparked off by Poland's membership in the EU followed by growing interest of Finnish companies in Poland, according to surveys made by ETLA and Finnish Central Chamber of Commerce, did not significantly improve Poland's position in Finnish foreign trade. With the shares of 1,3% in Finnish imports, 2,0% in exports and hardly 0,7% in total Finnish FDI in 2005 Poland is far below not only expectations but first and foremost the potentials represented by our economies. And this requires that positive tendencies shaped up during first two years of Poland's membership in the EU should be maintained, strengthened and continued.

The Polish economy is on a fast growth track. This, together with the size of the Polish market, growing consumption and in particular investment demand reinforced by the influx of EU structural funds (Poland the largest recipient country) create more opportunities for intense penetration of Polish markets by Finnish exporters and investors especially in such sectors as business process offshoring, R&D centres, ICT, environmental technologies, white goods, automotive or aviation industries. Poland, in turn is looking forward to increasing export of services and equipment as well as co-operation in subcontracting induced by booming Finnish shipbuilding sector. Equally important would be the growth in export of tourism and health services based on an attractive Polish offer reinforced by newly opened flight connection between Finland and Poland operated by Finnair, Blue1 and LOT. And last but not least, regular and close contacts between Polish and Finnish politicians and experts in the month preceding the Finnish presidency in the EU as well as during the presidency will prove conducive to the development of bilateral economic relations between Poland and Finland.

Andrzej Szynka,

Ambassador

Embassy of Poland, Helsinki

1) According to data provided by the Polish Ministry of Economy

Kaliningrad Transit: Achievements and perspectives

by Gerhard Lohan

Back in November 2002 the EU and Russia laid the ground, by way of a joint statement adopted at the highest possible level, for the transit of persons between the Kaliningrad region and mainland Russia. It involves the use of "facilitated travel documents" and has operated to the entire satisfaction of all sides ever since it was put into effect in July 2003. On average, 1.5 million persons travel annually to/from Kaliningrad and so far only relatively few had to be refused at the border or taken off the transit trains.

Transit of goods was covered in a joint statement adopted in April 2004 in connection with the transit countries' accession to the EU. The basic principles of freedom of transit without unnecessary delays or restrictions, and the exemption from customs duties and transit duties were confirmed in accordance with the related GATT rules and those of the EU-Russia Partnership and Cooperation Agreement (PCA). While generally aiming at keeping the cost of transit as low as possible, a clear distinction was made between private-sector services which will be provided under fair competitive and market-based conditions and administrative costs which fall under the responsibility of government authorities and which need to be proportional and cost-related. The statement also aims at simplified administrative procedures by which Russian transit declarations can be submitted directly to the New Computerized Transit System (NCTS) in Lithuania.

Issues related to the specific customs procedures have been fully settled. However, transit of goods also involves a variety of other controls which are partly product-specific such as phyto-sanitary inspections, for example. Both sides have addressed such matters under the auspices of the PCA, also involving the Lithuanian and Polish authorities who are in charge of practical arrangements on the ground.

Impressive growth rates in transit flows in both directions to and from Kaliningrad during the last two years witness to the fact that EU enlargement did not create obstacles to transit. Overall, therefore, the necessary adaptations in the transit regime to the EU enlargement have been made successfully. We can now build on those achievements with a view to further supporting the social and economic development of the Kaliningrad region as called for by the April 2004 statement. Both sides can be confident about their ability to jointly find adequate solutions for any future Kaliningrad-related issues.

So what issues would be on the agenda in the future?

Concerning travel of persons, the Visa Facilitation Agreement and the Readmission Agreement signed at the joint Summit meeting in Sochi last May have, for good reasons, received much attention on both sides. Visas will be easier to obtain and cheaper for Russian citizens living in Kaliningrad and in mainland Russia alike. Of course, EU citizens traveling to Kaliningrad will also get the benefit, thereby facilitating business contacts with the region and tourism. In case of illegal stay on the other side, the simplified procedure for return of such persons enshrined in the Readmission Agreement will be applicable around the Kaliningrad region. Lithuania's and Poland's accession to the Schengen area will in due course make it easier for Kaliningrad inhabitants to travel inside the EU. The EU Member States' consulates in Kaliningrad, some of which have only recently been opened, will take the responsibility for issuing Schengen visas. If ever the cost of such visas were to go up, this would not automatically affect the Visa Facilitation Agreement because that agreement sets the cost explicitly itself.

The abolition of the visa requirement between the EU and Russia has been agreed at the May 2003 Summit in St. Petersburg as a shared long-term perspective. When it comes, it would probably make any transit regime unnecessary. Although technical talks have started, this will take a considerable amount of time and require further substantial reforms in Russia. Visa-free transit could not be achieved any earlier through a high-speed train connection to/from Kaliningrad: this would be incompatible with the EU principles. Thus, for this option to be rejected it did not even take the feasibility studies carried out in 2004 which demonstrated the lack of cost-effectiveness of building a high-speed train connection.

Border crossing by persons to/from Kaliningrad could be made part of closer cooperation between the EU border management agency FRONTEX and the Russian Border Guard Service launched in early 2006.

Concerning transit of goods, there are a number of factors other than customs procedures and inspections which also matter, given their potential for reducing overall transport time and cost. In particular, the capacity of border crossing points and transport infrastructure may be as important. The EU has made available substantial financial support for modernization of border crossing points such as Chernyshevskoze and Bagrationovsk and projects will soon start on Mamonovo and Sovetsk. More funds could follow once the new European Neighbourhood and Partnership Instrument (ENPI) would have replaced TACIS, starting in 2007. Support to infrastructure modernization in the Kaliningrad region should be seen in connection with the implementation of the Pan-European Transport Corridors two of which cross the Kaliningrad region. These were also included in the recommendations made in 2005 by the High Level Group on the extension of the major trans-European transport axes to the neighbouring countries and regions which was co-chaired by the former Commission Vice President de Palacio and the Russian Transport Minister Levitin.

Railway cargo rates are another important factor influencing the cargo flows to/from Russia through Kaliningrad. The port of Kaliningrad is benefiting from rates which may unduly disadvantage other ports in the region. Russia's accession to the WTO can provide the context and criteria for addressing such questions.

Clearly, there are a number of other issues which together with transit determine the overall development prospects of Kaliningrad. The Commission has for some time advocated the need of a dialogue about those broader prospects. In February last, Commissioner Ferrero-Waldner visited Kaliningrad and had meetings there with Presidential Aide Yastrzhembsky and Governor Boos. The event opened a new phase of cooperation where transit and overall regional development objectives can be considered together with a view to maximizing the mutual benefit of further developments in Kaliningrad and in the Baltic Sea area at large.

Gerhard Lohan

Head, Unit Russia, European Commission

United by the Baltic Sea

by Mikko Pukkinen

This past summer will be remembered in Finland as exceptionally beautiful and warm. It has brought residents and visitors alike to the refreshing waters of the Baltic Sea. Many of them found their way to the unique Turku archipelago, which has been full of life.

Even during the summer months, parallel to prestigious sailing events like the Swan regatta and many cultural events, also "in-door" events related to the Baltic Sea and maritime issues have been organised.

In June, an important initiative took another step towards its implementation when the Foundation for Centrum Balticum was established. Among founding members are the City of Turku, the three universities based in Turku – University of Turku, Åbo Akademi University and Turku School of Economics -, the Region of Southwest Finland, as well as the cities of Uusikaupunki, Rauma, Pori and Vaasa.

The Foundation is another concrete example of a very close cooperation between the local and regional authorities and the universities. Private companies will join its work in near future.

This Foundation will establish, and maintain, a think-tank, which will specialise on the issues of the Baltic Sea Region (BSR). Its focal points will include sustainable development of the Baltic Sea, urban policy in the region, the BSR as an economic region as well as the European dimension of the BSR. The Centre will become operative during the 2nd half of 2006. Without doubt, it will become an important focal point for international cooperation.

Linked to the Centrum Balticum, the City of Turku hosted an important conference on 19 – 21 July 2006 on European Maritime Policy (see www.turku.fi/maritimepolicy). EU Commissioner responsible for Fisheries and Maritime Affairs Joe Borg and other recognised experts discussed how to combine both economic development and environmental sustainability to develop a holistic approach, which will contribute, to a future Maritime Policy for the EU.

During the Turku Conference, it became evident that all issues related to the seas must be discussed as a whole, not only sectorally.

The issue of governance was also discussed. Who is actually responsible for integrated Euro-pean maritime policy, and what is the role of various actors – including the role of cities and regions?

From Turku´s perspective, one key area is certainly safety issue. The size of vessels and the volume of traffic continue to grow, which has important implications for coastal cities such as ours.

Another important theme for us is the economy of coastal regions and islands. It includes issues such as tourism, development of knowledge society in isolated areas such as islands, and planning. International benchmarking would undoubtedly bee very useful also in these questions.

Mr John Richardson from the European Commission raised an interesting question about possible creation of a European Certificate of Maritime Excellence. Although still only an idea, this might be an interesting path to bring concepts such as marine Centre of Excellence and integrated maritime cluster to the Europe-wide discussion.

Above, I have discussed some of the topical issues in which the City of Turku with its partners is involved in the field of maritime policy and development of the BSR.

But one may ask why Turku is so active in the Baltic Sea Region? Let me share with you some thoughts on this.

Seen from the Central European perspective, Finland is an island: about 70% of Finnish imports and 90% of exports are carried by sea. Nearly a quarter of the sea traffic between Finland and foreign countries goes through the five significant ports located in south-western Finland.

The City of Turku, with central coastal location, has a long history as a Baltic Sea city since the days of the Hanseatic League. For centuries, this oldest city of Finland has been the gateway between East and West, through which not only new products but significantly also new thoughts, cultural influences and innovations travelled.

Now that the Baltic Sea has practically become an inland sea in the EU, the BSR offers great opportunities for Turku and south-western Finland. Provided, naturally, that these are utilised through active engagement and co-operation.

Turku has excellent connections westward to Stockholm, Gothenburg and Oslo, as well as eastwards to St. Petersburg, Moscow and all the way to Beijing via the new direct train connection. Train ferries - Turku has the only such service in Finland - link the route directly to Germany and other Central European transportation networks as well. It is vital that good operational conditions for maritime traffic also secure in the future.

Logistics is therefore a crucial dimension of Turku´s regional strategy - but not the only one. The three universities in Turku offer a unique expertise for active research and training related to the Baltic Sea region. For example, the University of Turku hosts the Baltic Sea University Network with almost 40 member universities. Åbo Akademi University is a key player in the Baltic University Programme, dealing especially with issues of environment and sustainable development. The work of the Pan-European Institute of the Turku School of Economics in analysing economic trends in the Russian Federation and the new EU member states is widely recognised.

Turku hosts also other important functions in the Baltic Sea cooperation. The City has the vice-presidency of the Union of the Baltic Cities, an active organisation of some 100 member cities. Turku hosts UBC´s Environment and Agenda 21 secretariat, a highly appreciated and effective body with a very substantial project portfolio and an international secretariat over a dozen experts.

Turku is the home to Finland's largest maritime cluster. The biggest and most luxurious cruise ships in the world are built in Turku, which is home to leading engineers in the field worldwide. The cluster also includes shipping companies, off-shore industry and subcontractors, ports, shipping and forwarding agents, the insurance industry and maritime education and research, to name a few.

Turku, as well as the Estonian capital Tallinn, will serve as the European Capitals of Culture in 2011. This provides a unique opportunity to present the cultural heritage and modern innovations of our countries and of the whole Baltic Sea Region for an international audience.

Let us do it together!

Mikko Pukkinen

Mayor of Turku

The shared longstanding history of Finland and Estonia provides the basis for EU cooperation

by Keijo Virtanen

When the Baltic States regained their independence in 1991, it created once more a new historical situation in the Baltic Sea area. The relationship between the large and small states in the area, and their relationship with the rest of Europe, was to take shape all over again. This turned out to be an extremely significant turning point in the international relations in the post Second World War period. Today, when there are more sovereign states in the Baltic Sea Region than some years ago and while most of them are small nations, their aspirations for national benefit in politics, economy and culture are clear. At the same time, they are getting in closer connection with the big centres of Europe and, in a wider context, with other international processes. The Baltic States are evidently taking part in the European integration processes as well as in the on-going globalisation tendencies. How are we able to maintain the traditional relations between Finland and Estonia in these new circumstances?

The recent economical and societal change in Estonia, Latvia and Lithuania has been surprisingly rapid. The EU membership of our closest neighbour, Estonia, has marked a start of a new phase between it and Finland. Although we feel culturally most connected to Estonia, it would be, however, advisable to consider the diverse characteristics of the peoples and cultures in the Baltic Sea area on a larger scale. The longstanding economical and cultural relations between the Baltic countries will naturally establish the preconditions for future cooperation, but the main basis of our relations is still the shared cultural heritage. At present, Estonia and other Baltic countries are intriguing and dynamic societies, and their geographical location alone is already holding great potential. Today, these countries can determine their own interests and preferences to a great extent. It is not self-evident, for example, that the North would be the direction where our closest neighbour Estonia directs its attention in the future. On the other hand, under the present situation, the common history and culture, shared experiences and cooperation have larger significance than can sometimes be realized in today's fast pace.

The cultural and societal mentality of the Baltic countries can be examined as a northern entity or as a mosaic of different peoples and nations where each has their own ideologies and political thoughts, with their own national heroes and artists. According to the first approach, the Baltic Sea area can be seen as the opposite to the Mediterranean world. The North has traditionally been seen as a cold and remote place on the edge of the world, and where every day life has been an endless struggle against the severe natural living conditions. It has been claimed that the fate of the North has been only to react to impulses from the South, not to create its own vigorous life and culture. During the centuries, life in the North has been given mythical meaning. This meaning consisted of the ideal of simple rural life and reliance on nature. Estonia and Finland have been natural parts of the North because of their religion, culture and language.

For centuries, the conception of an integrated European culture was related to the Catholic Church. After the sixteenth-century Reformation, the Polish-Lithuanian culture was connected to Roman-Catholicism and to the South, while Lutheranism started to dictate life – both material and cultural – in the North. This can be seen as the basic factor which has had an effect on the cultural plurality and diversity in the Baltic Sea Region. On the other hand, this factor has been smoothed by the faith in science and rational thinking. According to Professor Samuel Huntington, future conflicts are caused by cultural and religious borderlines, not by the political interests of power blocs. Professor Huntington draws the Eastern border of Western Civilization in the Baltic Sea area so that Finland, Estonia, Latvia, Lithuania and Poland are all part of it. The main criteria that he uses consist of the borderline between Western Christianity and the Orthodox / Islamic world.

However, it is not possible to define this kind of division very strictly. We Finns, for example, have absorbed influences from various directions. The Swedish political dominance as well as the influence of the Roman-Catholic Church came from the West, as the influence of the German Hanseatic League arrived from the South. The influences of the commercial system of Novgorod and the Orthodox Church came from the East. But taken more broadly, the entire Baltic area, including Poland and the Baltic nations, is regarded as part of the Western mentality, and as a barrier against the East. Evidently, the Eastward expansion of the European Union will further strengthen the Western values and the political and cultural choices related to them throughout the whole Baltic Sea Region.

Estonia's development during the past few decades has been described to be a small miracle. Its economical growth has been fast, and the inflation has been rather low. Today, the economy of Estonia is strongly connected to the European Union. The former Estonian Ambassador to Finland, Matti Maasikas, states that never before have Finland and Estonia had as much in common than now. We sit at the same tables, debate about the same questions, and we have to solve the same problems. Finland is Estonia's largest trade partner. After attaining the EU membership, Estonia has become an increasingly interesting trade partner for Finnish business companies.

The cooperation between Finland and Estonia is built on future expectations, the shared history providing the setting for it. There are good preconditions for such a neighbourhood that could get our countries and their people even closer to each other. That will be of mutual benefit.

Keijo Virtanen

Honorary Consul of Estonia in Turku and the Southwest Finland

Professor of Cultural History

Rector of the University of Turku

The promotion of mutual trade is an important way of developing the competitiveness of the Baltic Sea Region

by Jarkko Heinonen

The Baltic Sea region forms an important economic area. 310 million consumers live in this region, and their combined purchasing power is 50% greater than that of all the consumers in China. Furthermore, the growth of production in the Baltic Sea region is clearly faster than the average for the EU and, moreover, the new EU countries have taken steps to make their economies more dynamic. The growth of Russia – and St Petersburg in particular – is rapid, and cooperation between the Baltic Sea states offers the most natural way of developing mutually beneficial relationships between the EU and Russia.

Trade between Baltic Sea states has almost doubled in real terms over the past ten years, representing a steady 30% of these states' total exports for this period. Mutual trade has grown fastest since 2001, and it would seem that the share of the region's exports represented by mutual trade is on the increase. For most of these states, the most important export markets, and sources of imports, are the other Baltic Sea states.

The small scale of the Baltic Sea region's economies is the single biggest structural problem facing the area. In many sectors this has led to a situation where there is very little need to compete on national markets. This can be considered a key weakness of the entire Baltic Sea economic area. Properly functioning EU internal markets and closer cooperation with the non-EU countries of the Baltic Sea region is the best, and perhaps the only solution to this problem.

Regardless of the EU's internal markets, significant obstacles to trade still exist at the practical level. These affect small and medium-sized enterprises (SMEs) in particular, who have fewer resources to cope with the bureaucratic administrative work associated with importing and exporting. By way of an example, we can mention that 71% of the SME respondents to a questionnaire recently sent to the members of the Turku Chamber of Commerce consider that the wide range of product-specific regulations, which differ from country to country, hinder exports to other EU countries, or render them impossible. Even large enterprises recognise the countless administrative obstacles posed by the internal markets of foreign countries, but these companies consider such problems to be of lesser significance, because they are able to get around them by using a subsidiary within the country in question.

As far as many of the area's companies are concerned, the Baltic Sea region forms the most important and most easily utilisable market, and it would, in my opinion, be sensible to develop both the functionality of the EU's internal markets and the region's cooperation with Russia. In this respect, the Baltic Sea region could act as a pioneer within the EU, or even as a test area, where attempts are made to investigate the problems of internal markets and devise possible solutions. We should promote ever-closer common markets within the Baltic Sea region, in order to maximise the area's imports and exports, and thus create larger "home markets" for the area's SMEs, which often operate in domestic markets that are tiny. In this way, we could create an operating environment that gives enterprises a much better basis for growth and enables them to develop into actors that can even operate in larger international markets.

Work is needed in order to bring the markets for products, capital and human resources together, and to standardise the practices of the various official bodies. An example of this is taxation. Dealing with the tax authorities of the different countries is seen by SMEs as a restriction on imports. Even though at this stage it is not worth adopting the harmonisation of taxes as a goal, it would be useful to consider the taxation practices of other countries. In an ideal world, it should be enough for an enterprise to deal only with its local tax office. The local tax office already has all the necessary information concerning the enterprise; all that is needed now is a fluid exchange of information, and standardised practices and methods of operation. Naturally this also applies to the activities of the other authorities.

It would also be useful to consider possible steps to enforce free trade in services within the Baltic Sea region. As we all know, the service sector already accounts for approximately 70% of the gross national product of the countries of Europe. Furthermore, a large proportion of the trade in investment products includes installation and maintenance services. Opening the EU's internal markets to entirely free trade in services is therefore important not only for the development of the various service sectors, but also to prevent barriers to industrial exports. The Service Directive, which was achieved after some considerable wrangling, will naturally ease the problems associated with the export of services, but the aim must clearly be to achieve total freedom in the trade in services. Achieving functioning common markets for the entire services sector is particularly important for the EU member states within the Baltic Sea region, with the possible exception of Germany, because the relatively small size of the national markets, together with the geographical segmentation of these markets, may seriously hinder opportunities for the development of the various service sectors.

Consideration should be given in the Baltic Sea Region Development Strategy to establish methods to help SMEs reach wider markets, particularly in the Baltic Sea region. Given the size of our economic area, there are remarkably few enterprises within our region that operate on the international market. SMEs are needed that are willing to grow – ones that, in the right operating environment, would be able to exploit their potential to grow into large, expanding enterprises.

An internationally competitive cluster would provide an excellent environment for SMEs to grow, and would also increase the area's attractiveness to investors. It would therefore be useful to consider the possibilities for developing a cluster policy for Baltic Sea region. The easier it is to utilise the skills and knowledge of the various sub-contracting enterprises throughout the Baltic Sea region, the stronger the total competitiveness of the cluster. On the other hand, it would be useful for SMEs engaged in sub-contracting to be more active in seeking cooperation partners from a wider area than is currently the case. An important part of a Baltic Sea-wide cluster policy would be to facilitate networking between the so-called engine enterprises and the sub-contractors on a wider scale than is currently the case, and to maximise the benefits that this networking would bring. Genuinely functioning internal markets are, naturally, also a key factor in ensuring the viability of a Baltic Sea Region cluster.

Jarkko Heinonen

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Baltic Sea region's new EU member states increasingly important in the internationalisation of Finnish small and medium-sized companies

by Katja Heiskanen

As Estonia, Latvia, Lithuania and Poland joined the EU in May 2004, the Baltic Sea became virtually an inland sea within the European Union leaving only Russia outside of the integrated area. The EU-membership of the four countries has increased the interest of foreign companies to increase and initiate exporting and investment operations in the area. For example foreign direct investments in Estonia have over doubled in three years' time from EUR4035 million in 2002 to EUR10415 million in the third quarter of year 2005 (Bank of Estonia). According to the Bank of Lithuania, foreign direct investments in the country have increased from EUR3818 million in 2002 to EUR5278 million in the third quarter of 2005. Also the statistics of the Bank of Latvia and the National Bank of Poland show a growing trend in FDI towards the countries respectively. The increased interest towards the Baltic Sea Rim's new EU countries is well justified as all of the four countries' economies have been growing rapidly. Estonian and Lithuanian economies are expected to continue their strong growth, whereas Latvia currently holds the position of the fastest growing EU country.

The internationalisation of small and medium-sized companies has accelerated strongly since the eighties and the statistics since then have shown increasing importance of SMEs in home economies as they are key contributors as job generators, exporters and innovators. Taking this into account, a study was recently conducted to find out the importance of the Baltic Sea region's new EU countries in the internationalisation of Finnish small and medium-sized companies. The study focused on exporting and investment operations of Southwest Finnish SMEs towards Estonia, Latvia, Lithuania and Poland in 2004 and in 2010. The empirical material was collected with a survey sent to the managers of SMEs known to be encaged in exporting activities.

The results of the study indicated clearly that the Baltic Sea region's new EU countries are significant and will be increasingly important export and investment destinations to the studied SMEs. The number of companies exporting to the area is high. Of the respondents 43% reported exporting to Estonia in 2004. The figure for Poland was then 15%, whereas for Latvia 12% and for Lithuania 11%. In five years' time almost two-thirds of the studied companies – 57% − will be exporting to Estonia. As the number of exporting companies increases somewhat among industrial firms, among trading companies the number of companies exporting to Estonia nearly doubles. This can be in part explained by the positive expectations of the service and trading sectors on the Estonian market growth. In year five years' time 26% of the respondents will be exporting to Poland, 23% to Latvia and 19% to Lithuania. Most of the increase stems from industrial companies. The combined proportion of Poland and the Baltic States of the share of the value of exports will increase from 16% in 2004 to approximately 20% in 2010. The importance of the four countries for the studied SMEs in was in 2004 substantially higher compared to the total of Finnish exports.

Compared to exporting investments were found to be few. This is not suprising as SMEs often choose to use non-equity modes of entry due to lack of sufficient resources. Even though the studied companies are not as inclined to encage in FDI as they are in exports, it is clear that the Baltic States and Poland attract the SMEs to invest the most. The Baltic Sea region's new EU countries are the most important investment destination for the studied firms measured by the number of investing companies. The number of SMEs investing in Estonia will increase notably from 7% in 2004 to nearly 18% in 2010. Of the four countries Poland attracts 6% of the studied companies to encage in investment operations in five years' time. The number of firms investing in Latvia and Lithuania remains lower. Moreover, the proportion of the Baltic States and Poland of the total value of foreign investments is significant compared to the total Finnish FDI stock in the area. Interestingly enough, the results show, rather surprisingly, that the smallest of companies are a relatively active group to invest in the area. Certainly the finding implicates that the area is considered easy enough to enter even for companies with fewest resources. The growing markets were found to be a strong incentive for the studied small and medium-sized companies to be encaging in exporting as well some investment operation in the four countries.

Based on the empirical results a trend can be observed that the interest towards the Baltic States as well as Poland will be increasing in the coming years. Though the objective of the research was to find out the significance of the Baltic States and Poland to the studied companies, the growing significance of the Russian markets became clear as a by-product of the analysis. The small and medium-sized companies, in their part, seem to begin exploiting the previously unused trade potential in the vast and growing markets of Russia and Poland. The already familiar Estonian markets may very well be acting as a stepping stone to the Russian markets as well as to the southern markets of Latvia, Lithuania and Poland. The findings indicate that the main market area of the studied small and medium-sized companies is shifting from the previously more important EU15 countries to the near east. The trade with the Baltic States and Poland may to some extent be complementary to the trade with Russia. The significance of the EU15, though still considerable, will be decreasing in the favour of the Baltic Sea Rim's eastern countries, the Baltic States, Poland and Russia combined.

The whole Baltic Sea Rim area may very well be considered as a home market by the Finnish SMEs in the coming years. The countries within the area are close even for the smallest of companies to operate in. Especially the eastern part of the Baltic Sea Rim, due to the strong economic growth, offers good possibilities for those acting early on the rising opportunities. The smaller sized companies in particular, however, could benefit from actors that provide them an easy access to reliable information about the markets and the market developments. In addition to the information needs, the companies should be offered hands-on assistance on the practical level. Based on the research it can be concluded that organisations involved in local area development as well as different actors providing business support services designed for SMEs should take particularly the Baltic Sea region's eastern part into consideration when directing their efforts (www.tse.fi/pei/pub).

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Kaliningrad turns into an EU-flanked tax haven for Asian firms?

by Kari Liuhto

In 1996, a special economic zone was established in Kaliningrad to encourage investments in the region. The zone's attraction is duty-exempt import. If a company can increase the value of an imported product by 30 per cent and change its customs heading, it is entitled to sell the product exempt of duty elsewhere in Russia as well.

The special economic zone has resulted in a steep increase in Kaliningrad's foreign imports and sales to the mother country. The region's share of Russian imports is ten times bigger than its share of the country's GDP.

Despite its status as a special economic zone Kaliningrad has not managed to convince foreign investors. At the end of 2005, direct investments totalled less than 90 million US dollars, or slightly over 90 dollars per each Kaliningrad resident.

Direct foreign investments per inhabitant in Kaliningrad are only one seventh of the Russian average. In contrast, per-inhabitant investments made by foreign companies in Lithuania are nearly 20 times larger than those of Kaliningrad. This is a huge difference, taking into account that only 15 years ago both Lithuania and Kaliningrad came under the same economic system.

The Kremlin, too, has noted the disappointing progress in foreign investments. To rectify the situation, a new law for the Kaliningrad special economic zone entered into force in April 2006.

As provided in the new law, the special economic zone established in 1996 will be abolished in ten years' time. Companies that were active in Kaliningrad before the new 2006 legislation took effect will enjoy exemption from duty and may continue duty-exempt re-exports to Russia until 2016.

In a nutshell, the new law stipulates the following: a company that invests a minimum of 150 million roubles, or some 5 million US dollars, in Kaliningrad is exempted from income and property tax for a period of six years. After this it gets a 50-per cent deduction on taxes for another six years. Tax concessions are not altogether insignificant: Russia has an income tax of 24 per cent and a property tax of 2.2 per cent.

An comparison of foreign direct investment stock in the Baltic Sea region

	FDI stock change during 2000-2004	FDI stock per capita by the end of 2004 (USD)
Kaliningrad	428%	92 *
Russia	306%	689
Denmark	133%	18013
Estonia	360%	7198
Finland	230%	10695
Germany	128%	4222
Latvia	216%	1975
Lithuania	274%	1782
Poland	179%	1594
Sweden	173%	18074

* Kaliningrad FDI stock per capita at the end of 2005.

Sources: UNCTAD 2005, Kaliningrad statistics 2006, author's calculation

In terms of new investments, however, tax concessions carry less importance than does the predictability of Russia's investment climate. The main feature of the new legislation is that it will remain in force until the end of March 2031.

The new special economic zone will improve Kaliningrad's competitiveness in relation to its neighbours on the Baltic Sea. Some of the companies in Kaliningrad have already improved competitiveness at quite a startling pace. Rapid development may soon result in 'Made in Russia' being found on an increasing number of products on sale in the EU. Any assessments of the future competitiveness of Russian products should take into account, for example, that Kaliningrad-based Telebalt already engages in licence manufacture with South Korean Samsung.

In addition to Koreans, the Chinese have also noted the dormant potential in Kaliningrad. China's eighth biggest automobile manufacturer, Chery, has set up a plant in Kaliningrad, the goal being to manufacture 10,000 vehicles a year. Is Kaliningrad turning into an EU-flanked tax haven for Asian companies?

To date, Asian businesses operating in Russia have focused on the Russian market, but this may yet change. Companies and policy makers in the EU would hardly welcome the idea of an Asian tax haven in their own region.

Apart from the new special economic zone, Kaliningrad also offers splendid beaches, visited by more than 250,000 Russian tourists in 2005. The region is still waiting for a breakthrough among foreign travellers, though, with only 75,000 visitors from other countries entering the region last year. Why has Kaliningrad not managed to attract more foreign tourists?

Some of the reasons retarding the development of tourism in Kaliningrad include poor traffic and transport connections, slow border formalities, undeveloped conditions of airports, hotels and travel services, as well as the visa obligation. Granting EU citizens visa-free travel for short visits might give tourism a much-needed boost in Kaliningrad. This could apply, for example, to visits lasting a maximum of 14 days.

A decision on visa-free travel for fixed periods would carry more significance than the new law on special economic zone. If, for example, Kaliningrad were to be visited by half a million foreign tourists, each leaving 200 US dollars in the area, the foreign capital collected in one year would exceed the total amount of direct investments seen in the past 20 years.

Reciprocal visa waiver agreements between the EU and Kaliningrad should be made a long-term objective. In terms of visa-free travel, Kaliningrad could pave the road for closer cooperation between the EU and Russia.

Kari Liuhto

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Estonia's path to euro area

By Andres Lipstok

Among the new EU member states Estonia has been in a group of forerunners when it comes to the issue of joining the European Monetary Union (EMU). Estonia has always stated that it seeks to join the euro area sooner rather than later and entered the European Exchange Rate Mechanism (ERM II) on 28 June 2004, shortly after acceding to the European Union. The authorities' target date for joining the euro area was then set for the beginning of a calendar year after the end of the mandatory 2 years in the ERM II, i.e. January 1, 2007.

In April 2006, the Government of Estonia, in close cooperation with the central bank, decided that due to the level of inflation the 2007 target is no longer realistic and Estonia should make practical preparations for the euro area accession as of January 1, 2008.

Estonia intends to adopt the euro as soon as possible

The postponement of the accession target does not change our strategy to join the euro area at the first opportunity. The main driver for Estonia's early entry is to reap the economic benefits of the monetary union through increased trade and financial integration, which will foster economic growth and real convergence. This could be achieved through the reduction of transaction costs and a decrease in the interest rates via eliminating the exchange rate risk premium.

Joining the monetary union or participating in ERM II is usually deemed to entail some costs in other areas, e.g. short-term costs of fiscal consolidation and the cost of giving up independent monetary policy and flexible exchange rates as stabilization tools. These possible costs are essentially non-existent in case of Estonia as we have operated a successful currency board vis-à-vis EUR (DEM) for fourteen years (including during the ERM II as a unilateral commitment). Furthermore, fiscal discipline has been strongly entrenched in our political culture – the state budget has been at least in balance (in the last 5 years even in surplus) and the public debt is the lowest in the EU (below 5% of GDP). Therefore, joining the monetary union does not entail any significant changes for our fiscal policy as it has been in line with the Stability and Growth Pact principles for more than a decade.

Markets trust our euro accession strategy

The first two years in ERM II can be regarded successful as there have been no tensions in the exchange rate market. Also, government's decision to postpone the target date for the euro area accession by one year was a non-event for the markets and rating agencies. Estonia is still expected to join within a few years and a short-term delay is not treated as a major risk to our economy. This attitude is strongly based on the assumption that prudent economic policies that have brought success to Estonia so far will continue.

It is widely accepted that Estonia's economy is basically ready for the euro area membership, as countries with a small and open economy that have been successful under the fixed exchange rate regime with the national currency pegged to the euro for several years, should be most suitable euro area candidates.

Estonia does not have problems with price stability

Although the inflation in Estonia increased up to 4.9% in September 2005 and has stayed over 4% level, we do not regard our recent developments as a threat to sustainable long-term price stability in Estonia. The overall macroeconomic situation in Estonia has been favourable in recent years. Real GDP growth has hovered over 7-8% level for more than five years and accelerated further in the second half of 2005. Based on our baseline macroeconomic projections, the moderately positive output gap should gradually vanish without creating serious tensions in the economy. This assessment, together with the relatively stable inflation expectations and possible Balassa-Samuelson impacts, serves as a basis for our own conclusion that there are currently no fundamental problems with the price stability in Estonia. Nevertheless, this situation does not make it easy for us to fulfil the price stability criterion.

In this respect, the authorities have prepared a set of measures, which aim to fulfil the criterion after the second quarter of 2007. These measures include reprogramming the excise tax increases and keeping the fiscal stance as tight as possible.

As Estonia's difficulties with the price stability criterion are not unique and concern all countries with fixed exchange rates and in the catching-up process towards the EU average price level, then Estonia supports discussions on the economically meaningful interpretation of the criterion. For instance, it is not clear why countries with the lowest positive inflation rates are almost automatically the best performers in terms of price stability. Moreover, countries with floating exchange rates need not necessarily be the best benchmarks when assessing the ability to maintain low inflation in the single currency area.

Euro area enlargement is in everybody's interests

The enlargement of the euro area will contribute to the further development of the European Union. At the same time, it is in the interests of the European Union that the enlargement of the euro area is based on transparent rules. Otherwise the credibility of the euro as an international currency would be compromised. As mentioned above, this should not preclude discussions regarding the economically meaningful interpretation of the Maastricht criteria as the European Union and the euro zone itself have changed significantly since the discussions on Maastricht Treaty rules 15 years ago.

Andres Lipstok

Governor of Eesti Pank

HELCOM - creating a new environmental strategy for the Baltic Sea

by Anne Christine Brusendorff

Today, the Helsinki Commission, or simply HELCOM, is working on an ambitious new strategy to solve major problems troubling the Baltic Sea. The HELCOM Baltic Sea Action Plan, which has already been widely heralded as a pilot project for the protection of regional seas under the newly drafted EU Marine Strategy, will provide a unique opportunity to take joint wide-scale and decisive actions to achieve the ultimate target of having a healthy marine environment with balanced ecosystems for present and future generations to enjoy.

For more than three decades, HELCOM has been acting as the main environmental policy-maker for the Baltic Sea area by developing specific measures to protect and conserve its unique marine environment. The Commission, working through intergovernmental co-operation between all coastal countries, has produced appreciable environmental gains in the past 30 years, thus validating the conviction that the deterioration of one of the most polluted seas in the world can be halted and the state of the marine environment improved.

But despite some remarkable progress in the past years, the overall state of the Baltic Sea is still not satisfactory. In order to maintain the Baltic Seas natural assets for future generations a lot more has to be done.

In view of the various environmental problems some of which are proving difficult to solve, in 2005 the Helsinki Commission decided to draw up a strategic environmental action plan to ensure that all possible measures are taken to reduce pollution in the Baltic Sea and to repair the damage done to the marine environment.

The highlight of this innovative plan is that it will be based on a clear set of Ecological Objectives defined to reflect a common vision of a healthy Baltic Sea, e.g. clear water, no excessive algal blooms and natural distribution of plants and animals. The good ecological status definition will be set based on a holistic view and by creating a balance between the health of the sea the public wants and the human influences that they will accept. With this ecosystem approach protection of the marine environment is no longer seen as an event-driven pollution reduction approach to be taken sector-by-sector. Instead, the starting point is a common understanding and definition of a sea with a good ecological balance, which is deciding the further needs for reductions of pollution loads as well as the level and extent of human activities.

Another major highlight of the HELCOM Baltic Sea Action Plan is that it will be elaborated with the active participation of all major stakeholder groups in the region – from governments, through industry and NGOs, right down to individual citizens living on the shores of the Baltic Sea, to ensure that the plan is relevant and can be effectively implemented in practice.

The consultation process behind the drafting of HELCOM's Baltic Sea Action Plan was officially launched at a 'kick-off' Stakeholder Conference held on 7 March 2006 in Helsinki, Finland, where more than 200 participants, representing scientific and business communities, governments of the coastal countries, the EU, as well as major regional organisations met to discuss the objectives of the strategy and to provide input to its further development.

Commenting on the Helsinki Commission's work to create a strategic plan to rescue the marine environment, the State Secretary from the Finnish Ministry of the Environment Stefan Wallin underlined that "HELCOM is the only intergovernmental organisation within the Baltic Sea region with the mandate to deal comprehensively with the problems of the Baltic Sea, and to jointly agree on implementation of measures to preserve and protect the Baltic marine environment, to conserve natural habitats and biodiversity, and to ensure the sustainable use of natural resources within the Baltic Sea region". Wallin also noted that the preparation of the HELCOM action plan must be open-ended and transparent. "We must use this opportunity when preparing this new Baltic Sea Action Plan to make it as comprehensive and, at the same time, as realistic and action-oriented as possible."

The European Commission described the plan as "the cornerstone for further action" in the Baltic Sea region, and confirmed its intention to take an active part in its development over the coming months. The Commission thinks that in setting a definition of 'good ecological status' for the Baltic Sea as well as specific environmental targets and necessary measures, the Baltic Sea Action Plan will be instrumental to the successful implementation of the new EU Marine Strategy in the region. In this context the new plan makes HELCOM a forerunner, and a model to be followed by other regional marine conventions around Europe.

The Council of the Baltic Sea States (CBSS) also backed the HELCOM action plan. The Chairman of the CBSS Committee of Senior Officials, Kornelius Sigmundsson, said that "the CBSS Presidency recognises the value of HELCOM's Baltic Sea Action Plan as a very important aspect of our region's joint efforts to achieve a healthy Baltic Sea environment." Sigmundsson also added that as an overall political forum for regional intergovernmental co-operation, the Council of the Baltic Sea States will continue to encourage and support HELCOM activities.

Following the outcome of the Stakeholder Conference, at its annual meeting in March, HELCOM approved the core elements of the Baltic Sea Action Plan - a common vision of a healthy sea, and a set of Ecological Objectives to work towards so as to fulfil this vision.

The next crucial step in the development of the Baltic Sea Action Plan will be to identify and detail the kind of actions needed to achieve the agreed environmental objectives within a given timeframe for each of the four main environmental priority issues: curbing eutrophication, preventing pollution involving hazardous substances, improving safety of navigation and accident response capacity, and halting habitat destruction and the decline in biodiversity.

After a series of thematic meetings and a final Stakeholder Conference in March 2007, which will review a preliminary draft of the plan, the finalised environmental strategy will be adopted at a HELCOM Ministerial Meeting scheduled to take place on 15 November 2007 in Warsaw, Poland.

For further information on the development of the Baltic Sea Action Plan, please visit the HELCOM web site: www.helcom.fi

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European and Baltic dimension of strategic partnership between Poland and Lithuania

by Eufemia Teichman

On September the 5th this year 15 years will have passed from resuming diplomatic relations between Poland and Lithuania. The date marked a new era in the history of both countries. Both the endeavour to integrate with western cooperation structures and similar perception of their role in shaping new order and safety in Europe were main reasons for the strategic partnership which, due to Lithuanian initiative and with Poland's acceptance, has been functioning since 1997. What are the results of the experience of this partnership in the situation when strategic goals of both countries have been achieved?

In July 2006 Finland will take over the leadership in EU with four new members from the Baltic Sea region, Poland and Lithuania included. The EU Northern Dimension is known to be the priority of Finnish presidency. Will it be possible to add some experience of Polish-Lithuanian strategic partnership to this political endeavour?

The remaining part of my paper reflects on the very subject. The goal of strategic partnership between Poland and Lithuania was to cause EU and NATO accession of the two countries. To achieve this goal (following the Baltic States' example) common cooperation structures between parliaments, governments and presidents of both countries were ap-pointed. Besides a common military unit Litpolbat, whose aim in a way was to prepare Lithuanian army for NATO partnership, was created. We gained common experience in Trans-Atlantic, European and Baltic cooperation. Another political asset of Polish-Lithuanian partnership is the dialog with our eastern neighbors: with Russia (both our countries border with the Kaliningrad region), Belarus and Ukraine.

In reality political effects of the partnership prevailed over economic co-operation, however trade exchange dynamically rose (by some 30% annually on average, although asymmetrically to Poland's advantage), capital exchange also rose (though to a lesser degree), social relations evolved regardless of national minorities' problems being always an important element of this partnership. We have also learned cross-border cooperation (including the "Niemen' and 'Baltic' Euro-regions). On the other hand we have failed to take advantage of reserves inherent in maritime economy and tourism. Neither have we managed, for economic reasons, to solve several important, especially for Lithuania, matters connected with development and modernization of road and electrical power infrastructure (Via Baltica and the so-called transit energy bridge). Polish-Lithuanian strategic partnership became a significant political capital for both countries and was appreciated by both EU and NATO. Trust – strong basis for further cooperation was built. Both countries benefited from this.

What seems to be needed at present is a new big political project, the realization of which will generate new energy between partners. Strengthening of The North-South Axis on which political, economic and social activity of enlarged EU would concentrate may become such a project. This Axis, being a part of EU Finnish presidency, is devoid of ideological context (good West – bad East), does not eliminate existing trilateral alliances of the Weimar Triangle type (although its purposefulness in its present form seems to be almost exhausted), allows both to create European network of cooperation between new member countries and the more competitive, knowledge-based innovative economies of Scandinavian countries and to actively pursue by EU the neighborhood policy towards Eastern Europe countries.

According to my authorial concept, Poland has the following strategic interests in the Baltic Sea region:

1. Poland's resolved entry into "the Baltic club" in order to develop innovative and knowledge-based economy,
2. ecologic and energy safety (the Baltic energy ring, the Baltic gas pipe-line),
3. regional transport and cooperation, including the Baltic part of Russia,
4. Poland's accepting the role of an important liaison between the Baltic and Central as well as Southern Europe; the indispensable condition for fulfilling this role is building in Poland the necessary meridian communication infrastructure, especially a network of ports, terminals, highways as well as acceleration of Via Baltica construction.

Poland and Lithuania have a lot in common on the EU forum: attitude to-wards energy safety, eastern policy and history. Our approach to eastern policy, energy and environment protection brings us closer to Baltic and Scandinavian countries, while cohesion policy unites Poland with other EU countries.

Poland's relationships with Latvia and Estonia, apart from being very friendly, are not advantageous enough for all the partners. We will not find allies to criticize European constitution in Estonia or Latvia, for these countries do not lose much due to diverging from the Niece Treaty, but it is in Riga and Tallinn where we can find support for our attitude toward the Bal-tic gas pipeline.

Scandinavians have a long tradition in promoting such values as civic liberties and also have pragmatic relations with Russia. Together we can promote activities towards our eastern neighbors, e.g. towards Belarus, without irritating Russia.

Finland will not support us in the matter of energy safety as they think it is possible to have good relations with Russia and at the same time depend on gas deliveries from Russia in almost 100%, just as Finland does. Therefore for every important national, regional or EU interest, it is essential to create multilateral expedient alliances, taking advantage of our experience gained in bilateral relations between Poland and Lithuania.

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Third Wave co-operation needed in the Baltic Sea Region

by Esko Antola

The Baltic Sea Region is facing the third wave of regional cooperation in the Post-War period. The first wave marked the institutionalisation of the Nordic cooperation. “Norden” became a sub-region of its own and demonstrated a high level of integration in many fields.

The second wave of cooperation got its dynamism from the fall of the Cold War. New institutions and networks mushroomed in the early 1990’s. They served the transition of former socialist countries towards market economy. Local and regional actors became closely linked to the Baltic Sea dynamism. Pre-accession programmes of the EU strongly enhanced Baltic Sea cooperation. The most important new feature of the second wave cooperation was the very active role of civil societies in the region.

During the Second Wave “Norden” wanted to save its original Nordic institutions (Nordic Council, Nordic Council of Ministers) intact. This contributed to a new wave of institutions. The Baltic Countries followed the same pattern and established their own Baltic Assembly between the Parliaments in 1991 as well as the Baltic Council of Ministers (1994). For the region-vide cooperation the Council of Baltic Sea States (CBSS) was formed in 1992. Its geographical scope and membership pattern is wider including Norway, Iceland and Russia.

The third wave of the enlargement of the European Union in 2004 has made the Baltic Sea region an internal sea of the Union. It has become an inland sea of the European Union with one third of the EU’s member countries on its shores. In a broader context, the Baltic Sea area can be considered to include all the 11 countries that are members of the Council of the Baltic Sea States.

The accession period marked a deep process of socialisation for the new EU members. Socialisation was a necessity for the adaptation to the acquis of the Union. It was possible because of the existing liberal-democratic value base that these countries shared before the Second World War. New member states never completely lost their cultural heritage and links with Western Europe. This greatly helped their accession seen as a “return to Europe”. The “Second Wave” institutions greatly helped the socialisation process. Of a particular value was cooperation between civil society organisations.

The process of adaptation to membership has not been completed. The legislation required by the Union needs to be implemented nationally. The responsibility for implementation of the rules lies with the member countries. Nevertheless, the execution of rules and laws is not a matter of governments alone. Regions and local authorities as well as the civil society play a key role. The co-operation of the Baltic Sea area could be of great importance in strengthening common rules and ways of working. The Baltic Sea as an inland sea of the European Union will not be realised until the common rules are implemented. Particular attention should be paid to the strengthening of good governance in the Baltic Sea region.

The Baltic Sea needs a regionalisation strategy, Third Wave of institutions of cooperation. This calls for a contribution of all actors in the area. Co-operation also requires organisations and institutions that bind the projects and their implementers together. A new dimension is provided by the expanded European Union that will change the rules and ways of working in the Baltic Sea economic region.

The challenge, but at the same time a great opportunity, is closing the welfare gap that divides the region. The poorest member countries of the European Union (the Baltic States) are also the fastest growing economies in the EU. Their goal is to close the gap in the standard of living and welfare. The Nordic countries are among the wealthiest economies of the European Union, but suffer from fairly slow economic growth. They are searching for a means to preserve the welfare they have achieved.

Closing the cap would contribute to the economic competitiveness of the Baltic Sea area. The region needs a regional Lisbon Strategy. The Lisbon strategy offers a common framework to eight EU member countries. The most successful participants in the strategy are the Nordic countries and Germany. Channelling this success as the Lisbon strategy of the Baltic Sea is a major common challenge. The “Lisbon strategy of the Baltic Sea” should be made a common goal in the area.

It is impossible to envisage the Baltic Sea region without taking into account the Russian areas on the Baltic Sea. Both St. Petersburg and Kaliningrad areas are among the fastest growing economies in Europe. Connecting them as part of the Baltic Sea entity would open up new possibilities to the development of the Baltic Sea economic region as a European area. The relationship between the EU and Russia offers the framework for the participation of Russian areas bordering the Baltic Sea in the co-operation in the region. The streamlining of this framework is one of the key challenges of Finland’s Presidency of the EU in autumn 2006.

The Baltic Sea now needs first of all an independent review of its institutions and instruments of cooperation. Quite many of the second way organisations seem to have lost their mission and stamina. This concerns in particular the civil society networks. But also governmental organisations should openly and critically review their activities and missions. This is in particular the case with traditional Nordic institutions.

A wider perspective is needed if the interests of the Baltic Sea are to be articulated and transformed into action. Quite obviously there is overlapping between existing institutions. Review and critical assessment of the existing institutional structure is needed for the reconstruction of the Baltic Sea cooperation. This is going to be the first task of the Centrum Balticum, a new think-tank type of an organisation that shall open its activities in Turku early autumn this year.

The power of the Baltic Sea area could be much greater in the European Union, if it was able to speak with one voice. The Baltic Sea area seldom presents itself as a unified area, and rarely speaks with one voice. The area lacks a forum needed for forming a common will. This is a particular problem in the decision-making of the European Union and influencing it. There are a number of organisations and agreements between different countries in the Baltic Sea area, but none of them has been founded to channel the power and the common interests of the area outside its sphere.

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A New Wave of the Baltic Sea Cooperation on the Rise: Focus on St. Petersburg

by Esa Kokkonen

Since the revival of the Baltic Sea cooperation in the 1990s, the political agenda, structures and financing instruments for the cooperation have been more centred around challenges of the region than its opportunities. Topics and themes of concrete cooperation activities in the main fields of the Baltic Sea cooperation still mainly concern the solving of acute problems and prevention of environmental and other soft security related threats, as was the case already in the early 1990s. In addition to the still prevailing problem-solving and threat-prevention based approach to the Baltic Sea cooperation, new emerging themes of the cooperation - such as innovation, competitiveness and information society - are rising up the today's agenda for the Baltic Sea cooperation.

During the 1990s and early 2000s, the Baltic Sea cooperation was still characterized by projects and programmes facilitating the EU accession process of the Baltic States and Poland, and supporting Nortwestern Russia in various development needs. This one-way approach with the ones who donate and the ones who receive assistance is now gradually disappearing. Today's Baltic Sea cooperation is based on reciprocity and sustainable and equal partnerships, and knowledge and good practices are moving in various directions across the Baltic Sea. The old EU member countries in the Baltic Sea region are benefiting from rapid economic growth and dynamism in the region's new EU members and Northwestern Russia. This dynamism and innovative spirit is well illustrated by various "tiger leaps" that are taken in different sectors in the Baltic States – such as the astoundingly rapid information society development in Estonia.

St. Petersburg alone, as by far the largest metropolis in the Baltic Sea region, constitutes a highly interesting testing ground, resource base, and first of all, an active developer and future leader of the above presented new wave of the Baltic Sea cooperation. Considering its population of 5 million, rapid economic growth, strong innovative capacity and knowledge base in its numerous world-class universities, the involvement and inclusion of St. Petersburg in practical forms of the Baltic Sea cooperation is still on a surprisingly initial level. There are various reasons behind the fact that majority of unutilized resources and opportunities of the Baltic Sea cooperation stand in St. Petersburg. On the one hand, political and economic structures of the Baltic Sea cooperation still mainly deal with the federal level of Russian politics and economy, whereas actual needs and opportunities concern the Northwestern district. On the other hand, commitment, approach and procedures of relevant stakeholders are still sometimes based on the set-up of the 1990s "old wave" of the Baltic Sea cooperation.

After Moscow, St. Petersburg is by far the second most important center of ICT and information society related expertise in Russia. There is a half a dozen world-class technical universities with major ICT programmes in St. Petersburg. This knowledge base has attracted various major international ICT companies, including Microsoft, Siemens and IBM, to establish their R&D centers in the city. There is also a strong business cluster on programming and software development in St. Petersburg.

When also considering that St. Petersburg city administration is strongly committed to information society development by actively developing eGovernment services and infrastructure, it is easy to understand the multitude of opportunities St. Petersburg offers for ICT cooperation in the Baltic Sea region.

Considering innovation promotion as another key theme of the new wave of the Baltic Sea cooperation, St. Petersburg again constitutes a highly interesting area. The development of the regional innovation system is among key priorities of business development and investment promotion policies in St. Petersburg. Various technology centers and science parks are currently under preparation, and there is a strong interest to utilize e.g. Nordic technology center and business development concepts and practices in St. Petersburg. Regardless of strong research and development capabilities and innovation potential in universities in St. Petersburg, there is a major deficiency as regards the ability to turn scientific potential into economic results. Furthermore, there are significant defects in the protection and enforcement of intellectual property rights (IPR), including an alarming problem of large-scale counterfeit production as the most visible sign of the IPR problem.

In spite of the rise of the new wave of Baltic Sea cooperation emphasizing more opportunities than problems, environment still remains as the most important sector of the Baltic Sea cooperation for a long time. The Baltic Sea is one of the most polluted seas in the world, and its condition is so severe that it takes decades to achieve significant and sustainable improvements. As regards the strengthening EU-Russia partnership and the Northern Dimension as key elements of the Baltic Sea cooperation, and the crucial position of Northwestern Russia and St. Petersburg in the region, it is noteworthy that the Baltic Sea region is continuously facing serious risks caused by insufficient nuclear safety in Northwestern Russia, and increased transport of Russian oil through the Baltic Sea. Furthermore, so far only initial steps have been taken in the development of effective wastewater treatment in Northwestern Russia. The above mentioned risks can be managed only in close cooperation between the EU and Russia, and with effective and dynamic structures and instruments for the Baltic Sea cooperation.

Both the above presented opportunities and challenges call for further development, innovative ideas and well-tailored financing instruments for the new wave of the Baltic Sea cooperation. On its part, the Baltic Institute of Finland (BIF) is actively contributing to this task through its versatile project portfolio with St. Petersburg. BIF projects in St. Petersburg encompass a variety of both bilateral and multilateral cooperation activities from IPR to environment protection, and from eGovernment to construction sector.

Esa Kokkonen,

Director, The Baltic Institute of Finland

The Kaliningrad oblast and co-operation in the Baltic region

by Gennadiy Fedorov

Co-operation between Russia and the EU also could be stimulated by deepening of their interaction on the Baltic Sea region arena, while the Kaliningrad oblast should play an active role in this process. The well-known project "The Northern Dimension of the EU" is now transforming into the greater project "The Baltic dimension". The Baltic dimension project inscribes the Northern countries as well as Poland, Lithuania, Latvia and Estonia. Germany can also play an active role. North-West of Russia, including the Kaliningrad oblast, could be involved in this project too. Russian participation in this project would allow for more effective integration with the EU (40% of Russia's trade with the EU comes to Baltic Sea countries). Certainly, Russia is interested not only in trade. Other economic aspects of high importance are the investments, tourism, telecommunications etc. Cooperation could be very useful in others spheres of the Baltic dimension project, such as science and education, culture and sport, security and politics.

Kaliningrad oblast is an active member of many organizations for Baltic Sea region co-operation. The participation in these programs contributes the development of practical co-operation, contacts adjustment, promotion of different regions and investments attraction. But unfortunately, funding of co-operation projects by Russia (including the research projects) is insufficient.

The list of projects of the Baltic Sea countries and regions that are being actively implemented also includes the following ones:

- "Via-Baltica", "Via-Hanseatica"– the projects of motorways development, connecting the countries of the region;
- "The Baltic gateway" – the project of the network of motorway and ferries;
- "The Baltic energy ring" – the project of energy system development;
- programs of the Baltic Sea cities cooperation;
- ecological programs concerning the Baltic Sea basin; and
- educational programs ("The Eurofaculty", "The Baltic University
- Programme" – the Kaliningrad state university takes part in these programs very actively).

Kaliningrad is involved in many projects, but often only nominally. One of the projects that might be of interest is VASAB – 2010 ("Vision and strategies around the Baltic – 2010"), which is based on such values as development, environmental sustainability, freedom and solidarity. The document consists of four spatial elements, which could be studied and implemented for the case of Kaliningrad region as well:

- cities and urban networks;
- power system and transport networks;
- territories, supporting dynamism and the quality of life (such as the border territories as an instrument of international exchange; tourist territories; coastal zones, demanding special attention; natural and cultural landscapes of special importance); and
- comprehensive spatial planning.

To lower the drawbacks of the exclave character of the Kaliningrad region it is necessary to include it in the new spatial forms of international economic integration. These are the establishments of the sub-national level including regions of several states and featuring active cross-border and interregional cooperation, constantly growing level of the socio-economic integration. These include "large regions", "triangles of growth", "working communities" (associations etc), Euroregions. Euroregions are especially actively established and are functioning in the Baltic Sea region. They develop joint strategies, pull together financial means for solving common problems and for the implementation of interregional projects. The establishment of Euroregions with Russia's participation started as early as in the second half of the 1990s.

The participation of Russian regions in the Euroregions certainly differs from that of the regions of the EU countries (since Russia is not a member of the EU, and it does not seem to be going to enter it). Nevertheless, we hope that in the course of time the differences will be eliminated.

The Kaliningrad region and its municipalities are members of 5 Euroregions: Baltics, Neman, Sheshupe, Saule, Lyna-Lava. The region most actively participates in the Euroregion "Baltic" Its national secretariat is in Baltiysk. The Council and Presidium have been established. Three working groups (those of environmental protection, spatial planning and social issues) have been formed. Future joint projects have been planned and among them are the following ones: SEBTrans-Link, connecting Russia to the EU countries, projects aimed at tourist and resort infrastructure development, security in the Baltic Sea region, networks of analytical and information centres, and that of public health service. There are projects aimed at the reconstruction of the old part of Baltiysk and the setting up of a new international multi-purpose centre on the Curonian Spit. The implementation of the "Seagull project" (aimed at the elaboration and development of the Euroregion strategy), launched in 2001, is going on. This project is financed by such European programmes as Interreg, Phare, Tacis.

There is an interesting proposal by Urpo Kivikari (Finland) about "the South Baltic growth triangle". This concept proposes to use first of all:

- investment from Sweden, Denmark, Germany;
- work force from Poland, Lithuania, Latvia;
- raw materials from Russia through the Kaliningrad oblast; and
- the combination of these three elements could give a significant effect.

This idea is quite attractive for the Kaliningrad region, because its territory fits with the project considered for the implementation.

Gennadiy Fedorov

Professor Gennadiy Fedorov is a pro-rector of research and Dr Valentin Korneyevets a senior researcher at the Immauel Kant State University of Russia

The importance of higher education to attract investment and contribute to sustain economic growth and competitiveness in Kaliningrad

by Eric Brunat

The Socio-economic situation in Kaliningrad region

With a population of just under one million people, Kaliningrad region is in the paradoxical situation of being adjacent to the rapidly developing new EU member states (Poland and Lithuania), whilst being held back by its post – soviet legacy of struggling to adapt to a market economy. Despite significant growth over the recent years, and under-investment in old, over-manned industries, and combined with a too and fragile SME and services sector, these are the major defining characteristics of an economy that is falling behind its neighbours. At the same time the regional and municipal administrative structures are also in need of further guidance with reform measures and need assistance in developing a productive relationship with the private sector. This is needed at both the strategic planning and economic development framework level in order to buttress the vital socio-economic regeneration that the region requires.

On the one hand, it is in response to this major structural dislocation between public and private sectors, and the consequent inability of one sector to support the other, that the European Union is co-operating with the Regional Government in developing the concept of a 'public private-partnership' for strengthening business and administrative education in the region. A unique, brand new state-of-the-art MBA/MPA degree programme, including an innovative 'Integrated Cross Modular Learning Programme', is being developed involving major higher education institutions in the region. This will allow civil servants and business managers the opportunity to study a combination of modules covering public-private sector subject areas. This will hopefully, contribute to both retaining the best brains and attracting new competences, to the region as a whole. The expected impact on productivity, best commercial practices, and increased competitiveness should give a huge impetus to economic development in Kaliningrad. The expected economic growth will act as a pole of attraction for further forms of investment from European Union institutions in the framework stipulated by the new Law on Special Economic Zone, based on the new tax benefits in force since April 2006.

On the other hand, the strategic location of the enclave, adjacent to the Baltic economies, provides a great potential opportunity for economic and social interaction and growth, assuming that these fundamental structural weaknesses can be addressed and corrected. However, the continuing inadequacies of the higher education/training sector in providing updated, western-style public-private sector education and training, is acting as a brake upon the sustainability of any socio-economic revival in the region especially in the area of post graduate studies. Despite action underway, there is still a question mark whether this economic growth is sustainable over the medium term, and this can be summarised as follows:

The structure of growth is not sustainable because of a lack of national and foreign direct investment due to high transaction costs. The impressive exceeding of 10% GDP growth achieved so far during the period 2001-04, is more than for Russia as a whole. This pattern of growth is characterised by a lack of contribution from medium-sized firms and a short life-expectancy for small businesses. The big firms occupy probably too large a role in this 10% growth. Moreover, the demographic trends are very bad, with young people leaving the region, and these trends could have a major detrimental impact on the labour market in the medium term, and on the recruitment of students into higher education. So therefore, it is urgent to innovate at the post-graduate studies level to make the region more effective and attractive, keeping the best young people and attracting the best managers from other regions of Russia, and possibly from the EU and neighbouring states.

In addition, after the enlargement of the European Union it became more crucial than ever to identify the comparative advantages of Kaliningrad region within the globalisation process and the world economy.

Such problems are thus compounded by difficulties in the higher educational and training sector being able provide the requisite advanced forms of business and public sector education that is needed to streamline, stimulate and transform business management education and public sector training; thus the capabilities of enterprises and municipal authorities is being held back by an inability to fully exploit the real market and services potential that exists for them. Training needs analyses of companies and of existing higher education and training institutions, show weaknesses in the following areas:

1. Difficulties are being experienced by institutions in fully embracing the student-centred learning methodologies
2. An insufficient or even non-existent relationship, between the higher education sector and companies and municipal authorities, and a corresponding mismatch between the training needs of the public/private sector, and the services presently available from the education and training providers
3. An inability to provide the necessary diagnostic analysis of enterprise problems, resulting in a continuing lack of much needed consultancy assistance and in-company training for managers
4. The dearth of understanding and skills in how to use experience-based teaching and learning methodologies and to contextualise training in a comparative case study framework, that relates to real life public-private sector needs
5. The lack of strong partnerships with leading European Union higher education/training institutions has resulted in Kaliningrad training providers failing to act as a necessary conduit for the latest knowledge and skills transfer to either business agents or civil servants.

Business Awareness about SME Clusters

A dominant characteristic of the economic configuration of Kaliningrad region is the lack of a developed and substantial SME sector. A number of foci could be identified around which the potential stimulation of new SME formations could take place. It is of crucial importance to strengthen the economic fabric that contributes to the emergence of new SMEs to increase the density of firms, and to reach a critical mass to increase the competitiveness of the Kaliningrad region through a virtuous cycle from investment and production to growth. In this context the clusterisation could to some degree be an

outcome of any development of postgraduate studies. It is of crucial importance to systematise the dissemination of the latest tools for teaching local and regional economics. To reach these goals the modalities of local governance, the Corporate Social Responsibility and the Public-Private-Partnership concepts are amongst the major principles governing the cultural and socio-economic development. Applied research must focus much more upon the conditions of SME development and sustainability, in short the relationships between them, and with local institutions, big firms and of course with Universities.

These are of crucial importance for facilitating the process of bottom up development. They will also relate to the consultancy and training needs including the upgrading of labour performance and customer service needs, which will be of critical importance for their orbital development around the larger firms.

This would aim to encourage an enterprise culture, to unleash entrepreneurship and could in the medium and long term be a significant positive impact on the labour market, especially for the next generation of Kaliningrad's entrepreneurs, and for SME start-ups and spin-offs.

Regional and Administrative Reform: a key component of Kaliningrad's growth and development

In a globalised and complex economy the private and public sector are intimately bound together in delivering a concatenation of socio-economic, municipal and administrative services to citizens and clients alike. Inward investors are attracted to regions not just by low labour costs but by the quality of social, educational and administrative support services provided by the host region or country.

To attract to, and then retain this investment in Kaliningrad it is vital that this whole package of services is upgraded to EU levels and where possible close to the requirements of Acquis Communautaire. Success on the economic front will not be sustainable in the long term if the public and social services are not streamlined to meet this fast changing world. Practical reforms such as decentralising budgets, educational reform and the growth of a customer-care services culture, based on responsiveness to needs will be critical for supporting economic improvements for local people, to sustain the growth and to translate it into an attractive human development.

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A Good Foundation for the Future

by Per Stig Møller

The course of events in the Baltic Sea Region has in many ways been extraordinary. The Cold War is merely 16 years away, but in that short time span the region has developed into a very peaceful and prosperous one with crosscutting cooperation among all the countries in the region. Indeed a prime example of development and restoration of relations. Looking forward, regional cooperation is the answer to many challenges.

A prime example

The peacefulness and prosperity of the region has been consolidated through extensive and multifaceted cooperation. A fair amount of good will from all parties has been an important ingredient. Organizations such as the Council of the Baltic Sea States (CBSS) and others have provided important channels of communication for political leaders and officials. Citizens, NGO's, municipalities and private businesses were quick to find ways of exchange and cooperation, laying the ground for restoration of ties at all levels.

In the beginning, relations focused mostly on how we could help the Eastern European countries in their transition from a communist system to democracy and market economy. Ranging from good-lawmaking over the environment and military to advice on business, the projects were as multifaceted as they were constructive. Soon however, such projects became obsolete – one example being the fulfilment of the mandate of the CBSS Commissioner on Democratic Institutions and Human Rights in 2003. Early on, the perspective of EU and NATO membership was a driving force. Denmark played a major role in the fulfilment of that vision. Likewise the Partnership for Peace (PfP) initiative has been a major priority, encompassing not only the countries in the Baltic Sea Region, but also countries in the perimeter of the region. We are now all partners in the EU, NATO and other international fora. The question thus arises: how can our regional cooperation contribute in the future?

Looking forward

In a globalized world, where one does not necessarily look to ones neighbours first, developing regional relationships is still an important priority. True, we cooperate in the UN, EU, NATO and other organizations. There are however areas in which regional cooperation is the best approach or a needed supplement to ongoing cooperation at other levels. Moreover, existing regional initiatives could benefit from being expanded and deepened.

Take the environment for example. The countries in our region border the same sea, and we are all interested in preserving its wildlife and keeping it clean. A lot has been achieved through regional cooperation in this area, but we have to continue our efforts to the benefit of our citizens and future generations.

Another important area is energy. We all have an interest in working together to secure energy supplies and develop new and efficient technologies. Through cooperation we can achieve an adequate supply at competitive prices while still focusing on preserving our environment.

Health, especially when it comes to communicable diseases, is another area where cooperation is important. One compelling example is the recent spread of bird flu. Further efforts are also necessary to combat transnational crime, including trafficking and child abuse, which are serious problems in our region today.

All this said, it is important to stress that regional cooperation should bring additional value to the countries. We should not duplicate efforts of other organizations, nor should we cooperate just for the sake of cooperation. Instead, we should focus on areas where regional cooperation is the natural answer.

Together in a globalized world

These are all concrete ideas for further cooperation. There is however one more reason why cooperation of the Baltic Sea States makes sense: Globalization. Each country will benefit from being located in a strong and prosperous region, where business and welfare thrives. We must be economically and politically strong and we must have something to offer. We have to work together to develop our region further.

Research and development is a strong Danish priority, as it is for many in the region. Some countries in the region exhibit an incredible dynamism and vitality, displaying annual growth rates of 5-6% and thriving businesses. We could learn something from the entrepreneurial environment and we could offer cooperation in research and development. The EuroFaculty program and other such initiatives have laid the grounds for an extended cooperation in research and development, as has the many contacts between businesses.

Our region has a long history of cooperation and trade dating back to the Hanseatic League where the region prospered for the first time. We are so similar in many ways and have such a long common history – according to the legend, the Danish flag appeared across the Baltic Sea in Estonia. The pause in our relations represented by the Cold War was just that, a pause. By working together and building on our joint history, much more can be achieved in the future.

Dr. Per Stig Møller

Minister of Foreign Affairs, Denmark

Baltic Window of Opportunity

by Alexander Stubb

The latest enlargement of the European Union made the Baltic Sea - with the exception of Kaliningrad and St. Petersburg areas - something of an EU inner lake. A northern and modern version of mare nostrum, you might say.

After a long period of division and confrontation, the Baltic Sea is once again a gateway for free movement of people, goods and services. Upcoming Finnish and German EU presidencies open a window of opportunity for strengthening the region's economic integration within the EU framework.

In theory, EU's regional and cross-border cooperation should be conducted via the Northern Dimension Policy (ND), established already in 1999. The ND, however, is a part of EU's external relations policy and is often seen as a regional application of the EU-Russian co-operation. EU's Baltic Sea co-operation lacks an inner pillar - A Baltic Sea strategy.

The goals of any regional co-operation are stability, prosperity and sustainable development. In other words, we should be dealing with security, economic and environmental policies. I will concentrate in this article on the economic point of view.

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According to the Baltic Development Forum the Baltic Sea Region outperforms European peer regions in competitiveness. We have a strong physical infrastructure, skilled labour force and good educational systems. Still, the region's prosperity is far below peer regions. This can not be solely explained by the Communist period.

The region's main economic problem is the combination of the unfinished European internal market on one hand and our relatively small national markets on the other hand. Together these two factors lead to low competition and low efficiency. The Baltic Sea Chambers of Commerce has pointed out this problem in its 3T campaign: triple trade in ten years. One of the conditions for achieving this aim is to drop all temporary restrictions on the new member states' rights in the internal market. Adoption of the euro in the Baltic States and Poland will also help in further integrating the national economies of the region.

The difficulty of translating theoretical competitiveness and excellent education into economic prosperity is a common feature of almost all member states in the region. One of the key reasons is, once again, the small size of the national economies. This tends to concentrate business-sector R&D in a handful of large companies that rarely leave any breathing space for SMEs and strong clusters to emerge. The region needs a common innovation strategy.

Long distances are a distinctive feature of the region and make efficient logistics all the more important. Current transport systems are unfortunately designed mostly for national needs and are partially unable to meet the needs of growing goods and passenger transport in northern Europe. On top of its own intra-region trade, the region could also benefit transit trade thanks to its position as a link between East and West. This requires strong investing in e.g. sea transportation and the Via Baltica.

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EU, Iceland, Norway and Russia are now negotiating new guidelines for the Northern Dimension from 2007 onwards. The practical work should be completed by September. The intention is to include the EU's partner countries more fully to the decision-making of the program and possibly include a new pillar on transport to the program. Finland, that put forward the original proposal for the Northern Dimension in the first place, plays a key role in this work.

This is all good, but will not answer the need for genuine internal co-operation. The region has the potential to become the economic core of Europe and it has an enormous task in saving the fragile sea itself from pollution. This can not be done without a sound political framework, including the Council of Baltic Sea States and the Nordic Council of Ministers.

The European Parliament has already expressed its view on the need for a Baltic Sea Strategy. The ball is now in the member states' court.

Alexander Stubb

Author is a Finnish member of the European Parliament (EPP-ED)

Perspectives of Baltic Sea Co-operation and the Role of the Council of the Baltic Sea States (CBSS)

by Gabriele Kötschau

The dissolution of the former Soviet Union and the breakdown of the Berlin Wall led to significant changes in Europe, including in the Baltic Sea Region. Once such major change that took place during the end of the 1980s and the beginning of 1990s was the establishment of numerous regionally focused organisations, all which aimed to develop and secure stability and prosperity in the Baltic Sea Region. Among these organisations were the "Baltic Sea Parliamentary Conference" (BSPC, 1991), the "Council of the Baltic Sea States" (CBSS, 1992), the "Baltic Sea Chambers of Commerce Association" (BCCA, 1992) as well as the "Baltic Sea States Subregional Cooperation" (BSSSC,1993), the "Union of the Baltic Cities (UBC, 1991), the "Conference of Peripheral Maritime Regions of Europe – Baltic Sea Commission" (CPMR-BSC, 1996) and the "Baltic Sea Seven Islands Cooperation Network" (B7, 1989). Additional networks were established in the southern and northern regions of Europe, such as the "Black Sea Economic Cooperation" (BSEC, 1992) the "Central European Initiative" (CEI, 1989), as well as the "Barents Euro-Arctic Council" (BEAC, 1993) and the "Arctic Council" (AC, 1996; AEPS 1991).

The Baltic Sea Region is today at the "forefront of the enlarged European Union (EU)", situated within the core of the EU. It is without doubt that the latest EU-enlargement in May 2004 was yet another important milestone for regional co-operation in Europe. From a forward-looking perspective, there is good reason to believe that this enlargement will lead to better economic and social conditions for all, including in the countries that neighbour the European Union.

The CBSS, established by the region's Foreign Ministers in Copenhagen in 1992 as a response to the geopolitical changes in Europe, consists of eleven Member States and the European Commission. Notably, since the enlargement of the EU, eight out of the eleven CBSS Member States have become members of the EU. The valuable and constructive cooperation between the EU- and non-EU Member States within the CBSS is one very important, but not the only part of the colourful spectrum of activities in our region. The diversity of experiences in the countries around the Baltic Sea, stemming from their different systems, cultures and traditions, are an enriching factor for our entire area. Similarly, a shared history and a strong collective will to achieve economic growth and ecological development provide the driving forces for building a prosperous future and meeting the challenges globalisation. The increasing level of cooperation and networking in the region have promoted security and stability not only in the Baltic Sea Region, but also for the whole of Europe!

The newly independent states have, to differing extents, largely transformed themselves in just fifteen years – less than a generation. In particular, four of the new EU member states belong to the Baltic Sea Region. This process of transformation is ongoing, and, needless to say, it is already apparent that reforms are being implemented increasingly from the East, not from the West. Their economies are developing at a commendable pace and conditions are ideal for enhancing competitiveness. Moreover, these countries have a strong political will to capitalise on the present opportunities, and most certainly, their peoples are equipped with the skills required to see such changes through.

Whereas at the outset, the CBSS was mainly a forum for fostering trust and confidence – as well as for increasing cohesion between the countries with differing political, economic and historical backgrounds – the organisation today faces new challenges in developing and promoting issues of common interest.

To develop the Baltic Sea Region, we need close and constructive co-operation with the Russian Federation. As a full member of the CBSS, Russia participates and contributes to regional work at equal footing with the other member-states and the European Commission. This fact makes our framework for interaction an important element in the ongoing EU-Russia dialogue concerning the creation of the four Common Spaces. The CBSS cannot replace bilateral dialogue between Russia and the EU-member states, or between Russia and the EU itself. Their relations, however, can be strengthened through enhanced cooperation in the fields of common interest, while respecting the need for more flexibility and pragmatism.

In addition, there is an obvious need for closer co-operation with the EU's new neighbouring countries, especially as this cooperation relates to Ukraine and Belarus. Already an observer-country to CBSS, Ukraine is now working to improve its contacts and concrete cooperation with the Council. As to Belarus, co-operation with the "family" of the CBSS working structures presently takes place on a practical level. Identifying and enacting solutions to the problems of illegal migration, organised crime, the trafficking of human beings and the spread of communicable diseases (including combating the spread of the bird flu!) require that we co-operate closely with all our neighbour countries in order to achieve success. This vision of "broader co-operation" should be treated as an opportunity to establish security and stability in a wider Europe, as well as an opportunity to solve common problems through joint efforts.

The variety of cultures found in the Baltic Sea Region makes the area very attractive, as well as the presence of well-educated and highly motivated people. To this end, the Euro-Faculties have hastened the extent of integration in the European higher education environment. Let us now focus our attention on activities that enhance cross-border learning and research, in order to make the Baltic Sea Region a region of knowledge, a region of tolerance and mutual understanding. Let us also give young people the tools to get to know their neighbours, their cultures, traditions and languages. By offering internships and scholarship opportunities at the CBSS Secretariat in Stockholm, the CBSS attracts young people from Iceland to Russia, from Italy to the United States.

Although we must admit that there still is a lot of work to do (as for example in the case of the removal of barriers to trade and investment in the region), and there still is a certain lack of overall trust and confidence in our region, the Baltic Sea Region is an excellent example of cross-border-cooperation and of the integration of regions in the developing area of Europe. Very importantly, dialogue and cooperation must continue; while concrete projects on all levels, including those emphasising the people-to-people-approach and the valuable role of NGOs, can contribute to further confidence-building and an optimal level of development.

This concept has proved to be successful for more than a decade and could potentially serve as a model for other regions in Europe and globally. The exchange of information and experiences with the Black Sea Economic Cooperation, but also with other regional organisations could be of value in working towards the peaceful and successful development of the whole of Europe and beyond. The CBSS is ready to actively contribute to the success.

Dr. Gabriele Kötschau

Director of the CBSS Secretariat

Development of the Kaliningrad Region - New Perspectives

by Felix Lapin

The Kaliningrad region is a special region of Russia endowed with a number of unique competitive advantages as concerns the location of industrial enterprises and implementation of investment projects.

Without any exaggeration the region can be considered as one of the most dynamically developing regions of the Russian Federation. It is proved by growth of the economy, volumes of the industrial production, wide range of trade links, cargo turnover of the Kaliningrad ice-free port. According to the experts' estimations in 2006 the growth of domestic regional product will make 14,6%, whereas the increase in the national average DGP will make only 7,8%. The growth of industrial production in the Kaliningrad region made 57% (whereas the Russian average was registered at 9%).

In the Kaliningrad region the most important industries are mechanical engineering, metal-working, wood-processing, food industry, fuel and energy complex. Composite processing production index reached 104% in January-December 2005. The most significant increase was in wood processing industry – by two folds, food industry – 117%, textile and clothing manufactures – 112,3%.

The dynamics of development of the external economic ties demonstrate that the region gradually becoming a large center of export and import operations. At present, about 300 enterprises in the region are engaged in export of their products to over 70 countries of the world. The structure of export is dominated by oil, fish products, vessels and boats, fertilizers, cellulose pulp, products of inorganic chemistry, ferrous and nonferrous metals and products manufactured of these metals, paper and cardboard, machine-tools, machinery, and equipment.

Increase of import is determined by the establishing of local enterprises dealing with automobile and household appliances assembling, manufacturing of ready-made fish and meat production, and rapidly developing construction industry.

The main factors, which determine economic development of the Kaliningrad region, are the following:

- Nearness to European markets
- Intersection of inland, water and air ways and routs of transportation and communication.
- European and Russian railroad gauges
- Ice free ports
- State policy of the Kaliningrad region
- Determined priorities for the future regional development
- Special economic zone (two laws on SEZ in vigor)
- Federal Target Program for Development of the Kaliningrad region up to the year 2010
- Wide experience of international cooperation
- Region of cooperation between EU and Russia on social, economic and political development.

Implementation of the Special economic zone (SEZ) on the territory of the Kaliningrad region laid the groundwork for sustainable and dynamic development of the region. Legal status of the SEZ was determined by the Federal law "On special economic zone" from January 22, 1996. Changes happened in the Kaliningrad region and Russia as a whole, determined the necessity to adjust the existed regime of the special economic zone to new realities. The new version of the law, signed by the President of the Russian Federation on January 10, 2006 became the result of active work on the regional and federal levels. This law comes into force since April 1, 2006.

Preferences for investors are summarized in the table below: The new law will provide favourable investment climate, boost competitiveness of the produced goods, and create effective mechanism for the economic relations in the Kaliningrad region, which contributes to the development of exclave as a region of Russian-European integration.

It is clear for the Government of the region, that there is a necessity to accomplish the targeted transformation of the regional infrastructure in the nearest future. First and foremost, it concerns the following perspective activities:

- Encouragement of export-oriented production
- Development of import-substituting production
- Encouragement of innovations, research and development activities in production
- Implementation of resource-saving technology
- Development of small-scale power generation (compact water-driven power station, wind-powered generator, bio-fuel etc.)
- Positioning of the Kaliningrad region as an export site to European and USA markets
- Adaptation of EU and Russia standards on industry, ecology, infrastructure etc.

There is still a lot of work ahead aimed at large-scale development of energetic and transport complexes of the region. On the top priorities is the development of tourism, creation of resorts, leisure facilities and scientific centers. The Kaliningrad region is ready to provide support to all companies coming to the region with mutually beneficial proposals.

Felix Lapin

Minister of Economic Development

The Government of the Kaliningrad region

The Kaliningrad Region	
SEZ of the Kaliningrad region: two preferential regimes for investors	
Customs preferences	Tax preferences
- Established for the enterprises, which have been registered in the Kaliningrad region before April 1, 2006 and which enjoy preferences, provided by the Law from 26.01.1996 №13-FZ - Foreign goods imported in the territory of the region should be exempted from customs duties and taxes. - Goods exported from the Kaliningrad region to other regions of the RF should be exempted from customs duties if: - the commodity classification code has changed at the level of any of the first four digits - the share of the added value has reached 30% These conditions of SEZ will function for 10 years	**Pre-conditions**: -make **capital investments** -the volume of capital investments should be no less than **150 million rubles** -investment period for capital investments should be **three years** **Benefits for investors:** **-Income and property tax** rates are: -0% for the first 6 years -50% reduction from tax for the next 6years -guarantees to the investors are provided by the law -the law will function for **25 years**

Prospects and Challenges of the New Law on Kaliningrad Special Economic Zone

by Elina Pelto

Kaliningrad region is in many ways unique among Russian regions: it is the smallest of Russian regions, the youngest subject of the Russian Federation and the most western part of Russia. But first and foremost, it is the only enclave region of the Russian Federation.

The special location of the Kaliningrad region has worried Russian authorities since the region became separated from the rest of the country after the disintegration of the Soviet Union. In order to help the economic development of the region and ensure the supply of inexpensive consumer goods from abroad, the Yantar Free Economic Zone was created in Kaliningrad in 1991. In 1996 it was replaced by the law on Special Economic Zone (SEZ), and in the beginning of this month a new law on Kaliningrad SEZ came into force.

The SEZ regime from 1996 was based on free customs zone where the goods imported to the region were exempt from import customs duties and other customs levies. Also the goods produced in the SEZ and 'exported' to main territory of Russian Federation were exempt from customs duties and not limited by import quotas.

The status of SEZ was hoped to improve the region's economy and its population's living standard with the help of foreign trade and investment. However, the goal was not fully achieved: whereas the foreign trade of Kaliningrad region – especially imports – has grown substantially and the region has become a favorable import channel to the Russian markets, foreign investment to the region has remained very modest. Furthermore, the regime offering substantial customs privileges is considered to have contributed to the decline in the local industrial output as many local producers failed to sustain the pressure of cheap imports. Although the industrial production of the Kaliningrad region has experienced relatively strong growth in the last few years, the economic development of the region is hoped to yet improve with the help of large investment projects that the new law on Kaliningrad Special Economic Zone is expected to attract to the region.

The new law on Kaliningrad SEZ was accepted in January 2006, came into force in the beginning of April 2006, and will be in force for at least 25 years. The new law offers tax breaks for new but sizeable investments: companies who invest at least 150 million rubles (USD 5.3 million) in the Kaliningrad region's production over a three year period are exempt from paying tax on profit (24%) and on property (up to 2,2%) for six years. For the following six years, investors are given a 50 percent discount on profit tax. However, for the companies that have been active in the region before the new law came into force, the customs privileges of the former regime will remain unchanged during a ten year transition period.

Already before its implementation, the new law created active debates over its pros and cons. First of all, the ten year transition period when both old and new regimes co-exist can, on one hand, be seen as a good idea, as firms operating in the region need some time to adjust their business processes and too fast changes might be disastrous for the region's economy. On the other hand, two simultaneous SEZ regimes create a complicated situation where some firms are entitled to the tax breaks of the new regime, some firms to customs privileges of the former regime, and some to neither. The complexity requires more administrative capacity and control as the situation can easily lead to companies finding loopholes in order to minimize their taxes.

Secondly, the law offering privileges to large investment projects only, have not been welcomed by all. Some firms already operating in the region may find the legislative change debilitating their competitiveness. Small and medium sized enterprises (SMEs) are left outside the benefits of the new regime, although SMEs are generally considered to be one of the main sources of growth, economic flexibility and employment. Furthermore, probably the most promising regional cluster developed from the scratch within the last ten years in the Kaliningrad region is the furniture industry where the companies clearly belong to the group of SMEs.

Also the average foreign investment in the region is substantially below the limit required by the new law. Potential for attracting great amount of large new industrial companies to the region may be diminished also by the lack of available labor. Unemployment in Kaliningrad region is relatively low: on the first half of 2005 the official unemployment level was 1,7% and according to the ILO 4,5%. This is lower than in Russia on average and in the neighboring Lithuania and Poland.

Thirdly, the whole idea of offering tax breaks in order to attract large amounts of (foreign) capital to the region has been criticized. International evidence have shown that tax relieves do not play key role in firms' investment decisions. More important than tax breaks or customs privileges is a fair and predictable business environment. In this respect, probably one of the most important measures taken in the new law is securing its minimal term of existence for 25 years. The discussions of the destiny of the previous regime created uncertainty among local businessmen in planning their future activities. Thus, the new law is likely to strengthen the economic stability of the region, and decrease the investment risk.

The unique location of Kaliningrad region surrounded by the EU and the Baltic Sea could be seen not only as a disadvantage for the region's development. The location close to the European markets with relative good transportation connections certainly offers potential for the Kaliningrad region to become an important foreign trade hub in Russia. Only future will show how well the new SEZ regime manages to fulfill the expectations and attract also export oriented investments to the region.

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Co-operation and New Thinking Required for Protecting the Baltic Sea

by Juha Nurminen

The Baltic Sea is the most polluted sea in the world. Its biggest problem is eutrophication, i.e. the increase of basic biologic production caused by nutrient loads in the form of phosphorus and nitrogen. All seafarers are familiar with the symptoms of eutrophication: slimy shorelines, decreased visibility and, above all, the blooms of blue-green algae abundant every summer. Our common sea is in urgent need of practical and efficient protective measures. This is the eleventh hour for researchers and environmental actors, the public and private sectors and, above all, different countries to start addressing the problems as a unified front.

When the sea is in a state of distress, we must launch our efforts by analysing the overall situation. The metaphor about a doctor by the bedside of a dying patient is apt: we should set our priorities for the most urgent operations. St. Petersburg is by far the largest single source of pollution. More than 40% of all algal phosphorus, the key nutrient of blue-green algae, entering the Gulf of Finland originates from the sewage of St. Petersburg. Reducing phosphorus emissions is of primary importance for marine conservation, also in relation to other protective measures: if phosphorus is not eliminated, the abundance of blue-green algae may even increase when nitrogen emissions are being reduced by the states surrounding the Baltic Sea.

This is because the change in the nutritional balance makes the situation more favourable to blue-green algae at the expense of other species of algae. When the other groups of algae have used up all nitrogen, they can no longer proliferate too quickly. The blue-green alga, on the other hand, is capable of absorbing nitrogen direct from the atmosphere that always contains 78% of this element. The blue-green algae exploit this competitive advantage while also utilising the phosphorus reserves that are plentiful in the sea even towards the end of summer. Therefore, the phosphorus emissions of the main source, St. Petersburg, must be reduced immediately in order to avoid any negative side-effects resulting from protective measures taken in Finland, for example.

It is very challenging to try to motivate nations and countries recovering from social upheavals and serious environmental crises to invest resources in marine conservation, particularly when the impact of emissions is only visible after a long delay. The impact of the pollution loads of the 14 states in the catchment area of the Baltic Sea is wide-spread, making the problem everybody's problem. We must work together to solve these problems. Co-operation between the countries in the Baltic Rim is the only way to save the Baltic Sea.

Strategy researcher Michael E. Porter has stressed how important it is to have a thorough understanding of the circumstances and to seek the competitive edge. Looking at the matter from Finland's perspective, one may ask what strategic aces we have in our hands that allow us to stand out from other countries or regions. History shows that this is not the first time we have benefited from co-operation with our neighbour Russia. Co-operation seeks new forms in addition to the traditional ones when neighbourliness is also efficiently utilised for preserving the Baltic Sea. After all, only actions across borders will achieve sufficient changes in the ecology of our endangered sea.

Porter has also outlined a new kind of efficient philanthropy and called for a professional approach to charitable causes. He is challenging the actors to deliberate on the strategically best way to operate using the resources available. Porter emphasises the importance of the strategy — as in business life, it should define ways of setting yourself apart from the other actors and determine the goalposts for the organisation's operations. In order for a strategy to work, it must be put to practical use.

Enhancing charitable operations will have a considerably more significant positive impact on society, which is the basic purpose of the whole operation. The John Nurminen Foundation has endeavoured to apply a new way of thinking for solving the environmental problem. The strategic cornerstones of the Clean Baltic project initiated by the Foundation are clearly defined. During the analysis phase, experts were used to survey the available measures, and from these, a method was chosen that is measurably practical, cost-efficient, quick-acting and carefully defined.

The Foundation initiated the Clean Baltic project, which aims to expedite the introduction of the chemical phosphorus removal process at the main wastewater treatment plants of St. Petersburg. Finnish environmental experts have been stressing the importance of this project for a long time: "Removing phosphorus chemically from the effluent of St. Petersburg is by far the most cost-efficient and quick method of improving the state of the open sea areas of the Gulf of Finland", stresses Ms. Lea Kauppi, General Director of the Finnish Environment Institute.

The Clean Baltic project will cut up to 70% of the phosphorus emissions from the effluent of St. Petersburg, corresponding to 27% of the total algal phosphorus load in the Gulf of Finland and the Finnish Archipelago. This will have the visible effect of reducing the blooms of blue-green algae after just a few years of enhanced phosphorus removal.

The John Nurminen Foundation has proven to be a natural choice for implementing the project: it is agile, non-bureaucratic and independent. It has no hidden agenda; its only goal is to expedite the implementation of a protective measure that is vitally important to the Baltic Sea, which is a good formula for seamless co-operation.

Co-operation with the St. Petersburg waterworks Vodokanal and the City of St. Petersburg has proven to work well. Establishing a relationship of mutual trust, the St. Petersburg water utility Vodokanal has been the most important element of the Clean Baltic project. Vodokanal is now strongly committed to the joint project, which is a good indication of Russia's own willingness to invest efforts in improving the condition of our common sea. As a European city, St. Petersburg will comply with the wastewater treatment norms, as put by Mr. Felix Karmazinov, Director General of Vodokanal.

Curbing the local emissions from St. Petersburg is technically simple, inexpensive and cost-efficient. The Russians have no previous experience with phosphorus removal, which means that co-operation is necessary for speeding up the commissioning process. We do not have a day to waste since the ecologic situation of the sea is rapidly deteriorating.

The project will produce visible results, and is it very cost-efficient. The investments amount to approximately EUR 2 million and the total operating costs of the three treatment plants removing phosphorus are approximately EUR 2 to 2.5 million per annum. In order to implement the project, the John Nurminen Foundation has set up the "Clean Sea Fund", which takes donations from private citizens and enterprises concerned with the state of the Baltic Sea. The project has been received with enthusiasm, which is a good indication of how eager people are to really make a difference when it comes to the state of the Baltic Sea. Thanks to the donated working hours and media space, the fundraising costs are minimal. Many have also wanted to carry the message forward and taken the initiative to challenge their friends to contribute to providing first aid for the Baltic Sea.

We feel that the Clean Baltic project is a good example of a positive international environment project. Borders are crossed in many ways, both between states and between the private and public sectors. These, days, civic initiatives or private sector actors may also possess, in addition to their willingness to do voluntary work, skills or knowledge that is useful in supplementing the efforts of the public sector.

I hope that the practical project initiated by the John Nurminen Foundation will encourage others to join in the work of protecting the Baltic Sea. Where there is a will, there is a way.

Juha Nurminen

The Chairman of the John Nurminen Foundation

Tourism Development in the Baltic Sea Region in 2005

by Thomas Mielke

As UNWTO reported, the year 2005 sustained a sharp upturn in international tourism despite of several events which had a negative influence on tourism, e.g. the tsunami in the Indian Ocean, the war in Iraq, the crisis in the middle east, avian flu etc. The number of international arrivals has increased by 5.5% compared to 2004 (2004: 766 mil.; 2005: 808 mil.). Though the growth in 2004 was even higher (10%) the growth rate for 2005 is still 1.5% over the average annual growth of 4.5%. The prospects for 2006 are good – an estimated growth of 4-5% is to be expected, with a strong increase especially in the Eurozone.

According to the UNWTO, Northern Europe achieved an above average growth level – 7.1%. The main reason is certainly the good summer, an economic recovery in the main source market – Germany and last but not least, the image of Scandinavia as a safe and secure destination.* Germany itself also had a growth rate above average – the hotel accommodation statistic showed a plus of 6.4% for all foreign guests – the top source destinations were Europe and Asia.

In 2005 year there were 64.6 million arrivals (4.3% more than in 2004) in Poland.The considerable growth in arrivals from Germany consists mainly of same-day visitors. It is also worth noting that there was a 12.6% growth in visits from other, non-adjacent, countries of the 15 EU states. Inbound travel, mainly from overseas (USA, Australia, Japan, Korea Rep., Canada) went up substantially: by 27.6%. **

The Baltic countries still show an extraordinary growth rate. In 2005, the number of foreign overnight visitors to Estonia is estimated to have increased to 1.9 million (9% increase compared to 2004). Among them, 1.45 million stayed at accommodation establishments, whereas 0.45 million stayed with friends or relatives or at their own apartments. In 2005, the number of foreign overnights at accommodation establishments increased by 9%, reaching 2.98 million. In 2004, Estonia's total tourism receipts (foreign visitors' expenditures in Estonia and their payments to Estonian transport companies) amounted to EUR 891 mil. Tourism receipts accounted for 13% of Estonia's total exports and 40% of total services exports. In 2005, tourism receipts are forecasted to have increased by 5-6% (final data will be published by the Bank of Estonia in June 2006). ***

The growth in Lithuania is even higher: the number of foreign accommodation nights for the first two quarters increased by 20% compared to the same period in 2004. Europe and especially Germany contributed mainly to this development.

An important factor in this tremendous growth, especially in the Baltic's, is the radical infrastructure improvement. New hotels were opened in all three Baltic capitals – although there is still a lack of tourist accommodation, especially in the summer season. All three Baltic airlines recorded passenger growth despite the advent of low cost airlines (Ryanair, Easyjet). Air Baltic especially dramatically increased its network – offering flights to European destinations and to the CIS area or in 2006, even to Tel Aviv.

Ferry connections in the regions are constantly improved and volume has been increased. For example, the port of Helsinki had in 2005 8.83 mil. passengers – a growth of 2% compared to 2004. The biggest increase was recorded on the Helsinki-Tallinn route: 4%. The Estonian shipping company Tallink became one of the biggest shipping companies in the Baltic Sea region, introducing new ships on the Tallinn – Stockholm line and reopening Stockholm-Riga and last, but not least, by acquiring the Baltic Sea passenger division of the Greek shipping company Superfast which connects Finland and Germany. However competition in the ferry business in our region has become very tough and can be described as having reached overcapacity. Silja Line's Finnjet left the Baltic Sea for good, the ship Silja Opera is for sale and the Birka Princess had been sold.

Also the cruise business developed nicely within 2005. The number of cruise ships and passengers to the Baltic Sea increased. In 2005 Tallinn had 324 cruise ship calls. Last year the amount of cruise shipping was 40% bigger than in 2004, when cruise ships made 232 calls to Tallinn. And the number of cruise passengers rose from 205578 in 2004 to 295424 (including 46322 overnight cruise passengers) in 2005. Compared to these figures Helsinki had 248 cruise ship calls and Copenhagen 284.

In general the year 2005 was a very successful year for all countries in the Baltic Sea region, as our region becomes a more and more well-known tourist destination. No mass tourism, a safe and secure environment and clean nature are the main assets of future tourism development. Also world events like the IAAF world championship in Helsinki in 2005, the world championship in ice hockey in Riga and the football world championship in Germany this year will contribute positively to the tourism influx and the image of our region.

The Baltic Sea Tourism Commission (BTC) was founded in 1983 in Lübeck and is one of the oldest Baltic Sea organisations. The primary aim of the BTC is to promote tourism to the Baltic Sea region. Activities of the BTC are: general information to the public and travel trade about tourism in the Baltic Sea region, financed by membership fees and other contributions from our members. The BTC publication issued annually is "Baltic Sea Breezes". For more information please visit www.balticsea.com or call +46 708 123 580 or e-mail: info@balticsea.com.

Thomas Mielke

Baltic Sea Tourism Commission (BTC)

* UNWTONEWS Year XX, Issue 1/2006
** Institute of Tourism, Warsaw, March 2006
*** By ENTERPRISE ESTONIA/ ESTONIAN TOURIST BOARD as of 7 March 2006.

Riga - the Capital City of Latvia

by Aivars Aksenoks

Riga, the capital of Latvia, is situated in the middle of the Baltic States on the Southern coast of Riga Sea Gulf of the Baltic Sea. Historically the development of Riga city has been largely determined by geographical location. The fact that Riga is situated in the centre of Latvia and the whole Baltic Region, as well as on the crossroads between the markets of European Union and the Eastern regions contributes to the improvement of social and economical situation of the city nowadays. Today Riga has become a well-developed and competitive metropolis with versatile economics and diverse culture in the Baltic Sea Region.

Since the second half of 1990 when the development of Latvia economics restarted, Riga has increased its role in the national economic and social processes at a considerably faster speed than the other regions of Latvia. Nowadays Riga with its stable economical environment and skilled human resources has become the main driving force in the development of Latvia economy. Comparing Riga to other cities in Latvia, GDP has grown slightly faster and reached 58% from the GDP of the country. The rapid development of Riga has created favourable conditions for non-financial and foreign investment increase in the city. The majority of the investment made in Latvia is concentrated in Riga. Now Riga fulfils the economic activities and has business centre function in Latvia. Its favourable geographical location, productive human resources and well-developed infrastructure turn the city into an attractive place for investors from all over the world. Foreign investment stock in the company capital of enterprises registered in Riga exceeds 1 milliard LVL.

At international level Riga city is one of the fastest growing metropolises in the Baltic Sea Region which development impacts further territory than administrative and state borders. The total space of Riga administrative territory is similar to that of other metropolises on the Baltic Sea Eastern coast, but the functional territory of Riga city is considerably larger than its official administrative territory. Riga functional territory or agglomeration occupies 7000 km2 with the population of 1,15 million inhabitants instead of 307 km2 with the population of 0,7 million inhabitants. It serves as a proof that the market is considerably larger from the regional aspect, providing wide opportunities for investors. Moreover, from the planning point of view the perspective development of Riga City should be considered in the context of agglomeration of Riga, Latvia and even the whole Baltic Sea Region.

Riga is a centre of well- developed transport infrastructure that includes Riga Harbour, Riga international airport and railway and road network. Due to this Riga is an important transport centre supporting the link between the Eastern and European Union markets. In perspective Riga could turn into the Eastern gateway city to Europe. Riga is also an important partner in international trade where Riga Harbour plays an important role. Riga Harbour is one of the most rapidly growing harbours in the Baltic Sea region with the turnover of 24 million tons per year. It is essential to note the development of Riga international airport, being the principal gateway to Latvia for the vast majority of visitors. In 2005 the flow of passengers exceeded 1,9 million. Foreign visitors take interest in Riga not only as a business centre but also as an attractive place for tourism activities.

Riga is also well- known cultural, education and tourism center. The attractiveness of the city lies in its diverse culture, socialisation manner and sports. In recent years Riga has been the host in a range of remarkable events. This year in May Riga is welcoming the event of a global significance - the World Hockey Championship 2006. Moreover, in November this year the NATO summit will be held in Riga, being politically significant event at international level. The importance of Riga in global and regional context positively influences the future of Riga development in the Baltic Region.

Riga is developing into dynamic city with its economy being based on knowledge and high added value industries with skilled human resources, investment and new technologies. Since Latvia's accession to European Union, Riga city has acquired new cooperation opportunities with Eastern and Western neighbours. In perspective Riga city looks forward to further development of cooperation with other European metropolises, especially in the Baltic Sea Region, to achieve economic prosperity and well being of society.

Aivars Aksenoks

Chairman

Riga City Council

Kaliningrad and the Baltic Sea Region

by Alexei Ignatiev

The Russian Exclave of Kaliningrad sandwiched between Poland and Lithuania in the Southern Baltic Sea Region is a tiny part of the so-called "Baltic Community". It has less than 1 million of population and just 15,000 sq km of territory.

What is its current role in the Baltic Sea Region are and what it potentially could or should be?

Kaliningrad has been widely known as the place with the world's largest amber deposits. Not so many people outside Kaliningrad are aware of the fact that jewelry pieces sold in the airports all over the world are made of raw amber extracted from Kaliningrad's soil.

Another fact of interest is Kaliningrad's exports of gas to the European and in particular the Baltic markets. This gas is extracted from Kaliningrad's land and off-shore.

Among intellectuals, Kaliningrad is well known as the city where the outstanding German philosopher Immanuel Kant lived and worked. Though he lived a long time ago when the city was known under the name of Koenigsberg, Kaliningraders are very much proud of this fact.

Judging from the numerous discussions at various Baltic Sea Region Forums as well as from what one can read or hear in the Baltic mass media, Kaliningrad's image leaves much to be desired. In the minds of many Western people Kaliningrad is associated with poverty, heavy pollution, organised crime – i.e. a source of potential and real troubles and threats for its immediate neighbors as well as other Baltic countries.

For me – I was born in Kaliningrad and spent almost all my life – it is not easy to admit that this image reflects the reality. Virtually, there is some truth in it (and one should admit it is so difficult to find a place elsewhere in the world with none of the above mentioned problems) but reality is quite different.

Now Kaliningrad is one of the most economically dynamic regions of the Russian Federation. Due to its specific location, market-oriented mentality of the population and the privileges of the Special Economic Zone established 10 years ago, Kaliningrad businesses not only survived but actively developed and expanded mostly to the mainland of Russia. Almost one third of all TV sets and vacuum cleaners in the Russian market are assembled in Kaliningrad. Kaliningrad is also among Russia's leaders in meat and poultry processing. The numbers of cars and office space per capita are also among highest in the country.

On the other hand, Kaliningrad's importance for European businesses will be growing, primarily for Poland and Lithuania, which are very active in the Kaliningrad market. Many of European businesses have been using and will use the region as a bridgehead for penetrating the huge Russian market.

As to prospects, I believe that with the new Russian Federal Law on the Special Economic Zone which has been adopted by the Russian Parliament and is to take effect this spring Kaliningrad will become an increasingly interesting location for implementing big business projects targeting both Russian and European markets. The new tax exemptions as well as relatively low land, energy and labor costs seem to be attractive for those enterprises, which are seeking to improve their competitiveness by reducing basic costs.

Definitely, to become a Baltic Tiger Kaliningrad needs to substantially improve its governance: simplified business-related regulations, reduced and ultimately eliminated corruption, developed infrastructure as well as skilled and disciplined labor force are the objectives to this end. To reach these goals the new Kaliningrad Region Government is elaborating new pragmatic policies, which are to be shaped in the Regional Development Program soon.

So the nearest future will show if Kaliningrad managed to obtain and use the advantages and opportunities of its new enclave location within the EU and new business law environment.

Alexei Ignatiev

Founder and President

The Association of International Experts on the Development of the Kaliningrad Region

Baltic Rim Integration - Opportunity and Necessity

by Urpo Kivikari

All national economies that encircle the Baltic Sea region are now market economies, old or new ones. This means that national demands and supplies have a tendency to get international and united. On the one hand profit-oriented firms search new opportunities to market their products in the Baltic region. On the other hand, they look for advantageous inputs and favourable terms for subcontracting and other operations for relocation of production in this area. It is important to note that the exit of East-West barrier has given incitement to western firms to increase also their mutual cooperation. Many firms have found advantageous or even necessary to combine their efforts to carry out operations in former socialist countries and the Baltic Sea market.

An opportunity often means necessity, too. If the profitability of production could be improved by widening marketing to new areas or utilizing new inputs and partners in the Baltic region, the firms might be forced to benefit such possibilities. Otherwise, rivals that utilize those might get too strong competitive position.

The modern pattern of international division of labour makes national economies very closely linked to each other. A major part of foreign trade takes place within production processes. This imposes high standards and requirements for infrastructure, quality and logistics on all countries and companies participating that kind of international division of labour. Subcontractors or other partners have to meet not only their national qualifications but also those of Mercedes Benz, Nokia or whatever multinational partner. Particularly, these terms have been very severe on firms in former socialist countries. So far Russia, whose exports consist mainly of energy and metals, has managed to postpone the response to this challenge.

Traditionally exports and imports between two partners have consisted of different goods. This inter-industry trade which is based on different comparative costs in various countries. Today majority of trade between developed countries is intra-industry trade, that means exports and imports of similar goods. In the Baltic Sea region trade statistics indicate that new market economies' foreign trade is to quite high rate still inter-industry trade.

Naturally, the significance of the Baltic Sea region as a market and partner varies from country to country. For small and medium-size countries the Baltic Sea region is the most important market, whereas for big powers it is not so important. The majority of the foreign trade of Estonia, Latvia and Lithuania is carried out in this area. Also the economies of Poland, Denmark, Finland and Sweden are to great extent dependent on the Baltic Sea region. In Russia one fifth and in Germany only one tenth of all external trade takes place with countries around the Baltic Sea.

The importance of the Baltic Sea region becomes also evident from the fact that for all countries, exclusive Germany, the biggest trading partner is from this area. As expected Germany, one of the giants of the world trade, is the biggest partner for most countries. Finland has the top place in Estonia's trade statistics. Russia has maintained the leading position in commodity trade with Lithuania. Intensive growth of Polish-German trade has made these countries biggest partners to each other in the Baltic Sea region.

How "normal" or close to "potential" are the current trade flows? So called "gravity model" is frequently used to answer this kind of question. The model compares the real and "potential" trade flows using as explanatory variables such factors like the distance between partners, their populations and income levels. Gravity model proves for example that Finland's real trade with Estonia and Russia is very much above the potential level. Yet, the perspectives of trade are still bright also in these cases. More than any model the future development is based on economic growth and integration processes. Growth forecast for former socialist countries as well as their EU integration opens promising prospects for trade in the Baltic Sea region.

The development of intra-Baltic trade has laid the foundation for an economic region around the Baltic Sea. But commodity trade alone cannot unify a market, let alone furnish it with a distinctive identity. Rather, the intensification of integration is reflected in the increased mobility of factors of production. It is foreign direct investment (FDI) that significantly promotes the formation of new networks and leads to along-term convergence and integration of the national economies.

In old market economies, FDI is a conventional operation. In new market economies of former socialist countries, FDI is still a fairly new phenomenon. Into all new market economies FDI has brought besides capital also new technology, managerial skills and culture, readiness for risk-taking and marketing channels to external market. FDI have remarkable spillover effect in the economy of host country. Investors usually try to obtain new market and/or advantageous situation for production. In some of former socialist countries the role of inward FDI is very important, but the outflow of FDI has been remarkable only for Russia. Likewise in trade also in FDI the intra-Baltic flows play dominant role.

Despite rapid economic growth and other positive features in Russia's economy in recent years, the obstacles to FDI have exerted a stronger influence than encouraging factors. Russia contains the greatest natural resources in the world, a consumer and labor potential of a population of 145 million and limitless investment opportunities from the high technology to agriculture. But yet the truth is that FDI to Russia does not reflect these opportunities.

EU-Russia relations constitute a special issue of the Baltic Sea region integration process. EU-Russia relations have come a long way since relations between the EU and Russia were established in the beginning of 1990s. EU enlargement in May 2004 into the neighbourhood of the St.Petersburg area and the Kaliningrad province constitutes a challenge that should be responded to, both by Russian federation and by regional authorities. Paradoxically, EU enlargement , as such, increases EU-Russia integration more than any bilateral plan, agreement or programme between these partners could increase in foreseeable future. Although EU enlargement indisputably promotes integration between Russia and EU, many efforts are needed to secure that the integration really will work in the Baltic Sea region. Needed efforts will be deeply discussed in the conference “The Future Competitiveness of the EU and its Eastern Neighbours” hosted by the Pan-European Institute 1-2. September 2006, in Turku. (www.tukkk.fi/peiconference)

Urpo Kivikari

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The Baltic Rim Model

by Marcus Svedberg

As a political and economic concept, the Baltic Rim has been in the spotlight for about a decade. Cooperation among the governments of the region has increased rapidly and ambitiously in both scope and degree. The rationale for a closely integrated "Baltic Sea Economic Region" has been the topic of a bountiful supply of reports and conferences. Yet despite all the cooperation and the relatively high levels of integration in terms of trade and investment, the region needs more integration in order to stay competitive in the periphery of Europe. A continued push for economic and financial integration would not only boost regional competitiveness but could also serve as a model and a stimulus for deeper integration EU-wide.

The Baltic Sea region is doing rather well in economic terms, but arguably this is due mainly to the successes of the individual countries. Several analysts point out that more political will from the member states of the region is needed to realize the region's true potential. Their recommendations differ somewhat, but most often include improvements in infrastructure, human capital development and increased economic and financial integration as necessary building blocks for increased regional competitiveness, growth and ultimately, jobs and prosperity. In short, the level of engagement in the regions needs to move from cooperation and partial integration to more ambitious market integration. An alternative, less fortunate but probably more feasible, strategy would be to simply maintain the current level of integration. But this would likely mean that the full potential of the region would remain untapped.

If policymakers in the region do possess the will to push further, now is a particularly good time to demonstrate it. The next stage of integration is as much needed as it is unlikely to materialize elsewhere. The economic benefits associated with EU enlargement have already been exhausted and the EU member states have, at the same time, resisted or seriously weakened the proposals for further economic integration on an EU-wide scale. The failures to agree on the constitution, the service directive, the Lisbon agenda, and the free movement of labor give little hope that market integration will be driven from Brussels in the years to come. EU member states around the Baltic Sea could light the way by introducing a number of important joint policies for the region based on the principle of enhanced cooperation or other mechanisms.

The obvious first step would be to abolish the remaining restrictions on labor mobility within the region. Germany, Denmark and Finland should immediately remove the temporary restrictions on labor migration from the new member states. The countries in the region should jointly establish clear and transparent rules to avoid the labor market frictions that have become one of the most blatant features post-enlargement.

A logical second step would be to open up the labor markets for services as well. After all, one of the most important economic differences between goods and services is that many providers of the latter have been protected from international competition, thereby reducing competitiveness. The countries in the region cannot introduce the EU service directive on their own, but they can take the first steps toward an open market for services that does not discriminate against firms from other member states.

Integrating financial services more ambitiously could be a third initiative. The Baltic Expert Group argues that financial markets in the region are well integrated in terms of ownership but suffer from differences in regulation and supervisory overlap. A well-integrated financial system would have strong and positive effects for the trade and investment flows in the region.

A fourth measure could be to introduce a common corporate taxation policy. The tax reforms that have swept across central and eastern Europe were initiated in Estonia and will certainly reach a critical stage in 2006, when Poland plans to reform its tax system. There are already some effects of the increasing tax competition in the EU, as Finland and Austria have lowered their corporate taxes in response to low tax competition from neighboring Estonia and Slovakia. Many other longtime EU countries have or are planning to reform their taxation policies with at least implicit references to the increasing competition from the new member states. The EU Commission has proposed a common consolidated corporate taxation policy for the internal market, which is unlikely to materialize. It would be very interesting if the countries in the Baltic Sea region would take the lead on this issue by seriously discussing or even implementing a common corporate taxation policy.

These initiatives should not, of course, be viewed as alternatives to domestic policy-making. Reducing the cost of doing business in line with the recommendations of the World Bank Doing Business report and increasing competitiveness along Lisbon agenda lines should both be high on the domestic priority list.

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[1] See Berglöf et al (2005) "Prospering in the Periphery: Competition, innovation and economic integration in the Baltic Sea Region," The Baltic Expert Group, forthcoming.

[2] See for instance, Åkerholm (2005) "Why a Baltic Sea Economic Region? " Expert Article 23 in Baltic Rim Economies; and Svedberg (2005) "Tillväxten gynnas av olikheterna kring Östersjön" ITPS Tillväxtpolitisk Utblick No 8.

[3] Berglöf et al (2005).

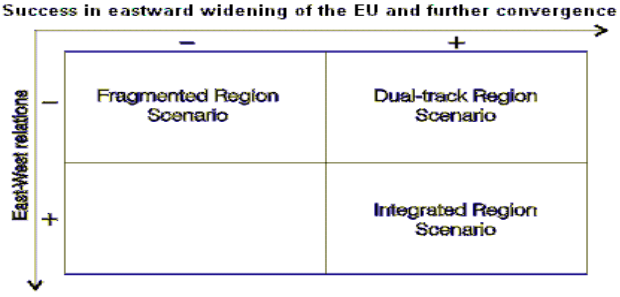
[4] Tervahauta (2005) "Platt skatt skärper konkurrensen om företagens investeringar" ITPS Tillväxtpolitisk utblick, No 9.

Futures Scenarios for the Baltic Sea Economic Space

by Erik Terk

The development of the first packet of scenarios, which was composed about 8 years ago by Erik Terk and Garri Raagmaa, was based on the premises that the development of a common region of cooperation will depend on the success, manner and rate of the EU expansion to the eastern Baltic rim (the accession of Estonia, Latvia, Lithuania and Poland) as well as the context and dynamics of the EU-Russian relations. It was presumed at that time that these two factors were interconnected. This did not refer to Russia's particular ability to prevent the Baltic States' EU accession, but the context of cooperation, which would appear between Russia and the enlarged EU after the accession. The main issue in this context was the role of the metropolis of St. Petersburg and its region in the future East-West cooperation.

Development scenarios of the Baltic Sea region



Regarding the possible events after the EU accession, the scenarios primarily concentrated on the introduction of the euro in the EU member countries, the convergence of the new members and the ways of involving Russia in economic cooperation with the EU.

The matrix depicted in the figure forms four possible development scenarios, three of which were developed in detail. For obvious reasons, the integrated region scenario was considered the most desirable, envisaging the establishment of a customs union between the EU and Russia by the end of the period and visa-free travel of North-west Russian residents in the EU territory.

When viewing the scenarios from the present-day vantage point, it can be stated that the EU enlargement was completed successfully without significant obstructions and approximately at the time forecast in the scenario. Estonia, Latvia, Lithuania and Poland will gradually increasingly integrate with the common economic space.

At the same time, the post-accession period has been characterised by the emergence of various factors obstructing further rapid integration. These were fears, typical of not the Nordic countries, but France, Germany and Austria, concerning the free movement of individuals and services, as well as the so-called social dumping of the new member countries. The scenario text forecast a relatively rapid accession of Sweden with the euro-zone, which has not taken place so far. Latvia has also problems with joining the euro-zone in the next few years due to high inflation rate (it is true that partly caused by the fast economic growth); the same may apply to Estonia. But since the scenarios were not drafted for a medium-length period but until 2015, there are no grounds for claiming that the positive developments depicted by the authors regarding the matrix horizontal axis could not taker place during the period. The developments along the horizontal axis can be generally judged as positive.

A separate issue is the question of the mutual integration of the Baltic States' economies and the geography of the Baltic States' economic relations within the EU. It was only with considerable reservations that the three Baltic States could be viewed as a common economic area. Trade between Latvia and Lithuania was (and still is) relatively voluminous, it is smaller, although still significant, between Estonia and Latvia, but very small between Lithuania and Estonia. Although no qualitative change has occurred in recent years, the trade and other economic cooperation between the Baltic States have become somewhat closer in the last 4-5 years. A tendency can be partially observed here: the decisions regarding integration in the Baltic States' markets are increasingly made in the head offices of the Nordic corporations. Significant differences could be observed in the foreign trade geography of the Baltic States: while Estonia already had very close and Latvia moderately close ties with the Baltic Sea countries and especially the Nordic economic area, Lithuania was a clear outsider in that respect. It has been claimed about Estonia's economy that it has become excessively "Nordic" and it would benefit from closer ties with the other EU countries. Yet the Nordic positions have not weakened in Estonia in the past 4-5 years with the sole exception of some weakening of Finland's role among Estonia's import partners (in other words, Estonia has somewhat diversified its import).

Along the vertical axis, i.e. the EU relations with Russia's and the CIS economic space, the development has been quite contradictory. On the one hand, the Russian economy has significantly (more than predicted) grown due to the devaluation of the rouble and the favourable situation in the world's fuel markets. Obviously, this makes meeting the Russian import demand to the EU highly attractive for the Nordic firms (e.g. Nokia). But even more important for the EU is Russia's role as a source of raw materials and fuel and for the border countries as a source country of the transit. But several tendencies predominating in Russia like certain distancing from the West (one of the indicators being the extremely indefinite state of a basic treaty determining EU-Russian relations in the future), the effective nationalisation of strategic enterprises, negative attitude towards the Western capital in sectors considered strategic, Russia's conflicts with the West regarding political control over the CIS states give reasons for concern. The EU has not succeeded in developing a common energy policy towards Russia, which results in a more vague energy cooperation in the future and in greater risks. The EU and particularly the Nordic firms have to some extent entered the Russian raw materials procurement and processing market (especially timber resources). The EU's Northern Dimension project remains in a rather vague state.

The above sets certain limits to the prospects of the EU-Russian cooperation. While these prospects are most likely positive regarding further trade (the impact of Russia's torturous movement towards WTO), they are unlikely to be encouraging regarding in-depth forms of integration. It is therefore still open, whether the further integration scenario should be sought in the top or bottom half of the figure. Among the EU member countries, this is crucial for Finland, Estonia, Latvia, Lithuania and possible Poland.

The developments in the new EU member countries on the eastern shore of the Baltic Sea depend, besides the background created by more or less favourable geopolitical or geo-economic factors, on these countries' ability to handle the tasks of modernisation and institutional development. The central factors in this process are taking advantage of the new technological opportunities, the development of new contemporary sectors of economy and coping with the inevitable increase of production input cost in the EU environment.

Erik Terk

Director

Estonian Institute for Futures Studies

2005

Poland and Baltic Sea Regional Cooperation

by Stefan Meller

Economic cooperation in the Baltic region is a tradition that goes back to the mediaeval time. In the cities like Tallinn, Stockholm or Gdansk one can still find signs of cultural and economic vitality which once emanated from this European inland sea.

Since 1989 – after a long break – we are back on track to built on the positive tradition of the past. Once more, the Baltic Sea region becomes a European growth area and rises to the challenges of globalization.

The impressive economic results of Poland an Baltic states is the best proof of this. Those countries have been successfully restructuring their economies for many years both in terms of changing legal framework and structure of industry.

Today Poland's foreign trade with partners from Council of Baltic Sea States (CBSS) accounts for approx. 42 % of total trade turnover (with clearly visible dominant role of Germany as a major trading partner).

For many years trade figures for CBSS countries have been noticeably higher than those for other trade partners. Only in 2004 our export to CBSS area grew by 30 %, reaching over 33 bln USD. The substantial part of foreign investments in Poland originates from Baltic Sea region. Companies from Sweden and Germany are amongst the ten biggest investors.

Poland as a member state of the European Union is vitally interested in improving the international competitiveness of its own as well as European economy. Therefore, we give our full support to the initiatives of strengthening and deepening the regional cooperation with a special attention to:

- cooperation in the energy sector and the development of infrastructure,
- eliminating barriers to trade and investments,
- reducing bureaucracy and creating better conditions for entrepreneurs (with focus on small and medium sized companies).

Latest economic results of countries of Baltic Sea rim clearly proves that business people have already started to explore the potential of a market of up to 100 million consumers. For example, volume of trade between Poland and Sweden almost tripled over last four years. Tourism and cross-border cooperation become increasingly important for local communities. By the fact of EU enlargement, countries like Poland got a change to fully participate in benefits of free trade in the region, but are also interested in other than trade forms of cooperation in following sectors:

- telecommunication and IT,
- energy management and distribution,
- housing and industrial construction,
- food industry,
- environment protection and eco – agriculture.

Thanks to the intensive economic cooperation between the CBSS countries, the Baltic Sea region will keep its position as a leading growth area in Europe and contribute to the mission of building lasting security in the region.

Professor Stefan Meller

Minister for Foreign Affairs of the Republic of Poland

Triple Trade in Ten Years - a Vision for the Baltic Sea Region

by Stephan Müchler

Since the beginning of the 90s, enterprises around the Baltic Sea Region have been trying to develop trade with the neighbouring countries on the other side of the Baltic Sea. The period between World War II and the dramatic changes in the autumn of 1989 seems to be more and more of a brief, strange period in the history of the region. Already in 1992, the Chambers of Commerce and Industry around the Baltic Sea responded to the needs of their member companies and founded the Baltic Sea Chambers of Commerce Association. Since then, BCCA acts as a network for more than 50 chambers in the region. Promotion of more trade in the region has always been one of our top priorities.

The propects today in the winter of 2005/2006 look very promising. Since the late 90s, the economic development of the region has been very strong in most of the countries. Poland together with Estonia, Latvia and Lithuania are continuously showing steady growth rates and this is of course reflected in trade development.

Since a couple of years BCCA has been promoting our vision, Triple Trade in Ten Years – 3T. This ambitious but realistic vision of more trade is based on our strong belief in the future opportunities of the region. Also, since the early 90s, trade has actually tripled in the Baltic Sea Region. Proximity is still a major force for more trade and contacts, and our region offers business opportunities within a reasonable travel distance in a large number of industries. If the enterprises shall be able to fulfil the possibilities however, necessary action must be taken in the following five areas:

Attitude – This is still one major obstacle in the BSR and perhaps the most serious one. Prejudices make people assume things about their neighbours, which limit the possibilities. To be able to deal with these prejudices there are two major tools. The first tool is contacts, where tourism is of large importance. The strong and positive view on the region shared by a majority of business peoples and public officials must be spread to the public. The second tool is facts; our authorities must gather relevant information and make this available in order to eliminate remaining prejudices.

Post-enlargement – Previous enlargements of the European Union give strong arguments for the importance of the post-enlargement process. If we manage to concur the national regulations, the advantages of a fully functional common market will further boost the economic development in our region. As in other parts of Europe, one of the most crucial issues has to do with the free movement of labour and in this perspective the service directive of the European Union is very important.

Infrastructure – The strong connection between the need for more transport and the growth of wealth is very well documented. In the BSR this means that governments and authorities need to develop the infrastructure to meet the demands that will be generated in a near future. These large investments will also bring regions around the Baltic Sea together, establishing interesting corridors of strengths in various sectors. In a shorter perspective it is also important to tackle a number of minor logistic bottlenecks that exists. These bottlenecks can seem to be of little importance from a national perspective, but often play a major role for the flow of goods for our neighbours.

Russia – When the Russian economy accelerates further in the coming years, the impact will be very noticeable in the rest of the Baltic Sea Region. Considering the opportunities for our region the importance of Russia is obvious. If we only manage to fully integrate the metropolitan areas around St Petersburg and Moscow, this alone will alter the economic geography in our region, increasing the regional market. But is not just a matter about business, we also need to fully interact with the research and development sector in Russia to improve our common competitiveness.

Free Trade – Limitations to free trade will limit the progress of our neighbours and in the long run weaken our own possibilities. This is the simple fact. But at the same time the globalisation is an ongoing development that from time to time is a tough process, imposing structural changes that affect our societies. To be able to sell the idea of free trade as a win-win game to the public is a mission for responsible politicians and the business life alike.

BCCA believes that 2006 is an excellent opportunity for politicians from the Baltic Sea Region to make the most of our region. Today, when almost all countries in our region are members of the European Union we need to market our opportunities in competition with other parts of Europe. Political initiatives are on the way with for instance the new version of the Northern Dimension Action Plan. The Baltic Sea Strategy from Members of the European Parliament is another good example. However, political rhetoric is simply not enough, but must be backed by concrete activities and decisions. The well-known Finnish decisiveness and action-orientation make the approaching Finnish Presidency of the European Union during the second half of 2006 the best opportunity for a number of years to promote our part of Europe. As well as support the positive development in the region, for the benefit of all Europeans.

Stephan Müchler

President of Baltic Sea Chambers of Commerce Association

European Integration is Bearing Fruit

by Kari Jalas

Finnish companies expect three basic things from European integration: Political and economic stability, dismantling of trade barriers and an operating environment that supports the international competitiveness of European companies. New EU Member States around the Baltic Sea are offering all of these.

The Central Chamber of Commerce of Finland uses its specially developed success indicator to evaluate the performance of European economies. On the basis of this indicator, the most successful economies in 2005 are Luxembourg, Latvia, Estonia and Lithuania (The Central Chamber of Commerce of Finland, Euro-Zone Economic Scan 2/2005, www.chamber.fi).

The success indicator is based on a growth and a stability component. Latvia, Lithuania and Estonia all rank in the top four for the growth component. These countries have experienced rapid economic growth and an increase in investments. In Latvia and Estonia employment has been growing faster than the average of the surveyed countries.

Estonia is the highest ranking of the three countries in the stability component, with Latvia and Lithuania ranking lower. Estonia is doing well as a result of its small national debt and surplus in the public sector. All three countries have big current account deficits that lower their rankings in the stability component.

Skilled workforces, low production costs and improving infrastructure attract international enterprises to expand their business activities into these countries. Poland takes a central position between East and West. Its national economy is as big as that of the nine other new EU Member States combined.

EU membership has clearly improved the business environment in the Baltic States and Poland. Finnish enterprises are sure to benefit from these rapidly developing markets. However, there is much more to be done to remove still existing trade obstacles.

EU Membership has improved the business environment in the Baltic States and Poland

The Central Chamber of Commerce of Finland conducted a survey concerning the functioning of the European Internal market of the Baltic countries and Poland in April 2005. A total of 280 Finnish companies with operations in the countries in question responded to the survey. Similar surveys were carried out in 2001 and 2002 (The Central Chamber of Commerce of Finland, The Finnish Business Perspective of the Baltic and Polish Markets, 2005, www.chamber.fi).

Finnish companies expected a large increase in the significance of the Estonian, Latvian, and Lithuanian and, in particular, Polish markets over the next five years. 80 per cent of the respondents predicted an increase in the significance of the Polish market. According to the enterprises the primary means by which Finnish companies can benefit further from this growing market potential will be by increasing their own exports, establishing subsidiaries, forming partnerships with local companies and increasing subcontracting.

Although the significance of the Polish market was on the rise, 57 per cent of the survey respondents still named Estonia as their primary market. Second position was shared by Latvia and Poland. Lithuania was viewed as a slightly less important market.

Estonian, Latvian, Lithuanian and Polish business environments have clearly improved over recent years. Finnish companies rated the countries and gave Estonia the best score (in a scale from 4 to 10 (best) with 7.56 (7.15 in 2001). The business environments of Latvia and Lithuania were rated slightly lower than in Estonia, with both countries receiving a score of 7.04 (as compared to 2002; Latvia 6.50, Lithuania 6.48). Poland received a score of 6.89 (as compared to 6.59 in 2001). The business environments were compared to Finland, which received a score of 9.

One fifth of the respondents felt that business culture in Estonia had improved during the last few years. The decrease in bureaucracy and growth in the economy combined with EU membership have brought about interest in the Estonian market. EU membership and improved business culture were seen as the most positive developments in Latvia. Almost half of the respondents in Lithuania recognized EU membership as the most important positive change in the country's business environment. Economic growth, developments in transportation and logistics were also underlined. One quarter of the respondents viewed EU membership as the most significant step forward for the Polish market. Bureaucracy has decreased and corporate culture has improved in Poland.

Estonia's primary problems were its low price levels (17 %) and low levels of purchasing power (15 %). The biggest problem in the Latvian market was the lack of language skills (17 %). Price levels (10%), trade practices and corporate culture (10%) were also mentioned as problems. The most significant problems for the Lithuanian market were its trade practices and corporate culture (22 %). Price levels (19 %) and stiff competition (19 %) were also seen as problems. In Poland, the biggest problems were in trade practices and corporate culture (23 %). Also mentioned were problems related to price levels (21 %), financing (19%) and bureaucracy (17%).

The activities of the authorities have improved across the board since the surveys that were conducted in 2001 and 2002. The greatest improvements have occurred in the activities of customs and border control authorities as well as those of the inspection and certification authorities.

A number of Finnish companies are planning to invest in the markets of the Baltic countries and Poland. Over half (55 %) of the large companies that responded to the survey plan to invest in either Estonia or Latvia during the next year, whereas 38 per cent of the large companies plan to invest in Poland.

Almost one third of all the respondents had invested in Estonia in the preceding 12 months. During the same time, 19 per cent of the respondents had invested in Latvia, 16 per cent in Lithuania and 23 per cent in Poland.

The Baltic Sea Area is already one of the fastest growing hotspots of the global market. However, its potential is not yet fully recognized. Unfortunately two crucial drivers of economic growth are still missing in the area: free movement of labour and a common currency, the euro.

Chambers of Commerce around the Baltic Sea are working hard to foster European integration in the area. The Baltic Sea Chambers of Commerce Association (BCCA) is committed in promoting prosperity and competitiveness in the region. The Central Chamber of Commerce of Finland has held a Vice Presidency in the BCCA since 2004.

Dr. Kari Jalas

The Central Chamber of Commerce of Finland

Poland after the Elections:
Addressing the Nexus between Fiscal and Labor Market Reform

by Ralf Wiegert

Since the parliamentary election in September, Poland's political landscape has been undergoing a profound shift. The SLD-dominated government suffered a crushing defeat, and the leading role was taken over by the right-wing Law and Justice (PiS), which formed a minority government headed by Prime Minister Kazimierz Marcinkiewicz. It is tolerated by populist and, mostly, conservative parties, including Samoobrona, the Polish Peasants Party and the League of Polish Families. Many had expected PiS to team up with the liberal PO (Civic Platform), which came in on second place in the elections, but these hopes were dashed as coalition talks failed in October. In the election campaign, PiS highlighted their goal to transform the entire political process, alter the constitution, and root out corruption. The question is, will they do likewise with the economic legacy?

As regards Poland's economic and financial woes, which include the highest unemployment rate in the European Union (17.3% in October this year) and stubbornly high budget deficits, it is obvious that at least the same attention paid to reforming political processes is required for economic and financial matters. Indeed, the key policy challenge for the new government remains fiscal consolidation. Unfortunately, this needs to be done amid a nascent recovery of domestic demand and expensive social policies (thanks to still-large structural problems in rural areas and heavy industry that cause persistently high unemployment). It was encouraging, though, that GDP growth has been recovering recently, equaling 3.7% year-on-year in the third quarter, which compares to 2.1% in the first quarter 2005. Of course, this result is a welcome boost for the new government, which may thus find more room for cutting spending or raising revenues next year.

The fiscal deficit (consolidated general government according to ESA-95 accounting standards) hit 3.9% of GDP in 2004. In 2005, however, tighter spending management and strong revenues have allowed the deficit to remain considerable smaller than envisaged in the original budget plan. The fiscal gap (ESA-95) will likely remain only slightly above 3% of GDP. Without doubt, this is an encouraging sign, although still much too high given that the economy has been growing vigorously last year.

Alas, the data according to the European Standards of Accounting (ESA) underestimate the true state of the Polish fiscal deficit. For, following the introduction of a second, privately managed capital-based but nonetheless mandatory pension pillar in 1999, the Polish government continued to include revenues for this part of the pension system into fiscal coffers. After all, the fiscal gap would be some 1.5% of GDP larger if Open Pension Funds' (OFE) revenues were excluded and interest payments on government bonds held by OFE included into budget accounting. Moreover, the stock of public debt currently trails very close to the lowest threshold level set by the constitution (50% of GDP by Polish accounting standards) and will eventually surpass it by end-year, a fact that automatically imposes fiscal limits for next year's budget Much harsher rules would be applied if the debt level exceeds 55% and the highest threshold level—60% of GDP. In the latter case, the government would have to submit a balanced budget for the following year. Naturally, this makes the case for fiscal consolidation even more compelling, irrespective of the Maastricht criterion, which is relevant for Eurozone accession.

These malign fiscal perspectives apart, it remains doubtful, though, whether a short-termed fiscal injection or a temporary monetary boost would suffice to push the Polish economy back to the momentum seen in 2004 – a policy framework that is frequently cited by leading PiS politicians. For, alas, despite high corporate profits in 2004 and still-healthy growth this year, Poland's corporate sector seems still reluctant to rehire workers, and the unemployment rate remained the highest in the EU by far. Fixed investment, moreover, has only hesitantly gained steam this year, although the inflow of European Union funds, high corporate profits in 2004, and recent policy rate reductions should have boosted investment significantly.

Reviving investment and, in the same vein, reducing unemployment, depends on the government's efforts to remove distortionary tax rules and simplify the tax system, tackle red tape and corruption, and, after all, consolidate fiscal finances in the sense that spending gets rationalized and the overall fiscal burden on the economy is reduced. Those who argue for pro-active monetary policy should note that the high fiscal deficit is a good deal responsible for the current level of the policy rates, and cutting back the deficit would give the RPP more leeway for slashing the rate.

Indeed, there is a nexus between fiscal and labor market woes. According to the OECD, the tax wedge, defined as personal income taxes plus social security payments minus cash benefits, was equivalent to 41.9% of a so-called 'average production worker's earnings' (APW) in Poland in 2004 (single worker without children with 60% of APW), while amounting to 41.5% for a couple with two children and one earner (100% of APW). The former figure puts Poland within the leading group of eight OECD countries, which display a level of higher than 40% as well, while the latter implies Poland ranking second, following only Turkey (42.7%).

A high tax wedge is particular detrimental for a country still undergoing structural shifts, and also for a country which is set to grow faster than other, more advanced countries. A large tax wedge puts the brakes on employment, because it is discouraging people to take up work while adding too large a tax burden onto employer's labor costs total.

That said, the new government's recently stated intentions are a mixed blessing for the economy. Although Marcinkiewicz reiterated earlier made promises to impose a ceiling for the central government budget deficit of 30 billion zloty (Global Insight estimates the deficit at 32-33 billion zloty in 2005), the new government, at the same time, made several costly spending pledges on subsidies for road and housing construction and on social transfers.

As a consequence, the future path of Poland's fiscal finances remains unclear, and it is hard to see how the new government will eventually manage to match both the deficit target – which is essential for budget consolidation –, spending pledges and satisfy their populist allies in parliament at the same time. Sacrificing the deficit target might be the most likely solution to this conundrum, although the new government will surely try to remain as close as possible to it. Real reform of Poland's tax system, including the income tax, remains a distant perspective under these circumstances, unfortunately. After all, though, the government's policy priorities will become more apparent only next year, as the cornerstones of next year's budget had been set by its predecessor, and any major reforms have thus de facto been postponed.

Dr. Ralf Wiegert

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The China Phenomena in the Baltic Sea Region

by Kari Liuhto

China has received a lot of attention from foreign investors due to the huge potential of its market, low production costs and the high growth rates of its economy. Due the aforementioned reasons, foreign direct investment (FDI) flows to China are impressive. Whilst admiring China's performance, one should not forget that that growth rates related to FDI are also considerable in the Baltic Sea region (BSR).

In fact, the Baltic Sea region's FDI growth is even higher than that of China in the past ten years, and particularly faster during the past 5 years. In the period 1995-2004, China's inward FDI stock more than doubled. During 2000-2004, it grew by 8% only. During the past 10 years, the inward FDI stock of the Baltic Sea region more than tripled. During this decade, it has grown by 57%, indicating much faster growth than in China. In terms of FDI inward stock per capita, the BSR would clearly outperform China.

Even if the FDI growth rates flatter the Baltic Sea region, one should not get too excited over them since a major part of the investment flows in the region are internal ones. In other words, the nine countries surrounding the Baltic Sea region invest in each other. For example, some 60-80% of all FDI in the Baltic States and Finland originates from another BSR country. Though the figure in Denmark, Poland and Sweden is considerably lower, it is still around 25%. Russia receives approximately 10% of all its FDI from the BSR and Germany 5%. Investment flows in the region result mainly from capital flows from the west of the region to the east (see BRE 2/2005).

As a great part of the FDI flows is due to intra Baltic investments, the region as a whole does not receive new capital but the capital only moves from one shore to another. Therefore, the China phenomenon in terms of high FDI growth rates in the Baltic Sea region is, to a great extent, a statistical bubble. In order to change the situation for the better, a common investment promotion agency and strategy for the whole region should be constructed.

Development of FDI inward stock (USD billion)

	1995	2000	2004	Multiplier	
				1995-2004	2000-2004
Denmark	23.8	73.6	98.2	4.13	1.33
Estonia	0.7	2.6	9.5	13.57	3.65
Finland	8.5	24.3	55.9	6.58	2.30
Germany	192.9	271.6	348.0	1.80	1.28
Latvia	0.6	2.1	4.5	7.50	2.14
Lithuania	0.4	2.3	6.4	16.00	2.78
Poland	7.8	34.2	61.4	7.87	1.80
Russia	5.5	32.2	98.4	17.89	3.06
Sweden	31.1	94.0	163.0	5.24	1.73
BSR-9	**271.3**	**536.9**	**845.3**	**3.12**	**1.57**
China	311.5	651.6	706.5	2.27	1.08

Sources: World Investment Report 2002 & 2005, UNCTAD

If the China phenomenon related to the FDI growth in the BSR is a statistical bubble, one should not forget that the China phenomenon takes place in the region in another form. In other words, economic relations with China are growing rapidly, imports in particular. In 2004, China accounted for some 3-7% of imports of all the BSR countries, excluding the three Baltic States, where the China accounted just 2% of their imports.

The relative importance of the BSR countries' exports to China is rather modest. Due to Russia's geographical location it is natural that China forms a substantial part (7%) of its exports. However in other BSR countries, China accounts for, on average, less than 2% of these countries' exports.

As investments have a tendency to follow export flows, some Chinese companies have already invested in the Baltic Sea region. Although China is statistically a minor player in the region, two Chinese investments in the region deserve special attention.

The construction project called the "Baltic Pearl" in the St. Petersburg region is China's biggest investment project in Russia and probably the largest project of the Chinese companies in the Baltic Sea region. According to this investment plan, a group of half a dozen Chinese firms aim at investing USD 1,25 billion to build a 180-hectare residential district in the City of St. Petersburg. The first part of the Baltic Pearl should be finished in 2008.

Huawei Technologies present another type of Chinese investment in the Baltic Sea region. In 2002, the company founded its R&D unit in Sweden. This Chinese telecom giant aims at harnessing Swedish expertise in Internet telephony and third-generation cellular technology. Obviously, the goal of Huawei Technologies is not to set up production in Sweden but to carry out R&D work there and bring the results of this knowledge to the use of its parent company.

To conclude, Chinese investments in the Baltic Sea region is still a rarity but probably in the future the presence of the Chinese firms will grow along with the accumulation of capital in China, which pushes its firms abroad to acquire fresh management skills and advanced technologies.

In my opinion, the companies of the Baltic Sea region should already prepare for this novel phenomenon though it is still unlikely that the presence of Chinese investments in the Baltic Sea region would grow as fast as the presence of the Russian firms. Despite a slower expansion, a thorough study concerning the business entry of Chinese corporations in the region should be carried out sooner rather than later. Such research might aid policymakers in anticipating the possible consequences of the Chinese business entry to the BSR.

Professor Kari Liuhto

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More Than a Decade of Purposeful Economic Policy

by Urmas Paet

Estonia is recognised for its stable and purposefully implemented economic policy. Analysts often praise Estonia's performance figures and various icons of Estonia's success —the prominent e-sector, the creative economic thinking based on liberal attitudes in the society, the combination of conservative fiscal and prudent monetary policies. Deservedly, these aspects of Estonian economy get positive publicity through the press and the international organisations.

The statistics are certainly encouraging: according to the data released by the Statistical Office of Estonia in June, 2005, the last ten years have demonstrated 6.1% and during the last five years even 7.2% average GPD growth. By preliminary estimations the economic growth of Estonia in the 2nd quarter of 2005 compared to the same period a year earlier reached 9.9%. According to the prognosis of the Bank of Estonia, Estonia's GDP growth in 2005 is expected at 8%.

A decade's economic goals have been completed — what next?

Estonia's progress so far has been visible. However, now that many of the policy goals have been fulfilled, we naturally also wish to satisfy our curiosity about the future. For instance, being a member of the EU, can we expect growth to continue? Or, in somewhat greater detail, could we expect the same policy line to be continued now that we are a part of the internal market and follow the acquis? The short answer is "yes".

In this brief article I wish to look into what is actually behind what we see happening every day, what are the processes that continue to shape our present reality as well as the future.

The legal tradition — basis for sound policy

The key departure point in any effort to understand Estonia, her past and future, is to bear in mind the respect of its people to the rule of law as well as trust in the historical practice of the Roman civil law tradition of Europe. This shapes the modern Estonian thinking about our economy today and also tomorrow.

In Estonia's constitution of 1992 one should easily find an extensive catalogue of civil liberties — in fact, the most important source of Estonia's liberal and stable economic policy can be traced in the second chapter of the constitution: the fundamental rights, freedoms and duties. The principles therein bear direct links to the implementation of the role of the state in encouraging economic activity — indubitably, these principles continue to constitute a sound basis for any new and innovative legal initiatives designed to improve any filed of activity. Among these principles, the key to achieving economic success in a modern country is the art of separation of the state functions, the domain of administrative law —from the daily business activities, the domain of civil law.

The role of civil law is reflected in the idea that competitiveness should be encouraged between equal parties that are to be given identical starting positions in their pursuit of business related goals. The daily concerns of administrative authorities have to be strictly separable from private business interests. Hence the state authorities should keep their intervention at minimal necessary levels — at those absolutely indispensable. The aim is to achieve the least burdensome state while providing maximum result for the good of the community whereas preserving the initiative and motivation of the people to work and create. Evidently such simple goals are easier to achieve, if efforts are directed at building a system that is free from exceptions, exemptions, or any other type of irregularities or excuses which, if tolerated, would inevitably blur and damage the relationship of the state authority and business in the society — would make the system less clear and thereby also less easy and more costly to run.

Abundance of state expenses deriving from exceptions is to be avoided. The administration should be easy to implement and understand while affordable to administer and sustain. Whatever state policy has been under discussion in Estonia, these principles have served as the foundation. These principles also broadly define the competitiveness of a country.

Efficient state for less money — any examples?

In Europe, a well known albeit disputed example of such policy-making is Estonia's flat tax system. For instance, as a country of principles we had to create a simple, transparent and efficient tax system based on not making exceptions and having a single tax rate for all taxpayers whether individuals or companies. In order to make the system efficient and less burdensome to administer, we also had to introduce to the thinking on taxation the idea that the businesses should not pay taxes in so far as they keep their money — including their profits, in the work process. It would be an unforgivable mistake to try to associate Estonia with a notion of a tax paradise — Estonia with her clear bookkeeping and taxation laws cannot be considered an easy place to engage in dishonest practice. It is a myth, cultivated by superficial observation, that Estonia has 0% corporate income tax — on the contrary, whenever money is taken out of business or spent on items not related to the companies' purposeful business, it gets taxed without exemption, whatever the excuses may be. Besides, upon taxable events, the level of taxes payable by businesses is not at all the lowest in the neighbourhood.

What could be the result of an efficient system to precisely collect what is due whereas keeping the capital at work? Motivation for the people to work hard, a strong disincentive for the companies to engage in double-bookkeeping. Besides, also the by-product of better and more representative statistics — definitely more reliable figures of economic performance. It also needs to be pointed out here that in Estonia, upon the end of the first half of 2005, in all tax categories the actual revenue had well exceeded the planned 50%, resulting in real budgetary revenue surplus to be spent on societal needs in 2005 as well as to make provisions for the future.

The general belief is that such policies have been useful and need to continue — no quick reforms can rival the economic effect of long-term sound policy.

Reforms and Transition versus Policymaking

In many sources of literature, ratings, etc. we find lots of talk about Estonia and Eastern Europe in terms of reforms. More often than not the process of transition is the focus that serves also as the point of departure for what actually should be regarded just a policy-related discussion between experts. Speaking about transition used to be the proper way to address the necessary economic policy adjustment issues until certain processes of the property reform were still at progress. These processes, privatisation as the most

important among them, were largely completed during the second half of the 1990s. On November 1, 2001, the legendary Privatisation Agency of Estonia had reached its very end —law dissolved it because its tasks were completed. Just to remind, the main method for the privatisation in Estonia was open international tender to pick up core investors.

In this conjunction I would also like to point to a representative summary of the reform period experience by the World Bank, published in 2002. In its foreword we find that one of the key messages of this study was to highlight the role of encouraging the entry and growth of new firms as opposed to the concerns over possible postponing of the pain of liquidating and restructuring the 'old sector' to any later time. The main significance of this work to this discussion derives from the practical orientation of this WB publication: we can find therein a representative benchmark for measuring the completion of restructuring as well as to decide whether an economy would cease to belong to the category of a transitional economy.

When is transition over? This question raised in 2002 by the World Bank and also answered in a simple way: "The wide dispersion in the productivity of labour and capital across types of enterprises at the onset of transition and the erosion of those differences between old and new sectors during the reform provide a natural definition of the end of transition." Hence, the very last enterprise sold by the Estonian Privatisation Agency in the end of 1990-ies as well as the decisive switch away from any privileged, exempted, excused way of different classes of property, most powerfully reflected by the vote of the people over 1992 constitution at the very beginning of restoration of the sovereignty of the Republic of Estonia — these would be the important markers to help define the beginning and the end of transitional economy in Estonia. These milestones also set the stage for any discussion over policy.

Stable and purposeful Policy

Although we have made a clear statement by our success in economic policy implementation, it is evident that some of the key areas of our focus nevertheless remain the same and continue to demand our inventive attention. Among them one would have to name first work with our legal framework, especially in the age of continued technical advances — the ability to adjust to changes becomes more and more critical.

Estonia wishes to be in the frontline of excellent policy-making. There is more than ever before in European history a need to focus on making Europe more competitive. The new challenges before Estonia similarly to very many other EU member states are the issues of ageing society, the environmental problems, and the natural limits to the energy supply. To remain competitive in the world of globalised economy all the nations around the Baltic Sea also have to continue to stand for the economic freedom while finding innovative ways to improve the efficiency of governance. The new situation for everybody is the situation of global competitiveness. In the challenges of policy-making under these evolving circumstances Estonia continues to support the flexible and proactive style.

Urmas Paet

Minister of Foreign Affairs

The Republic of Estonia

New Impetus for the Baltic Sea Co-operation

by Ville Itälä

With the enlargement of the European Union to the three Baltic States and Poland in May 2004, the Baltic Sea became an inland sea within the EU. Hence, eight of the nine countries bordering the Baltic Sea are now EU member states.

The Baltic Sea has historically played an important role within the Baltic Sea Region. Already during the Hansaetic times, the Baltic Sea united the countries surrounding it, in that manner bringing prosperity to the region. At present, the countries around the Baltic Sea make up a third of both the population and the GDP of the European Union. In addition to this, the Baltic Sea region is one of the fastest growing in Europe.

However, the Baltic Sea has equally been nominated as the most polluted sea in the world. The sea is shallow, with its average depth being only 58 metres, and its water changing slowly. Furthermore, 85 million people live in the catchment area; the load to this sea is serious.

Many of the causes of the Baltic Sea pollution can be targeted by actions of the EU. Furthermore, the St. Petersburg Southwest Wastewater Treatment Plant, commissioned last September, serves as a good example of co-operation between the EU and Russia. The plant will cut half the sewage flow that St. Petersburg has until now discharged untreated into the Gulf of Finland. The wastewater treatment plant is a step in the right direction. However, major challenges still remain: single-hull vessels increase the risk of oil tanker accidents, while other vessels are unable to withstand the winter conditions. Moreover, the load from agriculture to the Baltic Sea should be reduced.

The European Union has until now financed the Baltic Sea region as a part of its external policy through the Northern Dimension programme. The current programming period ends in 2006. Decisions on the continuation of the programme will most probably be taken during the Finnish presidency of the EU in autumn 2006. The challenge for the Finnish presidency will be to shape the concept of Northern Dimension to answer to the current needs of the region.

In this respect, co-operation with Russia has been an integral element of the Northern Dimension. The EU is currently reshaping its external aid instruments. Hence, co-operation with Russia will in the future be financed through the European Neighbourhood and Partnership Instrument. However, as eight of the nine countries bordering the Baltic Sea are current members of the European Union, the co-operation should not be seen as part of the EU's external but rather its internal policy. The Northern Dimension has ceased to be an interesting concept merely to Poland and the Baltic states. We need new approaches.

The Baltic Sea Intergroup of the European Parliament, with members from all the Baltic Sea states and beyond, has proposed a creation of a European Baltic Sea Strategy. The strategy would concentrate on areas such as environment, economics, culture and education and security. Members of the European Parliament have also suggested that the Baltic Sea Strategy should have budgetary position within the union's budget similar to the one the Mediterranean Strategy currently has.

Interest towards a new kind of Baltic Sea co-operation is clearly shown in Baltic Sea states as new initiatives to enhance the co-operation are taken around the region. City of Turku has defined the Baltic Sea region as one of its most important international operating arenas. A step towards boosting the efficiency of different actors' communication was taken in a study by Professor Dr. Esko Antola, suggesting creating a Baltic Sea Centre to the City of Turku.

I support warmly the proposal of Professor Antola, not only because Turku is my home town, but because I believe that there is a call for coordination of the co-operation. The City of Turku, one of the old Hanseatic cities with long traditions, would be a natural host for such an institute.

Ville Itälä

Member of the European Parliament

Vice-President of the Group of the European People's Party (Christian Democrats) and European Democrats

Why a Baltic Sea Economic Region?

by Johnny Åkerholm

The region around the Baltic Sea is among the fastest growing areas in Europe. But this is clearly not good enough from a global perspective, which is an increasingly relevant basis for judgement. The question is, can we do better by working together, and if so, what could we do?

There are many efforts to promote better integration in the Baltic Sea Region. But the truth is, that much of the interest in Northern Germany and Poland is tuned to the South, the Baltic States are concentrating their interest on funds flowing in from the EU, Russia is focusing on the European continent, and Norway looks towards the West. Moreover, many of the countries in the region concentrate their international cooperation efforts to Brussels. So, are the efforts to strengthen cooperation in the Baltic Sea Region illusory and not well placed?

No, they are certainly not. Enhanced cooperation can bring with it clear benefits. With globalisation, it is increasingly difficult to make a mark on the world map. For that, strong competitiveness is a necessary but not a sufficient condition. To be attractive, the area has to be large enough to be interesting from an economic point of view. But, given the divergent interests and the large differences in income levels and economic structures in the Baltic Sea Region, it seems like a highly heterogeneous area and not as one entity. Hence, the region as such does not have much international attractiveness.

As a consequence, while many of the Nordic countries figure high in the international assessments of competitiveness, direct investments to these countries are small, and the Nordic companies invest heavily elsewhere.

This heterogeneity is a weakness, which intensified cooperation could turn into strength, given that the basic level of education is good all over in the region. The differences in income levels provide for large opportunities for the reallocation of productive resources. No doubt, this has taken place in the past years, but the reallocation seems to be increasingly benefiting other regions. Furthermore, by taking a regional approach to infrastructure, in particular energy and transport, integration would be furthered and cost savings would be achieved.

Increased cooperation requires above all a strong political commitment:

- While there are increased efforts to facilitate the transfer of energy across the borders, a pre-requisite for the integration of markets, the generation of energy is totally un-coordinated. In fact, these decisions are figuring high on the national agendas in all the countries, but the solutions are very different. Eventually, integration of the markets might produce a "market solution" to the generation of energy, but it will take time. Costly and misplaced investments will occur in the meantime, and it will be more difficult to attach due attention to environmental questions. Much would be gained by a regional approach. But this does not seem realistic for the time being.
- Well-functioning logistics between the different areas in the region is a prerequisite for well-functioning integration. Cooperation is also essential in order to safeguard effective connections to the markets outside the region. Traditionally, the transport system has been functioning well between the Nordic countries, and new connections were created in the 1990's between the Nordic and Baltic countries. But many of these were based on the arbitrage arising from the high taxation of alcohol in the Nordic countries. As this taxation is adapted to the free flows of goods and services, the economics of the existing transport links come into new light. This does not reduce the need for transport, but new approaches are needed when the implicit "subsidies" disappear. Again, a regional rather than national approach to solve these new problems would be most efficient.
- Cooperation in education and research and development could also bring substantial benefits to the region as a whole. Again, while the individual countries have many strong spots, the region is not attractive enough from an international perspective.
- It must be accepted that the economic structures will adjust to the differences in economic conditions. In practice, labour intensive production will have a tendency to move to low-cost areas, which cannot be expected to provide all the public services and take all the related costs in the short- to medium-term. The challenge for the more developed areas is to generate new, higher qualified, higher paid jobs instead of those that disappear. This will become easier if the whole area is more integrated and hence more attractive. Integration is no zero-sum game; when income levels in the region increase, also the attractiveness of the region increases, and all benefit. Hence, the movement of jobs into the poorer regions will not only help them but also make it easier for richer regions to find compensating activities.

How could international financial institutions, such as the Nordic Investment Bank, support the integration process? There are a number of opportunities for this, as long as the political support for the process exists.

- IFI's can coordinate the initiatives and put together cross-border projects, both technically and financially. They can also provide the long-term financing, which is needed for the realisation of infrastructure projects that typically have a long digestion period. NIB has experience from these kinds of projects, e.g. Via Baltica. But this typically requires that funds for technical assistance are available, which makes it possible to use the necessary resources needed for the technical and financial structuring.
- IFI's can help to put together innovative financial packages, which on the one hand involve the private sector (and hence reduce the burden on the budget) and on the other hand multiply any infusion of grant funds. The Southwest Wastewater Treatment Plant in St. Petersburg is a good example of such a project. Contrary to a widespread belief, generated by the generous supply of EU funds, these kinds of projects can never be fully financed by grant money, and the challenge is to use the available funds as efficiently as possible.

Johnny Åkerholm

President and CEO

The Nordic Investment Bank (NIB)

Spatial Polarisation of the Baltic Sea Region

by Tomas Hanell

Spatial polarisation in the Baltic Sea Region (BSR) increasingly predominates across virtually all fields of the society as globalisation and structural change have taken a firm grip of both its eastern and western areas alike. The cities and urban areas in the region are the main engines of its development. This does not imply that more peripheral locations would be untouched by economic globalisation, though empirical evidence suggests that its effects do differ, dividing the regions and cities of the BSR into "actors" and "reactors". Small and peripherally located settlements lacking the necessary levers to actively take part in the international division of labour often suffer most in this respect.

The concentration of economic activity, population, corporate decision-making, labour, foreign direct investment, knowledge, and innovation to the metropolitan areas of the BSR is substantial, much more so than in several countries of continental Europe. For example, more than 90% of the HQ's of the largest BSR enterprises are located in metropolitan areas, primarily in the western BSR. In the eastern BSR the concentration to these cities is not as marked, as 60% of the 40 largest eastern BSR HQ's are located in metropolitan areas, most of the remaining ones are however also in large Polish cities (e.g. Krakow and Wroclaw). Furthermore, of the BSR offices of the 46 most global producer service firms more than 90% are located in only eight metropolitan cities of the region. Thus the nine capital regions of the BSR (plus Hamburg and St Petersburg) account for more than a third of the region's entire production value, although they contain only a fifth of its population on a mere 3% of its land area.

Among those one hundred (NUTS3) regions in the EU with the lowest GDP per capita in 2002 no less than 56 were within the BSR. Additionally all seven Russian BSR regions qualify in the same category as in all likelihood would those from Belarus – were comparable data to be available. Even more alarming however are the most recent development trends. Comparing the total regional disparities between 1995 and 2002 (Norway and the Russian BSR 1995-00) they have increased in all countries save for the Russian parts of the region (table).

Similar concentration patterns are also discernible with regard to employment although in traditional Polish manufacturing cities in particular the decline in the number of jobs has been colossal. Disregarding the obvious national differences, city size remains an important factor in explaining new job creation. In general, the larger the city, the more favourable has been the development of its employment. To make matters worse, there is an ongoing process of labour reorganisation in the BSR where agricultural jobs lost in peripheral regions and manufacturing ones in industrial regions are being replaced by service sector jobs in metropolitan areas and other large cities. This transition process cannot but help to reinforce the ongoing shifts in the settlement structure of the region. Thus, in countries – such as Poland or Belarus – that have both a large rural population and a relatively underdeveloped service sector, the likelihood of increased future rural-urban migration seems greater. Or will it be a question of emigration?

The demographic magnetism of larger cities in general and metropolitan areas in particular is strong. The migration surplus to the twelve metropolitan cities during the period 1995-2001 was on average 0.2% each year. However, suburbanisation and increased commuting entails that the absolute winners among the cities of the BSR (when taken as a group) are smaller settlements in close proximity to metropolitan cities, for which the corresponding figure was 0.5% per year on average. Imbalances in the demographic structure reinforce migration patterns where small and peripherally located settlements are rapidly ageing whereas young persons flock to larger cities.

Nonetheless, many of the BSR countries are relatively small in economic terms and are thus often simply unable to compete on a par with the major European economies, let alone globally. As such, then the concentration of effort into the promotion of a select few urban centres seems rational. The question however remains whether this type of concentration is sustainable in the long run. Or is it even sustainable today?

Tomas Hanell

Research Fellow

Nordregio – Nordic Centre for Spatial Development

Country or area (nr of regions)		Standard deviation of GDP/capita 1995	2002	Absolute change (units)	Relative change (%)	Interpretation Disparity at onset	Tendency
Sweden	(21)	7.9	11.9	4.0	50.7		
Denmark	(12)	12.8	14.3	1.5	11.8		
Lithuania	(10)	13.4	24.1	10.7	80.0		
Poland	(16)	15.1	20.2	5.1	34.1	Small	Increasing
Norway *	(18)	15.2	16.2	1.1	7.0		
Finland	(20)	16.6	19.6	3.0	18.2		
Russian BSR *	(7)	29.0	14.8	-14.3	-49.1	Large	Decreasing
Latvia	(5)	29.3	39.2	9.9	34.0		
Estonia	(5)	34.3	38.9	4.6	13.5	Large	Increasing
German BSR	(7)	39.2	43.3	4.1	10.5		
BSR total **	**(121)**	**18.8**	**22.4**	**3.6**	**18.9**	**Average**	**Increasing**

Deviation based on indiced values. * 1995-2000 ** Excluding Belarus

Lithuania - Ambitious Plans in the New Space

by Kęstutis Daukšys

Successful Reforms

This last decade has seen a number of important economic reforms in Lithuania, which have undoubtedly paved the way for the country's successful integration into the EU.

Lithuania's economic progress has received high marks from foreign experts. For instance, the World Bank report on the investment climate in 145 countries, 'Doing Business in 2005', ranks Lithuania at no. 6 among the world's best reformers. Also, Leszek Balcerowicz, President of the National Bank of Poland, noted at the beginning of this year that Lithuania was pursuing the best fiscal policy in Eastern Europe. Moreover, the German Economic Institute in Cologne, Germany (Institut der deustchen Wirtschaft Köln) has recently declared that at present Lithuania is the only one of the new EU member states fully satisfying all 4 Maastricht criteria that countries claiming membership in the Eurozone must satisfy. Finally, the European Commission acknowledged that among all the countries of the EU, Lithuania has been the most successful in incorporating EU internal market directives into national law.

Fast Growth

Lithuania's GDP jumped 9.7% in 2003 and 6.7% in 2004 while the country's industrial sector grew 10.8%.

In 2004 Lithuanian exports increased by 21% and cumulative FDI rose by 18.2%. Furthermore, the listed securities market managed by the Vilnius Stock Exchange, which along with the other Baltic as well as Scandinavian exchanges is part of OMX Exchanges, grew by 68% on average in 2004. Moreover, mobile network penetration in Lithuania today exceeds 100% while Internet penetration grew from 11% in 2002 to 39% at the beginning of 2005.

During the first half of 2005, the Lithuanian economy jumped another 7%. According to International Monetary Fund forecasts, Lithuania's GDP will increase 7% in 2005 and 6% in 2006. The prevailing opinion of the experts holds that Lithuania is not in danger of economic overheating because a lot of room for further development still exists.

Favourable Business Environment

Lithuania offers a harmonious combination of favourable investment conditions. The country produces almost half the GDP of the Baltic States and has the largest and most diversified supply chain in the Baltic States.

Moreover, the results of a survey conducted by the World Bank and published in its recent report 'Doing business in 2005: Removing Obstacles to Growth' show that Lithuania, compared to the other new EU members, provides the easiest conditions for starting and developing a business. In addition, Lithuania invites foreign investors and businessmen to use its investor-friendly tax system (for example, corporate tax is only 15% regardless of how the profits are allocated.) as well as a 16-year tax break in the country's two free economic zones (enterprise zones), one near the ice-free port of Klaipėda and the other at the international logistics centre in Kaunas, which is near an international airport and the north-south highway connecting Scandinavia with Central Europe.

Rapidly developing production clusters in electronics, mechatronics, biotechnology, laboratory and industrial lasers, the logistics and distribution networks, and the shared services and research centres, create an extremely favourable environment for foreign investors.

In order to attract new investments and encourage the expansion of existing ones, the industrial infrastructure necessary for developing greenfield investments is being rapidly developed. Target incentives and support for new investment projects are also planned. The development of promising businesses is also actively supported by EU funds.

Baltic Region of the Future

Lithuania's aims for the future are ambitious but well-grounded. First of all, Lithuania is seeking to become a member of the Eurozone by the beginning of 2007, one of the earliest of the new EU states. Moreover, the country plans to maintain the pace of their economic growth and join the club of advanced EU countries. Lithuania has also set its sights on becoming the regional leader in the field of knowledge economy.

The basis of Lithuania's ambitions consists of sustainable effort and rapid development, which has been widely commented on. For example, at the end of 2004 'FDI Magazine' of the Financial Times group surveyed 140 European cities and regions and named Vilnius, the capital of Lithuania, the Eastern City of the Future, and the Kaunas and Vilnius region the Baltic Region of the Future. These and other positive assessments are the result of the successful reforms made in Lithuania as well as country's ambitious plans for future development.

People keep asking: "What is the secret of Lithuania's rapid growth and what distinguishes it from the other Baltic States and Eastern European countries?" One of the most specific features of Lithuania, one which its people are deservedly proud of, is the extremely high level of education, which enables the country to produce greater added value and is ensuring the rapid development of the national economy.

Another precondition for the country's successful progress is Lithuania's continuing close economic integration with its Scandinavian and other Baltic Sea neighbours. Danish, Swedish, German, Russian, Finnish, and Norwegian businesses are the biggest investors in Lithuania. They, along with Polish companies, are also among Lithuania's most important foreign trade partners.

Mr. Kęstutis Daukšys

Minister of Economy

Republic of Lithuania

Baltic Banking is Modern and Concentrated

by Mart Sörg

The introduction of a market economy in the Baltic States during the last two decades took place simultaneously with structural and legal reforms. Development of the financial sector has been one of the more difficult areas of reform, since at the start of transition economy there were no relevant benchmarks for the market economy financial institutions and markets.

Reforms in the Baltic banking sectors started in 1988, three years before the restoration of political independence. Baltic countries preferred to introduce commercial banking. They had one more aim in reconstructing their banking systems – to restore financial independence from Moscow. As a consequence, Baltic Republics became pioneers in reforming the banking system in the former USSR. After the hyperinflation of 1991, which had reduced the real value of the obligatory initial capital of commercial banks by several times, a boom in establishing a new type of bank was observed. The first stage of development of new banking ended in banking crises: in Estonia 1992-1994, in Latvia 1995-1996 and in Lithuania 1995-1996. The banking crises in the Baltics were imminent, because the reorganisation of banking coincided with a time of reforms in the monetary and economic systems as well as with deep economic crises. In addition, the risk management systems of the new banks did not conform to the real needs. The crises resulted in the bankruptcy and mergers of banks, and the arrival of foreign banks as strategic investors for Baltic banks. The crises cleared the Baltic banking sectors from weaker links and presented both the central banks and the managements of operating banks with directions for improving the banking regulation and management practices.

As can be seen in Table 1, according to EBRD calculations, the banking sector reform in Estonia is practically finished, but the index of reform of non-bank financial institutions is lower – 3.3. Compared with Estonia, the success of reforms in other Baltic States is slightly smaller, which motivated the Hansapank Group to expand from Estonia to Latvia's and Lithuania's market and to improve the financial sector performance in these countries. The concentration of banks is very high in the Baltics. In the Baltics we have 43 operating banks for a population of ca 7 mln. For example, in Finland 5 mln inhabitants are serviced by almost 350 banks. Banking sector concentration is the highest in Estonia, where Hansapank's market share, by assets, is over 50%, and the share of the next biggest bank, Eesti Ühispank, is approximately 30%. A third of the Baltics' banking market, by assets, is in the hands of Swedish-origin SEB (Eesti Ühispank, Latvias Unibanka and Vilniaus Bankas) another third is in the hands of Swedbank via the Hansapank Group. Domestic banks and other foreign bank branches (from Finland, Germany and others) provide considerable competition for the two leading bank groups in several fields of activity.

Table 1. Banking sector indicators in 2004

	Estonia	Latvia	Lithuania
EBRD index of banking sector reform (1 min, 4 max)	4.0	3.7	3.0
EBRD index of reform non-bank financial institutions	3.3	3.0	3.0
Number of banks	7	23	13
Total assets (% of GDP)	76	84	33
Market share of the 5 largest banks (%)	98	63	82
Foreign-owned bank assets in (%)	97	47	91
Non-performing loans of total assets (%)	0.8	1.8	na
Return on equity, ROE (%)	23.0	21.4	13.0

Source: EBRD Transition report 2004, Part 3; ONB WP 96, 2005, p.5., Eesti Pank

The assets of the Baltic banks have grown much faster than GDP in the Baltic States. One reason for this is the enormous potential for growth. Banking assets in the Baltics stand at levels well below 100% per GDP – far from the level achieved in the Eurozone, where it was more than 260% in 2003. Despite the decrease, the interest rates and interest margins of Baltic banks are continuously highly profitable. High profit and expanding ambitions require developments in the banks' management systems and the introduction of new products and services.

For the aforementioned reasons the payment environment in the Baltics is mostly electronic, and instead of less efficient payment instruments, Internet banking and debit orders are widely used. The speed of development of electronic banking has high growth rates. For instance, the number of bank cards issued in Estonia has reached one card per inhabitant. The number of points of sale (POS) accepting card payments has also increased 3.4 times during last five years.

From Table 2 we may see that the number of card payments per capita in Estonia is several times higher than in other new EU members, former socialist economy countries (except Slovenia). Good automated teller machines (ATM) and points of sale (POS) network is the basis of this success. The development of electronic banking in Latvia and Lithuania is also quickly going up.

Table 2. Use of cash and payment cards in 2003

	Cash in circulation/ GDP	Number of card payments, per capita	Number of payment cards, per capita	Number of ATMs and POS terminals, per 1 mln inhabitants
Czech Republic	9.20	5.50	0.62	3.268
Estonia	6.10	35. 20	0.88	7.260
Hungary	7.30	7.00	0.66	2.702
Latvia	10.20	10.20	0.77	4.789
Lithuania	8.30	7.30	0.62	3.475
Poland	6.20	4.07	0.39	2.389
Slovakia	8.00	5.60	0.56	2.852
Slovenia	2.70	49.00	1.70	16.674

Source:European Central Bank. Blue Book. February 2005.

Foreign businessmen and visitors to the Baltics have expressed the opinion that our banks are operating in accordance with modern market economy patterns in every respect. The above-presented indicators demonstrate the same fact: Baltic banks have achieved the level of trustworthiness, novelty of products, and standards characteristic of banks of the developed countries. Accession to the EU a year ago gave us hope that the extremely high concentration in the Baltic banking sector will decrease in the future, as it is likely that several big European banks will try to enter our prosperous emerging market. The first signs thereof are applications to our Financial Supervision Authorities to establish representative offices in the Baltics and the boost of share prices in the Baltic Stock exchanges. For instance, in Vilnius the Stock Exchange share price of Ukio Bankas rose by the middle of August more than double compared with the last two months. And in August 23rd this year Svenska Handelsbanken, which has one of the highest ratings in Europe and is operating in 18 European countries, informed the market that they have a strategy to establish a branch-office in Tallinn in first half of 2006. Planned head of the Tallinn Office, Harri Tuohimaa, already is preparing the branch activities in temporary rented rooms in Tallinn.

Mart Sörg, D.Sc. (Econ.)

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Professor of Money and Banking of the University of Tartu, Head of Institute of Finance and Accounting.

The Position of Southwest Finland as a Baltic Growth Centre

by Juho Savo and Hannu Elo

The most important growth centres in the Baltic region and current position of Southwest Finland

Definition of the Baltic region

Herein, we confine the provinces and corresponding areas bordering the Baltic as those comprised within the Baltic region. The criterion, therefore, is marine traffic contact with the Baltic Sea. In this respect, the Baltic region includes, for instance, Hamburg but not Berlin, the Turku area but not that of Tampere, etc. This selection may, of course, be criticized as excessively limited. On the other hand, it is consistent, as it closely combines the concept of the Baltic region with the Baltic Sea itself.

Population centres in the Baltic region

The number of inhabitants is regarded as one of the ordinary specification criteria for centres. On this basis, two metropolitan areas in the Baltic region stand out in the highest class: St Petersburg and Hamburg, which have millions of residents.

The capitals of the Baltic nations are comprised within the next class. Including the surrounding cities, the number of inhabitants in the areas of the capitals is roughly in the order of one million residents, an exception being the Stockholm area, where 1.7 million inhabitants live.

Those Baltic cities whose population figures vary approximately between 100,000–400,000 are included within the third group. The largest urban areas in this group, Kaliningrad and Göteborg, are actually considerably larger than this.

The large cities and urban areas of the Baltic region, 2002-2004

	City	Urban area
St Petersburg	4 565 000	5 410 000
Hamburg	1 729 000	2 515 000
The capitals and capital city areas of the Baltic region		
Stockholm	762 000	1 684 000
Riga	733 000	..
Copenhagen	502 000	1 086 000
Helsinki	559 000	976 000
Vilna	542 000	..
Tallinn	397 000	..
The other largest cities and urban areas in the Baltic region		
Kaliningrad	427 000	950 000
Göteborg	478 000	810 000
Gdansk	461 000	..
Szczecin	415 000	..
Århus	294 000	..
Malmö	267 000	..
Kiel	230 000	..
Lubeck	220 000	..
Rostock	197 000	..
Klaipeda	192 000	..
Turku	175 000	260 000
Oulu	126 000	..

Turku's twin cities, Göteborg and Århus, which are in close marine contact with the Baltic Sea via the Straits of Denmark, are included here as borderline cases.

If the number of inhabitants were the most essential criterion in the competition between the cities, Turku would belong to the tail-end of the third class. Fortunately, this is not the case.

The most important areas for production in the Baltic region

The strength of Baltic centre areas can also be measured by the areas' production, which tells more about their accomplishments. These areas are clearly grouped in a different sort of order of magnitude to that of number of inhabitants.

Clearly, the most vigorous and prosperous areas for production in the Baltic region are Hamburg and the county of Stockholm. These are followed by the region of Uusimaa, the counties of South Sweden and the region of Copenhagen. However, already after these come the region of Århus and Southwest

Finland, which is in eighth place. For instance, the Baltic urban areas of North Germany (with the exception of Hamburg) and the capital areas of the Baltic nations remain far behind in this comparison. Nevertheless, the comparison only indicates the general trend, since the area-related concepts do not completely conform to each other. Information on the St Petersburg area has not been available.

Area	GNP 2002 in bn euros
Hamburg	76.3
County of Stockholm	73.1
Region of Uusimaa	49.5
County of Westrogothia	42.0
County of Skåne	30.6
Region of Copenhagen	27.4
Region of Århus	19.7
Region of Southwest Finland	13.0
Pomerania (in Poland)	11.5
North Ostrobothnia	9.0
Western Pomerania (in Poland)	8.9
Kiel	8.3
Lubeck	5.9
Region of Riga	5.7
Vilna	5.2
Rostock	4.9
Northern Estonia	4.4

On the basis of the grouping according to production level, Southwest Finland and Turku are able to reach substantially more significant business partners than that indicated by the population figure.

Research and product development in the Baltic region

If the relative position of Baltic region centres is assessed from the perspective of developmental possibilities, their essential importance appears to be their investment in research and product development. According to the statistics for 2003, the investment of the Baltic nations in research and product development as a share of the Gross National Product (%) was as follows:

R&D investments as of GNP in 2003

Sweden	4.27
Finland	3.51
Denmark	2.60
Germany	2.50
EU-25	*1.93*
Estonia	0.77
Lithuania	0.68
Poland	0.59
Latvia	0.39

Finland's investment in research and product development was, after Sweden, the world's second highest and relatively multiple by reference to, among others, the Baltic nations. This offers potential for the preservation of a competitive position in

the future. At the same time, it must be remembered that the new member countries of the European Union shall receive increasing investment as EU support also for research and product development, which shall improve their possibilities for success.

The significance of universities and institutions of higher education from the perspective of the areas' position

Three universities function in Southwest Finland: namely, the University of Turku, Åbo Akademi University and the Turku School of Economics and Business Administration, in addition to the country's most comprehensive polytechnic institute. As a result, the area has, in total, approximately 40,000 students in attendance at university and other institutions of higher learning. The universities referred to have a very broad international cooperation network in both the Baltic sphere and the entire world. This means considerable resources with ensuing development in mind, and will raise on their part the relative position of Turku and Southwest Finland amongst the Baltic centres above and beyond the statistical figures listed. More than anything else, the trump for the Southwest Finland region in competition amidst the Baltic areas is quality rather than quantity.

Ensuing possibilities within the Baltic sphere for Southwest Finland

Southwest Finland, with over 450,000 inhabitants, is a vital region demarcated within the Baltic. In addition to agriculture, industry and education, the area is particularly profiled by its high expertise, communications technology and the biosciences. The region's enterprises with a competitive edge, globally speaking, are the Nokia cellular phone assembly facilities in Salo, the Aker Finnyards shipbuilding docks in Turku, Raisio Group food production plant in Raisio, Valmet Automotive motorcar assembly in Uusikaupunki and both the Schering and Orion pharmaceutical companies in Turku.

The area's three large ports — Turku, Naantali and Uusikaupunki — enjoy good connections all round the Baltic and inland on a secondary basis as well as to the capital district and further onwards from there to Russia, into St Petersburg's economic region. Turku has air service via Helsinki, Stockholm and Copenhagen throughout the world. Turku's urban area is, due to its location and favourable connections, a significant logistics cen-tre for the Baltic region.

The ensuing possibilities for Southwest Finland within the Baltic sphere are largely based on its current points of departure, on the foundation of which plans and programmes oriented towards the future have been brought into being.

Goals of the regional plan and regional programme

The vision for Southwest Finland's regional plan for the year 2020 is:

The region of Southwest Finland shall be a competitive, European district centre whose strengths rest in logistics and interaction. The backbone of commercial life shall be the area's industry, the fields relying on new information technology, the biosciences, and tourism. The educational standard shall be high and the region capable of being proud of its university and educational concentration. The appeal of the region shall be centred on the Turku and Salo area.

For the 2005-2008 period on its part, the points of emphasis for the regional programme have been selected as follows:

1. *The region's competitive edges shall be ensured by means of expertise and creativity*
2. *The region's success shall be safeguarded by developing its economic life*
3. *A significant Baltic region centre shall be developed out of Southwest Finland*
4. *Active functions are to be added to assure welfare*
5. *The environment shall be made the factor of attraction for the region*

In the consideration of ensuing development, it is especially important to assure the instruction-based and research-related resources for the region. In particular, the resources and initiation sites for the fields of emphasis — for instance, the biosciences, mathematics, process chemistry, medicine and dentistry, pharmaceutics, welfare and health, ICT and maritime and metal industry, culture and comprehensive education in the arts — should be safeguarded. Most recently, the pharmaceutical development unit of VTT Technical Research Centre of Finland as well as the functional foods development centre at the University of Turku have initiated operations in Turku. Extensive international exchange between institutions of higher education is also being maintained.

Southwest Finland's centre of expertise operations is being looked after by Turku Science Park, which transmits and applies new data and know-how for the requirements of business life as well as establishing the prerequisites for innovations. *The Regional Council of Southwest Finland proposes Turku as the city-based location for the new Nordic research and innovation center, Nordforsk.*

Turku is being developed as the nation's second most significant cultural city. *The City of Turku has set a goal to be the EU's European City of Culture for 2011. Cooperation is being built with, among other places, Estonia's European Capital of Culture.*

Southwest Finland's objective is to further strengthen its best production clusters. Successful product development and profitable business operations represent essential practical aims. The goal is that *The Turku and Salo axis shall be developed into a strong Baltic region centre which is specialized in the metal field as well as in the aspects related to ICT, logistics and envi-ronmental, health and technology and their beneficial exploitation in production.*

Above all, the economic advancement of the Baltic area is important to Southwest Finland. Finland's most important commercial partners are Germany, Sweden and Russia, of which the last-mentioned is ascending to first place. Contacts with all Baltic countries must be actively nurtured.

Southwest Finland's international cooperation within the Baltic sphere

Southwest Finland enjoys traditional collaboration with the Nordic countries, Russia, Estonia and North Germany. The most important areas of cooperation are the Stockholm and Mälar Valley area, those of western Estonia, the economic area of St Petersburg and other parts of Northwest Russia, in addition to the state of Mecklenburg-Vorpommern in Germany. Most recently, a cooperation programme was signed with Poland's Pomerania region. The Riga district is recognized for the collaborative potential between the areas.

The international networks of municipal and other local associations further, with their own operations, the internationalisation of the region. For example, the City of Turku functions actively in the Union of the Baltic Cities (UBC), with the University of Turku and Åbo Akademi University coordinating the Baltic university network in the case of the former and the Baltic Programme for education with respect to the latter.

The following are included within Southwest Finland's international objectives:

- *to promote the placement of international businesses in the region*
- *to expand the cooperation between Southwest Finland and the greater Stockholm area with environmental questions as the main point of emphasis*
- *to broaden collaboration with the Baltic nations and Poland, including marine traffic connections*
- *to participate in the Gulf of Finland growth triangle via the South Finland alliance*
- *to further initiatives towards the advancement of Baltic marine traffic connections as part of the pan-European traffic network and especially as respective to the Baltic motorway*

- *to develop Turku Airport into a freight traffic centre as part of Turku's logistics centre as well as ensure connections for the airport's passenger traffic to Helsinki, Stockholm and Copenhagen*
- *the Pro Saaristomeri (Pro Archipelago) environmental programme, the aim of which is to halt the deterioration of the Baltic Sea and improve its condition, requires comprehensive international cooperation within the sphere of the Baltic.*

The Southwest Finland region is ready for all cooperation in the Baltic region which is in accordance with the attainment of the objectives it has set for itself.

Juho Savo, Executive Director

Hannu Elo, Senior Adviser

Regional Council of Southwest Finland

The New Latvian Role in the Baltic Sea Region

by Artis Pabriks

Traditionally, geographic location has been considered the main source of economic well-being for the Baltic States. However with increased globalisation new factors that contribute to the national growth are emerging. The rapid development during recent years indicates that Latvia and its neighbors Estonia and Lithuania have been successful in making full use of these factors, in addition to the traditional location-based benefits, e.g. transit. So Latvia sees its future as the inspirational catalyst of regional development and that of the EU.

The values Latvia brings to the table include economic dynamism, governmental efficiency and open economy.

Economic Dynamism

Economic dynamism refers to development as measured by both economic figures and attitudes. Since 1999, when the Russian economic crisis struck, the Baltic States have exhibited GNP growth in excess of 6% for most of the years and Latvia even reached 8.5% in 2004. Naturally such growth is attributable to the low-income base and rapid foreign direct investment growth. However there are also several factors that comprise the macroeconomic environment facilitating these economic activities. These factors include the level of tax burden, the business and investment climate, labour availability and skill level.

Latvia has one of the lowest tax burdens in the European Union. Despite criticism from some of the Western European countries, Latvia strongly believes that lower taxes and simpler administration (e.g. a flat tax rate) best meet the challenge of the general trend of global efficiency, both in corporate and governmental sectors.

Although Latvia's performance in business and investment climate indicators has not always been consistent, it has been improving lately. Efficiency is the key challenge in this area and should be the focus in Latvia and in other countries in the region if they want to compete successfully in the global marketplace.

The availability of labour and skills is perhaps the single most critical aspect that needs to be addressed for the future development of Latvia. Quantitatively the available employee pool is decreasing due to low birth rates and outbound migration. Qualitatively the match between education and the needs of society and business needs to be constantly addressed. Long-term labour productivity needs to be improved in order to sustain the economic development.

Whilst not directly linked to the economic figures, societal attitudes play a key role in supporting the development. Whilst a low income level is naturally a strong motivator for increased effort (e.g. Latvia has one of the longest work hours in EU) a strong desire to succeed is prevalent in Latvia. With its business environment and attitude, one can say that in Latvia seems much closer to a curious mix of American style business dynamism than to a traditional model and of European economies based on high social values protection.

Governmental efficiency

In the environment of capital mobility and nearly all-encompassing information, governmental efficiency plays a key role in ensuring the competitiveness of a country. An inefficient government would not be able to survive with low taxes. Latvia with its low tax burden can be used as a good example of government efficiency; the small size of the country allows identifying the opportunities for further improvements. Still, in the light of increased competition from China, India and other Far Eastern countries, the countries of the Baltic should actively investigate opportunities for mutual cooperation that would increase efficiency.

Open economy

Whilst difficult to accept emotionally, a decrease in international trade barriers is the key to competitive development. Consequently, Latvia strongly supports the provisions directed towards minimising the cost of doing business internationally and opening its market. This philosophy has been reflected in the legislation regulating state purchases, business registrations, land ownership and profit repatriation.

Outlook

The huge potential for growth in several underdeveloped sectors in Latvia – be it infrastructure or construction – will provide possibilities for sustained economic growth in the medium term. From the investors' perspective, one should also continue to fully use the advantage that Latvia serves as a natural bridgehead for any economic activities in the Baltic States. This, in turn, is in the interests of the whole region.

In conclusion, Latvia's role on the Baltic Rim region should be not only viewed as a transit point, but also as a catalyst and example of efficient operations in corporate and governmental sectors. Especially, when currently EU-15 countries are experiencing an economic downturn, the experience of Latvia and other Eastern Europe countries should be further investigated to propose actions that would improve the competitiveness of each and every county and the EU as whole.

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The Baltic Countries and Integration into the EU Innovation Environment

by Jari Hyvärinen

Ongoing globalisation process increasingly supports the use of highly-skilled employees and R&D for industrial innovations, quality requirements and technological change. Technology and know-how transfer foster the accumulation of human and knowledge capital in low-wage countries and facilitate its survival in international production sharing. However, firms in developed countries prefer highly-skilled employees, especially in R&D, even if wage costs are high. R&D has a positive impact on performance and product quality and it relates positively to outsourcing.

The efficient partnership between final and intermediate producers requires a sufficient infrastructure. This is an urgent topic after the Baltic countries have joined to the European Union. These countries need a new national innovation regime that combines financial governance with governance in production and governance in innovation. The Baltic countries will be able to survive competition in the future enlarged-EU market when the contracting environment with the EU firms and foreign direct investments are assured.

When considering industrial FDI and outsourcing to the Baltic countries, mostly these were under the remit of multinational companies and they have utilised their internalisation advantage to expand their activities in the CEE markets, because it has been more advantageous to produce closer to consumers and hire high-skilled and low-wage Baltic employees. Moreover, the Baltic firms need these core investors from abroad who could be helpful in installing new methods of corporate governance and managerial incentives as well as enclosing Baltic firms in market-based information, know-how and innovation networks (Hyvärinen – Borsos 1994; Hyvärinen 1996, 1999, 2004).

So-called endogenous growth theory which was developed in the early 1990s emphasised that the R&D resources and therefore innovations is one of the main sources of economic growth. We suggest that in Baltic circumstances the endogenous growth effect might work: a small open economy with slightly higher human capital than in the rest of the world starts to trade with its intermediate goods, its investment in human capital can give an ever-increasing impact on growth. We argue that, in the Baltic countries, the advantages of EU industrial integration might be higher than the effects of integration in the EU countries, because small economies are more flexible to adapt R&D-intensive production compared to larger applying CEE economies.

A signal to Baltic firms is that they should be active in hiring skilled personnel when they take part in the EU outsourcing process. This generates the final producers' incentives to search for their conceivable partners from such a region, and Baltic firms might be better off by finding more profitable contracts with the EU final producers. As discussed in the previous section, the starting point for highly-skilled employees in R&D is estimated to be at a higher level in the Baltic countries. The next task is to find a partner among the EU final producers to fulfill their practical skills in their firm-specific training programs.

Innovative Critical Mass around Skill Spillovers is needed

Baldwin (1989) proposes that a critical mass around successful spillovers is needed and those can be found in the regions in which similar types of firms work as clusters and knowledge is spread in co-operating projects. When the successful spillovers take place in regions in which similar types of firms work as clusters, the Baltic capitals, Tallinn, Riga and Vilnius fulfill such a purpose. Moreover, several studies such as Lundwall – Johnson (1994) and Gregersen – Johnson (1997) stressed especially that institutional learning is needed so that innovations can be successfully implemented. However, to become such a regional cluster the learning economies or regions need international R&D integration and thus cross-border skill spill-overs. Baltic institutional change should move towards such a learning economy.

Externalities are important with rapid technological change and EU-Baltic Co-operation

Firstly, it can be argued that the active improvements of the Baltic governmental regimes are one of the key factors when considering fluent externalities and the rapid entry of new technologies. Especially in the Baltic countries, innovations need interactive R&D co-operation with EU firms and technological programs, and without the adaptation of the Baltic institutions, the growth of innovative activity might be moderate. The co-operation should be focused more clearly on targets that match with the production sector, such as education, information technology, EU technical standards, applied research and other parts of the knowledge infrastructure.

Secondly, the economy, with the increasing force of learning and technological change, is responsible to check, and when necessary revise, those governmental regimes (Gregersen – Johnson 1997). As found directly after the re-independency of the Baltic countries, traditional infrastructure investments such as energy and transport have already been finished or are in the home stretch. As the targets of industrial policy, these will become less important after their decreasing costs in the near future but for that reason the regimes should be focused more clearly on targets, by matching with the production sector, such areas as education, information technology, EU technical standards, applied research and other parts of the knowledge infrastructure.

Thirdly, in relation to EU-Baltic technological co-operation, the benefits of the spill-over effects are main externalities, and highly advisable for Baltic firms because it might be the fastest way to mitigate the EU technology gap.

As found above, international dissemination of new ideas and technologies takes place by international industrial integration and through the operations of multinational corporations, and the spillover effect is positively related to efficiency gains, both in intra-industry and inter-industry spillovers. Imitation and other externalities are premises but the Baltic firms should take other innovative steps of their own.

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This paper is based on the research of Hyvärinen's PhD project at the Graduate Institute of International Studies, Geneva, 2000-2004.

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A common Baltic Sea investment agency could attract new capital into the region

by Kari Liuhto

The countries surrounding the Baltic Sea are highly dependent on the economic relations between them. Of all Baltic States' foreign trade, clearly more than half takes place with other countries that surround the Baltic Sea. The dependency of Poland, Sweden, Finland and Denmark on trade within the area is slightly less, but still around 40%. The Baltic Sea nations account for one-fifth of Russia's foreign trade and one-tenth of Germany's.

In spite of the globalisation, it is probable that regional co-operation in the Baltic Sea region grows. The EU accession of the Baltic States and Poland, and the expanding energy co-operation between the EU and Russia increases further the economic ties between the countries surrounding the Baltic Sea. The Baltic Sea is Russia's most important route for transporting oil abroad, which strengthens the region's importance in the EU-Russian energy-related co-operation. The Baltic Sea maintains this position at least until the end of the next decade, when oil exports through the Barents Sea and the Sea of Japan may exceed those going through the Baltic Sea.

Foreign direct investments are not increasing the amount of capital within the region

According to a UN report, foreign direct investments in the Baltic Sea Region have grown at an exceptional rate. The amount of foreign direct investment more than trebled between the years 1995 and 2003. The growth of such investments in the Baltic Sea economic area has even outstripped that of China!

Inward FDI stock in the BSR (million USD)

Baltic Sea Region (BSR-9)	1995	2000	2003	Change 1995-2003
Denmark	23 801	66 701	76 195	320 %
Estonia	688	2 645	6 511	946 %
Finland	8 465	24 272	46 400	548 %
Germany	192 898	470 933	544 604	282 %
Latvia	615	2 084	3 320	540 %
Lithuania	352	2 334	4 960	1409 %
Poland	7 843	34 227	52 125	670 %
Russia	5 465	25 226	52 518	961 %
Sweden	31 089	93 970	143 230	461 %
Total BSR-9	271 216	722 392	929 863	343 %
Other				
EU-25	1 161 997	2 356 102	3 509 032	302 %
China (incl. Hong Kong)	362 401	803 815	876 519	242 %
USA	535 553	1 214 254	1 553 955	290 %

Source: UNCTAD

Nevertheless, we cannot yet talk of a 'China phenomenon' in the Baltic Sea Region. New external foreign capital is going into China, strongly supporting growth and creating new jobs.

Here, on the other hand, foreign investment growth can largely be attributed to investments between Baltic Sea countries. In other words, capital is being transferred from one shore of the Baltic Sea to another, so the total amount is not increasing.

The companies in the northern and western parts of the Baltic Sea are particularly active in the region's internal investments. The Danes are particularly active in Lithuania and Latvia. Finland is among the three most important investors in Estonia and Sweden. Swedish and German companies are significant investors allover the Baltic Sea Region. It is important to notice that also the companies based in the Baltic States, Poland and Russia have started their expansion abroad. This expansion has so far concentrated on the nearby countries i.e. the Baltic Sea Region.

All Baltic Sea countries would benefit from external capital investment

In order to boost the economic growth of the Baltic Sea region, we need capital to flow in from outside the area. Because of the Baltic Sea economy's internal interdependence, new capital growth in the region would also benefit those countries that are not direct recipients, and therefore, it would now be mutually beneficial to initiate co-operation aimed at attracting external capital into the region.

Tighter co-operation is more a question of the will to make it work than of significant financial outlay, because national investment agencies are already collecting most of the necessary information. The next step would be to gather all this national information in a common Baltic Sea investment agency that would be accessible and free-of-charge for all.

An agency such as this could operate in a virtual fashion. Potential investors could easily study investment possibilities in all the Baltic Sea countries via a common internet portal. These web pages could then be linked to those of national and even regional investment bureaus, allowing the investor to make direct contact with whoever is actually offering the investment support service.

A joint investment service for the Baltic Sea countries would be a natural extension to the co-operation that has long taken place between Baltic Sea states, towns, chambers of commerce and universities. As well as the countries actually bordering the Baltic Sea, inviting Norway and even Belarus into the agency could prove to be a wise decision for the future.

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Intra-FDI stock in the BSR (rank)

Recipient country (data as of), stock by countries %, (rank)

Investor country	Denmark (2003)	Estonia (2004)	Finland (2003)	Germany (2002)	Latvia (2004)	Lithuania (2004)	Poland (2004)	Russia (2004)	Sweden (2003)
Denmark	***	2% (6.)	4% (5.)	1% (12.)	8% (3.)	15% (1.)	3% (9.)	~	3% (9.)
Estonia	~	***	~	~	8% (5.)	8% (6.)	~	~	~
Finland	2% (8.)	24% (2.)	***	2% (10.)	8% (6.)	8% (5.)	1% (17.)	~	16% (3.)
Germany	4% (6.)	2% (7.)	5% (4.)	***	15% (1.)	11% (3.)	13% (4.)	11% (4.)	6% (6.)
Latvia	~	1% (13.)	~	~	***	2% (13.)	~	~	~
Lithuania	~	~	~	~	1% (16.)	***	~	~	~
Poland	~	~	~	~	~	1% (16.)	***	~	~
Russia	~	2% (9.)	1% (11.)	~	7% (8.)	8% (4.)	1% (20.)	***	~
Sweden	20% (2.)	46% (1.)	54% (1.)	2% (8.)	11% (2.)	15% (2.)	5% (7.)	~	***
Total BSR-9	27%	77%	64%	5%	59%	68%	21%	11%	26%

~ less than 0.5% of total FDI Source: National statistical authorities, central banks and investment agencies

Finnish firms expanding their operations in the Baltic Sea Region

by Riitta Kosonen and Piia Heliste

Finnish firms have been active in the Baltic States and especially in Estonia since the beginning of bilateral trade between Finland and the Soviet Union. It seems that the Finns have come to stay in the Baltic States.

The motives for Baltic operations have somewhat changed in the course of time but in general, the operations of Finnish firms have grown constantly. Companies seeking for cost advantages have often later realised also the local market potential. Finnish providers of business services that have followed their customers to the Baltic countries have later expanded their customer base to local actors. Finnish firms in the fields of information technology, textile and furniture, have been seeking for cost advantages particularly in Estonia through outsourcing or own production operations. Retailers, foodstuffs industry and construction companies have been attracted by the growing Baltic markets.

Among the Baltic countries, Estonia has been the easiest market for Finnish firms to enter. Most Finnish firms have succeeded well in Estonia, and some Finns have even gained the position of a market leader (e.g. HK-Ruokatalo, Vaasan&Vaasan, TeliaSonera). Considering the large number of Finnish firms operating in Estonia, there seem to be relatively few firms that have clearly failed. Estonia has actually been a test market for internationalisation for many Finnish firms. For example, Elcoteq, which is currently operating globally, started its internationalisation from Estonia in the early 1990s. At the break of the millennium, also Finnish retail and foodstuff companies started to look for growth through internationalisation and often headed to Estonia. In the future, one factor challenging foreign operations in Estonia is the lack of labor force. In certain sectors there are already major difficulties in finding professional labor force. Companies often train their employees themselves.

In Latvia, Finnish firms have encountered considerably more problems due to the unpredictability and lack of cooperation of the state or local administration. The stumbling of several Finnish firms in Latvia indicates that the Latvian business environment is clearly more difficult than e.g. in Estonia. Although there are Finnish firms active in various sectors in Latvia (e.g. telecom, foodstuff, retail), individual investments made have been relatively small in value.

As a rule, Finnish firms have entered Lithuania following their competitors. Therefore, they have faced relatively severe competition in the Lithuanian market. However, it seems that Finnish operations in Lithuania have not witnessed any major problems as in Latvia. Finnish investments to Lithuania have been fewer in number but larger in value compared to Latvia. Investments have mainly been targeted to telecom, foodstuff, retail and energy sectors.

During the past 10 years, the business environment has undergone tremendous changes in the Baltic countries. Especially Estonia has developed rapidly, and Finnish firms have a very positive image about Estonia's business environment. The Estonian legislation and other formal institutions regulating the firms' operations are on a western level. However, being based on German and other Central European models, the Estonian legislation partly differs considerably from the Finnish one. For example, as regards issues concerning ownership of land and real estate, the knowledge of local lawyers is often indispensable. The problem is the lack of precedents and as yet unestablished legal praxis, which sometimes shows in unexpected court rulings.

Also informal institutions in Finland and Estonia are becoming more similar. This is due to the foreign investments flowing to Estonia and importing western business practices. On one hand, business practices are modernising as the older generations are withdrawing from working life. Younger than 30-years-old-Estonians have not worked in Soviet companies. On the other hand, there are still some clear differences between Finnish and Estonian business lives. For example, the role of personal relations is emphasised in Estonia, and the personal network of a candidate may be a central factor affecting the selection of a local partner or manager. Companies try to achieve good contacts e.g. with the local administration, which may in many cases speed up and ease problem solving. Corruption was a considerable problem in Estonia especially in the beginning of the 1990s. Lately, however, corruption has clearly diminished, although there are still some regional differences. In general, the corruption situation is much better in Estonia when compared to Lithuania or Latvia, not to mention Russia.

Many Finnish firms nowadays view the Baltic countries as part of their home market, which covers the entire Baltic Sea region. Estonia alone is no longer an interesting target market. Rather, Estonia opens avenues to business opportunities in the East (Russia) and South (other Baltic countries). However, Estonia's potential as a stepping stone to Russia has so far not realised. Trade with Russia was expected to accumulate as the double tariffs were removed in conjunction with the EU membership. High expectations have been undermined e.g. by increasing import tariffs of metals from Russia. Russia has also tightened e.g. the hygiene requirements of imported Estonian foodstuffs. Nevertheless, all the Baltic countries undoubtedly have good preconditions to compete for transit trade to/from Russia as their ports and other communication infrastructure are improving. As the cost advantages are gradually disappearing, the competitive advantage of the Baltic countries will most likely increasingly base on their logistic potential.

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This article is based on CEMAT's research report "Internationalization of Finnish firms in the Baltic States in 1987-2004 and Finnish investment experiences from Estonia" (in Finnish) available at www.hkkk.fi/cemat.

The Baltic Sea - A New Dimension?

by Paula Lehtomäki

The Baltic Sea region cooperation – stretching from Russia in the East to Norway in the West, from Germany and Poland in the South to Sweden and Finland in the North – has been an effective response to the fact that these countries sharing a common Northern geography can better face challenges collectively than singly.

Modern challenges affect domestic, social and economic development as a result of the globalisation process. Through cooperation, the Baltic Rim region has been able to raise its influence in the EU, by showing progress on a regional level towards the goals of the Lisbon Agenda. The Baltic Sea region has enhanced the economic efficiency and world market competitiveness of the European Union as a whole. The key to this success has been increasing integration by removing the existing barriers for trade and investment.

Now the Baltic Sea region is entering a new stage in its economic development. With the accession of Poland, Lithuania, Latvia, and Estonia to the European Union, all countries, except Russia and Norway, are now part of one integrated economic area, subject to common rules and regulations in many areas. The new EU members on the Baltic Rim are moving out of transition into their next stage of economic development as young but established market economies. Regional cooperation is shifting from western countries providing support to their eastern neighbours to a more balanced give-and-take where both sides invest to achieve joint economic returns.

This new stage of development is in many ways a confirmation of past achievements. The enthusiasm that fueled the Baltic Area cooperation throughout the 1990s was well founded. But that will not be enough, we can not simply sit back and enjoy our previous successes based on the existing models and means. In order to take advantage of all the opportunities opening up in the interest of the region and its business community, a new strategy for cooperation is critical. This new strategy can be built on the institutions and networks created in the last decade but will have to be based on a hard-nosed look at the facts to make the case for why businesses and political leaders should invest their energy in this regional effort.

The actual starting point for the strategy composing is very challenging indeed. The Baltic Rim-region has many times been referred to as one of the most dynamic areas in the world economy. This is very true. Especially Estonia, Latvia and Lithuania have, over time, been very successful, albeit from a rather low footing. In a great number of clusters, such as telecommunications or forestry and wood processing, for example, the Baltic Area has reached a strong position, notably on a regional level and not just on any single national one.

We need to find ways how the level of economic performance and integration can developed as a function of enhanced and mutually harmonised quality and business environments across the whole of the Baltic region. The process of economic integration has been very impressive, but not completely on a really universal Baltic Area level: the process has many times been stronger between individual pairs of countries, for example, Finland and Estonia.

The differences in integration in different dimensions are pointing still to the existence of a number of real or perceived barriers holding back stronger economic ties. That is why we must go on in upgrading the context for cross-regional activities through transportation and infrastructure investments.

With regard to the world market aspect, the competitiveness agenda for the Baltic Rim requires more than just an assessment of where we stand today; it needs to be based on where exactly we want to go. We can not be strong in all areas, we must have priorities. Based on current discussions, the Baltic Area very understandably wants to be innovation-driven, focused on clusters such as IT, telecom, be active as a bridge to the Russian market and predominantly industry-driven and so on. But what of our aspirations regarding environment rules, progressive gender and labour relations, tax and regulation issues or social welfare state models? Do we have enough common ground on these issues to be able to utilise them as competitiveness factors for the whole Baltic Sea Rim? This is a question that deserves some serious consideration when talking about a new strategy for cooperation in the Baltic Sea region.

And last but by far not least: we must take care of sound business environment based on a sufficient predictability of the legislation framework and practical operation conditions for the enterprises involved. Especially in this area huge differences exist between parts and countries of the Baltic region. Even if historically explicable they are nevertheless delineating one of the main obstacles for the increase of economic integration and interaction. As long as they prevail they will have a negative impact on the further development of Baltic region, making it unnecessarily vulnerable, even to outside influences.

As the saying goes, the future Europe will be a Europe of regions to a much greater extent than the actual holistic entity. That will be a challenge even for the Northern part of our continent. But this challenge we accept with trust in our capabilities. The Baltic Sea region has all the prerequisites to become once again a closely integrated economic and cultural area such as the one it was in times past. For that to happen, we need to cooperate, but the success of our efforts up to now gives me confidence.

Paula Lehtomäki

Minister for Foreign Trade and Development, Finland

On the Marine Oil Transportation and Terminal Development in the Gulf of Finland

by Jorma Rytkönen

The Baltic Sea, the largest brackish body of water in the world, has always been an important sea route connecting the Nordic countries and Russia to continental Europe. Surrounded by nine countries, it also has some of the densest maritime traffic in the world. The Baltic Sea is also a European inland sea and important fairway between the European Union and Russia. The financial importance of this is significant. The strong economic development of trade in the Baltic See area is also reflected in the development of shipping. Consequently, when economies strengthen and trade increases, it is important that shipping and the transport system in general are not restricted by various barriers, bottlenecks and certain institutional differences. Trade development, however, is leaning towards general standards with harmonized tools and legislation

Rapid development of the oil transport - Gulf of Finland in focus

The disintegration of the Soviet Union forced Russia to start developing its own Baltic ports and terminals and to find new routes to export its oil. The Baltic States have enjoyed a remarkable economic boom, especially regarding new port and terminal development and oil transportation.

In 2000 the total amount of oil transported on the Gulf of Finland area alone was 40 million tons, in 2004 about 100 million tons and may reach 190 million tons by 2010. Russia is now the largest oil producer in the world, and the high market price of oil also puts more pressure on Russian plans to bring more oil into the world markets. Thus the development of the marine oil transport and development has been especially busy in Russia and Baltic States.

There are a lot of new oil terminal and development projects going on in the Russian Ports of the Baltic Sea. The largest oil terminal in the area is the Primorsk oil terminal which last year accounted for roughly 40 million tons alone. Together with crude oil export, the oil product transportation will soon commence, and the capacity in the future may achieve an annual level of 60 - 80 million tons. Other large scale terminals are Vysotsk, St. Petersburg's oil terminal and Ust Lugas's port area, including Vistino.

Finland's largest oil terminal in the Gulf of Finland area is Sköldvik, near the city of Porvoo. Its annual oil transportation varies between 15 - 16 million tons, but is expected to grow to 18 - 20 million tons in the future. Some amount of oil has been also transported through the ports of Kotka and Hamina as transit.

Estonia's largest oil terminal is the port of Muuga, situated close to Tallinn. It handled around 25 million tons of oil in 2004. Other main ports handling oil products are Paldiski, Paljassaare, and Miiduranna. However, there are new ports under construction, such as Aseri and Sillamae, which may have a significant oil transportation role in the future.

As traffic volumes on the Gulf of Finland seem to continue and rise rapidly, the risk of accidents is increasing accordingly. In three years' time the total number of ship calls will have more than doubled in the main oil harbours in the Gulf. Some positive developments can be noticed in the tankers that visited the Skölvik, Primorsk, St. Petersburg and Tallinn oil terminals in May 2004 when comparing the data in 2001: new vessels have been taken into use, and the tankers' age development has also had a positive effect on the vessels' structure as well. These are good signs of an increase in safety consciousness in oil transportation.

How to minimise the risk?

One fact covering recent decades has been the significant improvement of maritime safety. There are many reasons affecting this positive development. Many of these reasons are based on past accidents such as the "Erika", "Prestige" or "Baltic Carrier". Also new actions against terrorism, such as the ISPS code and new mandatory regulations in ports have improved general safety. However, even if the parts of internal or external safety are taken care of, there are still the human-machine interaction and the environmental issues left as a parts of the total safety concept. Here we have the most promising field to work with, due to the simple truth that human-related accidents represent around 80 % of the total amount of accidents.

In April 2004 the International Maritime Organisation (IMO) nominated the Baltic Sea, except for the Russian territorial waters, a Particular Sensitive Sea Area, PSSA. This is a direct signal to seafarers to take into account the Baltic Sea's vulnerable environment. An especially sensitive part of the Baltic Sea is the Gulf of Finland, which is shallow and surrounded by a broken coastline of bays and islands, and which is partly covered by ice in wintertime.

In recent years the Gulf countries have taken several steps to improve safety. An example of recent measures is the Gulf of Finland mandatory Ship Reporting System (GOFREP) which came into operation in July 2004. The system was established to improve maritime safety, to protect the marine environment, and to monitor compliance with the International Regulations for Preventing Collisions at Sea.

Nevertheless, no system, no regulation, nor double-hulled tankers can totally eliminate the risk of accidents. Due to the fact that maritime transport, and especially oil transport, is increasing dynamically, the most important task would be to identify the environmental risks and then to proceed systematically to decrease hazards and any negative impacts on nature.

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2004

Doing Business in the Baltics - a World Bank Perspective

by Thomas Laursen and Roger Grawe

Background

The Baltic countries have grown rapidly since the mid-1990s, but income levels remain at less than one-half of those prevailing in Western Europe. The overarching question now is whether the high growth rates of recent years can be sustained over the medium-long term, thus allowing for rapid convergence toward average EU income levels. There is little doubt that part of the recent dynamics reflects the very low starting level a decade ago, with strong productivity growth owing partly to continued labour shedding and the reallocation of resources toward more productive sectors and with high investment rates responding partly to the need for upgrading a depleted capital stock. More recently, rapid credit growth has fuelled a boom in domestic demand, resulting in large current account deficits, which cannot be sustained indefinitely. At the same time, however, investment and productivity growth also reflects the general improvement in the investment climate and substantial inflows of foreign direct investment, augmenting not only investment but also transferring know-how and new technology. It is difficult to disentangle the relative importance of all these factors, but looking more closely at the business and investment climate may help.

Business and investment climate

The Baltic countries generally compare favourably with other new Central European EU member countries on various indicators of doing business and investment climate (Annex). Among the Baltic countries, no consistent ranking seems possible. While Estonia leads according to several indicators (economic freedom according to the Heritage Foundation index, competitiveness according to the World Economic Forum and IMD indices and overall transition according to the EBRD transition indicators), Lithuania comes out on top according to the World Bank assessment of ease of doing business. In fact, Lithuania now ranks among the Top 20 globally in this assessment, with the other two Baltic countries close behind. Slovakia is the only other country in the region included in this group, one place behind Lithuania.

The same is true when looking at other aspects of the investment climate such as macroeconomic stability, production costs and financial sector development. The Baltic countries — in the context of their fixed exchange rate regimes — have all pursued prudent fiscal policies and have low levels of debt and inflation. Estonia and Lithuania were in the first group of countries (along with Slovenia) to join the ERM-2 — the "waiting room" for Euro adoption — and Latvia is expected to follow soon, despite a burst in inflation following EU accession. Nevertheless, rapid credit expansion and high current account deficits remain a source of concern. Production costs are relatively low in the Baltic countries, with average wages around EUR 400 per month (some 30% lower than the largest Central European countries) and effective corporate tax rates are also among the lowest in the region. In terms of financial sector development (as measured by assets or credit to the private sector as a share of GDP) Estonia and Latvia are broadly in line with the average for the region (although far behind the EU15), while Lithuania has only come about half as far.

Looking at foreign direct investment inflows (FDI), the Baltic countries again seem relatively attractive, with FDI in Estonia for example, amounting to an average of 7% of GDP in 2002-03 compared to an average of 4% of GDP in Poland, Hungary, and the Czech Republic during the same period. However, available evidence suggests that most of this foreign investment has gone into relatively low-value added and low-skill labour intensive industries

Key challenges

Looking ahead, even with the relatively conducive investment climate, the Baltic countries face a number of important challenges in order to sustain high growth rates in the face of increasing competitive pressures, both from other countries in the region and from countries further East. While the prospects for maintaining macroeconomic stability are favourable, the risks from continued rapid credit expansion and large current account deficits should not be underestimated. Perhaps the most important area where further reforms are needed is privatisation of the remaining large state-owned enterprises and strengthening competition, particularly in the energy sector. Banking and financial market development remains a key priority, not least in Lithuania, with easier access to finance for new, entrepreneurial, small- and micro-enterprises a top priority. Additional efforts are also required to increase flexibility in the labour market, including reducing the tax wedge. Finally, there is ample room to improve the legal system, especially relating to bankruptcy, creditor rights and enterprise restructuring, as well as regulations affecting land registration and use, the latter certainly in Lithuania. Corruption remains an important challenge, especially in Latvia and Lithuania. In the longer run, improving further the quality of education and building national innovation systems will be crucial to develop a knowledge-based economy and move up the technology ladder in production and exports. Nevertheless, if the dynamism of recent years is a good indicator, there is the fundamental commitment of both private and public sectors in all three countries to a successful reunion with the European family, which suggests that doing business in the Baltics will continue to be a winning proposition.

Thomas Laursen is Lead Economist for Central Europe and the Baltic States in the World Bank and Roger Grawe is Country Director for the same group of countries.

Annex (Doing Business in the Baltics – a World Bank Perspective)

INDICATORS OF DOING BUSINESS AND INVESTMENT CLIMATE

	scale (high - low)	Estonia	(rank)	Latvia	(rank)	Lithuania	(rank)	Other EU8 countries average*
Index of Economic Freedom 2004 (the Heritage Foundation)	1-5	1.76	(6)	2.36	(29)	2.19	(22)	2.60
Growth Competitiveness Index 2004 (World Economic Forum)	7-1	5.08	(20)	4.43	(44)	4.57	(36)	4.45
The Business Competitiveness Index Ranking (World Economic Forum)	Ranking		27		49		36	
IMD - World Competitiveness Ranking 2004	U.S.=100	68.43	(28)	n.a.		n.a.		53.71
EBRD Transition Indicators 2004	4.3-1							
Large scale privatisation		*4.0*		*3.7*		*3.7*		*3.7*
Small scale privatisation		*4.3*		*4.3*		*4.3*		*4.3*
Governannce & Enterprise restructuring		*3.3*		*3.0*		*3.0*		*3.2*
Price liberalisation		*4.3*		*4.3*		*4.3*		*4.2*
Trade & Forex systems		*4.3*		*4.3*		*4.3*		*4.3*
Competition Policy		*2.7*		*2.7*		*3.0*		*2.9*
Banking reform & interest rate liberalisation		*4.0*		*3.7*		*3.0*		*3.6*
Securities markets and non-bank financial institutions		*3.3*		*3.0*		*3.0*		*3.2*
Overall infrastructure reform		*3.3*		*3.0*		*2.7*		*3.2*
Doing Business 2005 (IBRD/The World Bank)							17	
Starting a Business								
Number of procedures		*6*		*7*		*8*		*9*
Time (days)		*72*		*18*		*26*		*47*
Cost (% of income per capita)		*7.5*		*17.6*		*3.7*		*14.5*
Min. capital (% of income per capita)		*49.7*		*41.4*		*62.8*		*86.6*
Hiring and Firing Workers								
Dificulty of hiring Index	*0-100*	*11*		*78*		*33*		*19*
Rigidity of hours Index	*0-100*	*80*		*20*		*40*		*52*
Dificulty of firing Index	*0-100*	*40*		*50*		*40*		*28*
Rigidity of employment Index	*0-100*	*44*		*49*		*38*		*33*
Firing costs (weeks)		*33*		*42*		*38*		*29*
Registering Property								
Number of procedures		*4*		*10*		*3*		*5*
Time (days)		*65*		*62*		*3*		*164*
Cost (% of property value)		*0.5*		*2.1*		*0.9*		*3.3*
Getting Credit								
Cost to create collateral (% of income per capita)		*43.0*		*1.5*		*4.1*		*7.7*
Legal rights Index	*10-1*	*..*		*8*		*4*		*6*
Credit Information Index	*6-0*	*5*		*4*		*3*		*4*
*Public registry coverage (per 1,000 adults) **		*0*		*6*		*44*		*10*
*Private bureau coverage (per 1,000 adults) ****		*95*		*0*		*0*		*132*
Protecting Investors								
Disclosure Index	*7-0*	*4*		*5*		*6*		*5*
Enforcing Contracts								
Number of procedures		*25*		*23*		*17*		*27*
Time (days)		*150*		*189*		*154*		*647*
Cost (% of debt)		*10.6*		*11.0*		*14.1*		*11.5*
Closing a Business		*3.0*		*1.1*		*1.2*		*4.2*
Time (years)								
Cost (% of estate)		*8*		*4*		*8*		*19*
Recovery rate (cent on the dollar)		*40.0*		*85.0*		*52.4*		*35.8*

* Czech Republic, Hungary, Poland, Slovak Republic, Slovenia

** Number of individuals and firms listed in the public credit registry with current information on repayment history, unpaid debts or credit outstanding. The number is scaled to country's adult population (per 1,000 adult population). If a public registry does not operate, the coverage value is 0.

*** Number of individuals or firms listed in the private credit bureau with current information on repayment history, unpaid debts or credit outstanding. The number is scaled to the country's adult population (per 1,000 adult population). If a private bureau does not operate, the coverage value is 0.

CBSS and the Economic Cooperation in BSR

by Hannu Halinen

The Baltic Sea Region is a heterogeneous area, reflecting clear diversities; it is like a mosaic composed of local, regional and national activities. On an intergovernmental level, diversities also prevail, although European integration has recently made its mark in economic and political fields. Under these circumstances, is there a sufficient enough basis to talk about a common identity, to identify the Baltic Sea Region as a brand? I think one can distinguish a common BSR vision commensurate, at least, with the Mediterranean – a vision based upon such features as competitiveness, human development (education, culture, tourism, welfare state) and an ICT/information society.

The BSR has undergone a paradigm shift during the last fifteen years, with the emphasis moving from political to economic, social and environmental development. This has affected the role of the four main intergovernmental organisations in the region, the Council of the Baltic Sea States (CBSS), the Nordic Council of Ministers, the Arctic Council and the Barents Euro-Artic Council.

As a follow-up to the Baltic Sea Summit in June 2004 in Laulasmaa, Estonia, the CBSS is engaged in reassessing its role within the regional playground after the EU enlargement. To be specific, the Heads of Government expressed expectations on our cooperation to become more pragmatic and result-oriented. The process of exploring new approaches to economic cooperation complementary to the EU agenda is underway. The search for a new niche that the CBSS could occupy in regional affairs would require a certain reprioritisation, taking into account three parallel processes: EU enlargement, Russia's accession to the WTO and developments within the creation of the EU-Russia within the four "Common Spaces". It is probable that first outlines of the re-evaluation work led by the permanent CBSS Working Group on Economic Cooperation (WGEC) would be already sketched by the next CBSS Ministerial meeting in Sczczecin, in June 2005.

The economic cooperation in the CBSS is based on two documents adopted by the Ministers in charge of Trade and Economy; the Bergen (2000) and Moscow (2002) Action Plans. The WGEC was established in 1993 with a wide and flexible mandate of monitoring and developing the overall cooperation in the economic field. It is tasked to identify ways and means of increasing the perception of the BSR as an attractive area for investments.

Such topics as reducing barriers to trade and investment, including the promotion of entrepreneurship, the improvement of conditions for the border-crossing of goods, the fight against corruption and enhanced cooperation with the Russian North-West regions are high on the agenda for the current Polish Chairmanship in CBSS. At present, particular importance is given to the investment promotion.

There is a general understanding that the infrastructure around the BSR and, first of all, at its Eastern part, needs significant improvements. Such a situation impedes both the growth of trade and investment, as well as efforts by the member-states to increase competitiveness. It is thereby assumed that the "infrastructural" topic could be successfully addressed on a regional level, subject to an appropriate commitment by the member-states. In this conjunction the feasibility of a new regional financial institution for Northern Europe, in complementing the existing institutions, could be considered.

Due attention should also be given to the "soft" infrastructure – the ITC, as one of its key and essential prerequisites for economic growth. I would refer to the work within the Northern e-Dimension Action Plan (NeDAP) aimed at strengthening the leading position of the BSR in building an information society. The NeDAP is run by the CBSS Group of Senior Officials on an Information Society. As of 2005, the efforts of the SOIS would be enhanced by an expert and the financial potential of the Nordic Council of Ministers (NCM). Furthermore, the idea of establishing a Common Baltic Information Space could provide a substantial contribution to the fulfillment of the Lisbon Strategy, at least here in the BSR.

One of the key conditions for strengthening competitiveness is a closer link between the economic actors and education/research institutions. Innovation and advanced technical solutions, especially in the field of SMEs, could be crucial for both market expansion and attracting new investments. A knowledge-based economy is a goal that needs to be consistently pursued to this end.

Along with the WGEC, some other CBSS family working structures with a specific profile such as, the ad-hoc Working Group on Transport, Baltic 21, and BASREC – cooperation in the Energy sector, are also contributing well to economic cooperation. An increased coordination of activities between them, as well as with other regional actors, including the EU Commission, the BDF, the Barents Euro-Arctic Council, the NCM, the OECD, and the Baltic Sea Forum – Pro Baltica, is indispensable.

Ambassador

Hannu Halinen

Director of the Secretariat

Council of the Baltic Sea States (CBSS)

www.cbss.st

Lithuania in the Baltic Sea Rim after EU Enlargement

by Audrius Brūzga

Lithuania's accession to the EU along with Latvia, Estonia and Poland, has brought about 'tectonic' changes in the Baltic Sea Rim. The Eastern littoral states of the Baltic Sea are now firmly locked in a 'jig-saw puzzle', called Europe. They are also an in-tegral part of the Baltic Sea Area, a most dynamic and promising region in Europe. We, in Lithuania, see plenty of opportunities opening before us in this new environment. We know there are also challenges ahead and an ever-growing urge to work to-gether with partners for a common interest.

Here is Lithuania, a new EU member, in a nutshell: a future cohesion Member State with a dynamic economy, a borderland state with 922 km of eastern EU border, a country bridging the Baltic Sea and Central Europe and advocating a strong trans-Atlantic link. How does this translate in real life? Lithuania will continue to advocate the EU Cohesion policy as a means to nar-row the economic and social gap in the enlarged European Un-ion. The disparities between the countries are even more visible in the Baltic Sea context. At the moment Lithuania accounts for only 42% of GDP per capita among the EU-25. The 'catch-up' process, therefore, is an essential element in the economic per-formance of the country.

This is also one of the reasons why Lithuania supports the Lisbon process. We think that it is absolutely imperative for the EU to become a dynamic, competitive and knowledge-based economy in order to be able to compete on the global level. It is also a 'win-win' strategy for Lithuania and her fellow EU neighbours. Today we know that the Lisbon strategy is in need of good 'repair' because it is failing. Perhaps, the working group of Mr. Wim de Kok will come up with solutions on how to make these repairs, but first and foremost, we need faith in the de-clared goal for the EU to have the best economy in the World. Without it and without the commitments of the governments con-cerned, the efforts will be in vain.

Part of the problem in many EU countries is the economy it-self. In sharp contrast, the economy of Lithuania is doing ex-tremely well. It is perhaps the major driving force in the develop-ment and progress of the country. The impressive growth of GDP, a low budget deficit and low inflation rate are indicative of a healthy and vibrant economy. "Ballistic Baltic"- that's how US investment bank Goldman Sachs characterised Lithuania.

EU membership, of course, is a key factor here. The opening of the single market, substantial EU financial assistance and a significant increase in FDI will be beneficial for the entire country. Specific sectors, such as the manufacturing industry, wholesale and retail and also agriculture are expected to gain even more from the EU enlargement than others. In the years 2004-2006 Lithuania will receive financial assistance from the EU in the amount of EUR 2.7 bn, which accounts for 1.5 – 2.0 % of GDP growth.

However, for the most part the economy is growing because of reformed taxation, finance and market regulation. Generous foreign and national investments, expanding exports and growing domestic consumption have played their important roles in stimu-lating the Lithuanian economy. Expectations are that in such an environment, a sustainable annual GDP growth of 6 to 7 % in the medium term looks very realistic.

EU membership has also brought along some not-so-welcome changes, particularly those affecting trade regimes with third countries. Of special interest and importance are relations with our neighbours in 'Wider Europe': Russia, Ukraine, Belarus. According to an EU Membership Impact Study, commissioned by the Lithuanian Ministry of Economy in 2003, import to Lithuania from third countries will be 5.9 % more expensive than before. On the other hand, the increase in import costs from Russia will be 'cushioned' by the EU's General System of Preferences (GSP). As far as exports are concerned, Ukraine, as a target market for Lithuanian manufacturers, will become more expen-sive by some 12-13%. Perhaps, a certain comeback is possible when Ukraine joins the WTO and negotiates a trade regime with the EU. Lithuania is certain to advocate a speedy conclusion to such an agreement, and actively promotes EU perspective for Ukraine. We think that Ukraine belongs to Europe and that she has to be integrated into the EU's single market. This may hap-pen gradually, over a period of time, when adequate reforms are implemented. Successful and consistent reforms, as indeed in Russia and one day in Belarus also, will have a direct positive effect on economic growth of our entire region.

And then there is also the Kaliningrad Region, another EU borderland in the Lithuanian neighbourhood. Given the favour-able geographic location and the positive EU enlargement fall-out effect, the region is in a good position to turn into a very at-tractive place for business. The long-awaited Targeted Federal Programme for the Development of the Kaliningrad Region up to 2010 should lay the foundations for the economic transformation of the region and provide favourable conditions for foreign inves-tors. In addition, Lithuania is a strong advocate in the EU of adopting a special EU programme or action plan for the eco-nomic and social development of the Kaliningrad Region. The transit of people and goods from Russia to Kaliningrad through the territory of Lithuania goes according to the rules agreed by the EU and Russia, to the satisfaction of all the parties involved. However, this operational transit regime is only one important element in the efforts to foster better access and engagement with Kaliningrad. Entrepreneurship is the road to success. Lithuania already happens to be a major partner with the Kalinin-grad Region, coming third after Poland and Germany in terms of FDI and first in terms of the number of companies with foreign capital. There are at least 600 Lithuanian enterprises doing busi-ness in Kaliningrad. Most of the Lithuanian investments went into the food-processing industry, manufacture of furniture and elec-trical appliances, the service sector and construction.

The interest of our business people in the markets of our Eastern neighbours is only natural. It is, of course, profit-oriented. But there is more to this than meets the eye. Integrated regional economies will boost our global competitive powers and will bring about stability and prosperity to the whole region. There is, however, one important issue to address in this context, and that is infrastructure. The development of cross-border infrastruc-ture networks is instrumental in building a modern and competi-tive region. Furthermore, without the adequate infrastructure we will not be able to connect with the rest of Europe.

Construction of the 'Via Baltica' motorway, a major transport artery running through the Baltics and Poland to Central Europe, has been a priority project for the countries involved for a number of years now. As the 'Via Baltica' is nearing its completion, this cooperative approach needs to be put to work in another no less ambitious project known as 'Rail Baltica'. The increasingly con-gested European roads point to only one viable alternative – railroads. The European Commission has placed strong empha-sis on the development of modern railway networks. It is no acci-dent then, that 'Rail Baltica', a brand new European gauge rail

track, with high-speed trains running from Tallinn to Warsaw, has been included in the Quick Start programme. The estimated cost of the project, partly financed by the EU, is EUR 3.9 bn. The first stage, a track from Kaunas to Warsaw, is expected to be com-pleted by 2010. This requires rapid and effective cooperation among the countries involved, both in their public and private sectors. A good network of roads and railways, together with the motorways of the Baltic Sea, will help to build an integrated mul-timodal transport system, which is beneficial to the whole region.

Transport and energy issues, of which the construction of a new gas pipeline through the Baltics and implementation of the Power Bridge electricity grid connection to Poland will continue to feature on the Lithuanian agenda. The Baltic Sea Area will not 'breathe' at full capacity if it has no proper outlets to the outside world. EU policies and directives have to be complemented by the New Neighbourhood opportunities and enhanced by the trans-Atlantic partnership. A combination of these three ingredi-ents is also likely to produce the most desirable results for the countries on the Baltic Sea Rim.

Audrius Brūzga, Ambassador

Embassy of Lithuania, Helsinki

Internationalisation of Estonian Economy through Foreign Direct Investments (FDI)

by Alari Purju

Post-socialist economies have, in general, low levels of domestic savings due to their low levels of incomes. The source of foreign direct investments (FDI) is foreign saving and so additional resources will be available, contributing to the process of restructuring, economic growth and the development of technology in the recipient countries. Estonia has been one of the most successful Central and Eastern European countries in attracting FDI on a per capita basis. In addition to invested resources, the spill-over of business culture, plus an additional demand for local companies are important results of the FDI-s.

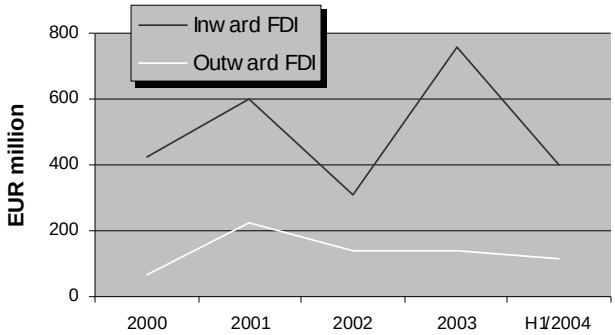
There are, in principle, three components in FDI: equity capital - the purchase by foreign direct investor's shares of an enterprise in a country other than its own - reinvested earnings and intra-company loans or intra-company debt transactions. The inward and outward FDI-s have been different sides of the same coin and created a basis for the internationalisation of economy.

The Estonian economy is closely connected the economies of Finland and Sweden via trade linkages. These countries are also the two most important sources of inward FDI, creating together 67% of the FDI-s into Estonia. Sweden is Estonia's greatest single FDI investor. The bulk of the FDI from Sweden has gone into the Estonian banking, transport and communication sectors. The major part of FDI from Finland has been directed towards the manufacturing, transport, trade, construction and real estate sectors. One reason why Finnish investors invest more in wholesale and retail trade is that majority of tourists visiting Estonia come from Finland. Those companies are also serving tourists in Estonia, especially in the capital. On the 30th June 2004, FDI into Estonia formed EUR 5.9 billion. The income of foreign direct investors in 2003 was EUR 543 mln or 10.6% from all invested money (direct investment stock in Estonia). From earned money, EUR 403.5 mln or 74.3%, was reinvested. The FDI-s have annually created up to one third of the gross fixed capital formation of Estonia.

The majority of Estonian outward FDI was converted into real estate, rent and business services and the finance. Approximately two thirds of the FDI went into Latvia and Lithuania. The total amount of outward FDI was EUR 938 mln on 30th June 2004. For further analysis of sources of outward FDI-s, it is reasonable to separate direct and indirect investors. Direct investors are domestically-owned firms from that country. Indirect investors are themselves affiliates of foreign parents, located outside a country.

On that basis, it is possible to separate into two periods, outward FDI from Estonia. Until 1998, locally-owned Estonian companies formed the majority of Estonian outward investors. After the financial crises in Russia in August 1998, Swedish commercial banks acquired the majority of shares in the two largest Estonian banks. The target of those bids was the already created Baltic network. On a minor scale, that also occurred in other sectors. So, the majority of Estonian outward investments have been acquired by foreign firms and the Estonian direct outward FDI projects were transformed into indirect ones in that process.

Inward and outward FDI in 2000-2004



The FDI-s played a major role in internationalising economies, linking the business units in different countries into a joint network. The inward FDI have been a pre-assumption for outward FDI during the second stage of that process. Prospective EU membership also played an important role, targeting the Baltic market as an overall region. It was possible to forecast that they would become EU members in the near future. This meant the harmonisation of the institutional framework and lower transaction costs for foreign investors. Estonia is a connecting link and firms registered in Estonia function as agents of Swedish and Finnish outward investors targeting the Baltic markets as a wider area for economic activities. The question for future research would be the role of Estonia as a possible mediator for Scandinavian investments towards Russia after EU enlargement.

Alari Purju

Professor of Public Economics at Tallinn University of Technology, Faculty of Economics and Business Administration and Visiting Professor at the Turku School of Economics and Business Administration, Pan-European Institute

Estonia's FDI, EUR million

Indicator	2000	2001	2002	2003	H1/2004
GDP (current prices)	5 926	6 304	6 761	7 109	4200*
Gross fixed capital formation	1 519	1 798	2 145	2 285	1350*
Inward FDI	424	603	307	756	398
Outward FDI	66	225	140	137	118
Gross fixed capital formation / GDP (%)	25.6	28.5	31.7	32.1	32.1
Inward FDI / GDP (%)	7.2	9.6	4.5	10.6	9.5
Inward FDI / Gross fixed capital formation (%)	27.9	33.5	14.3	33.1	29.4

Sources: Statistical Office of Estonia, Bank of Estonia, author´s calculations **estimate*

Latvia on the European Ship

By Valdis Krastins

It is very easy to assume that all the new member countries have boarded the EU ship with the same luggage. The Copenhagen criteria, the need for universal adherence to the Stability pact and to universal human rights instruments, efforts to make the law system compatible with EU regulations – the constant rehashing of these and other mandatory-for-all tasks during the accession time was almost bound to create an illusory vision of all ten now neatly alike, equally positioned and ready to start a sportsmanlike competition. Nothing could be further from reality. Every country has had its own development and is entering the EU on its own terms, dictated by history and the resources presently available.

During the last decade of the 19th century and the first decade of the 20th century, Latvia was a heavily industrialized region of the Russian Tsarist Empire, producing many items for the all-Russia market, including, for instance, ships, railway cars etc. At the beginning of First World War most of these industries were evacuated to Russia, the rest was destroyed by military action.

It took the newly independent Latvian state ten years to build an economical system functioning in accordance with available resources, with the geopolitical and trade situation, which, with the rise of Soviet empire, was an absolutely different one. The result was a deeply satisfactory one, putting Latvia at the end of 1930-ies on par with, for example, Denmark by GDP, income per head, educational level. The trade balance was positive, notwithstanding the fact that Latvia had to import practically all its energy sources.

The Soviet occupation and consequent incorporation into the USSR put an end to all these positive developments. The first year of Soviet rule was spent uprooting everything and everyone, especially “the class-enemy” – Latvian farmers, businessmen, not to speak of former officials and politicians. Then came the Second World War, the shadowy years of German occupation, and by the end of it in 1945 Latvia was worse off than in 1920, and under a renewed foreign, Soviet occupation at that.

During the first 25 years of the post-war period the Soviets tried to rebuild the pre-existing industries, many of which were then geared to the needs of the military machine. For instance, a leading enterprise – VEF, was transformed into a leading military communications factory completely under the control of military HC.

Then came a still more menacing turnaround in Soviet policies. The efforts of a group of nationally minded people at the local Communist leadership to keep the economical development of Latvia in some proportion to the needs of the so-called Soviet Republic created in Moscow a suspicion of separatist tendencies. From there came a directive to integrate Latvia completely into an all-Union system and abandon every attempt to keep it separate.

It started a period of frenetic factory building, sometimes in glaring contradiction with local resources and needs. For instance, in Daugavpils a factory was built for producing metallic chains for all kinds of combustion engines; its production covered up to 50% of Soviet needs. A gigantic microchip factory was erected in Riga, for a time the only enterprise in USSR producing laundry machines was in Riga, it was in this city that 50% of Soviet electrical trains were built. An immense pharmaceutical factory was created near Riga, producing for all-Union needs. So were huge textile and knit-wear plants, producing many times more that could be absorbed by local market, not to speak of glass fibre producers etc.

The scheme was simple and effective in political terms: raw materials and workforce brought in, production out, leaving local authorities with the social, ethnic and environmental fall-out. Logistics or other economical considerations did not play a role, it was a question of integrating Latvia completely - ethnically and economically - into the Soviet system.

That was the ethnically, socially sensitive and economically awkward background for the first Latvian government after regaining independence in 1991 in its efforts to return to market economics. All the following ones have been involved with reprivatisation, restructuring and splitting up procedures, trying to convert the Soviet era giants into something economically reasonable and feasible, at the same time making the banking system work and coping with the environmental side, which was completely ignored under Soviet rule. This has not gone easily at all, especially after Latvia started aiming at being a member of EU. The national debt and budget deficit had to kept under strict control; both are and have been within the boundaries prescribed.

Even now, retrospectively, there is a debate in Latvia about the debt and budgetary restrictions maybe playing too big role in holding back the rebuilding of a normally functioning Latvian economy – especially because the Latvian farming industry could not be the source of income that it was in the twenties and thirties of the last century. But it was decided to “hold the line”, to take the restrictions as a price for obtaining EU membership and the funding that comes with it. It was maybe the most difficult decision to take in connection with Latvian membership of the EU.

Now the first and foremost task is to direct EU financing and Latvian co-financing where it is needed most in the long-term perspective. It means regional development – especially where the Soviet-built factories had to be closed for economical reasons. Then the support for small and medium size enterprises, thus creating a safe economical buffer zone and giving the population in the countryside a chance to make a decent living, because farming as it is still known to many Latvians, has little hope of being successful. The farming side of the EU membership may be the most difficult, sensitive and painful one; the ideas about it are still being formulated. Then there is a need to enhance the road and railroad system, modernise ports, put money into the forest industry as the foremost Latvian natural resource.

But the most important task is to enhance and speed up monetary turnover, the cash flow. Foreign trade is one of the options for that. Latvia has been doing well in this field but not enough, as the restructuring of the economy has diminished the percentage of industrial products in GDP. Nevertheless foreign trade is now 70% with EU countries (in 1991 Latvian output went almost completely to the rest of the Soviet Union). Russia would be a natural and welcome trade partner, but as long as Russia is still coping with the emotional consequences of the loss of Balticum and is putting up artificial trade barriers, there is not much hope for improvement. A further opening up of EU markets in connection with our membership is therefore a most welcome development.

It should be clear by now to the reader that Latvia will not be in favour of abandoning its control of the fiscal system; low taxation is and will be very important in creating a competitive framework for investments. Nor would the idea of European federalism find many supporters in Latvia so soon after escaping another so-called “union”. Much more attractive is the idea of close cooperation with other Baltic Rim countries, especially with Nordic Council countries. But we feel that here too, all should be done in the European context, as the feeling of being a part of Europe, where we belong, is very dear to the heart of every Latvian.

Valdis Krastins, Ambassador

Embassy of Latvia, Helsinki

Key Trade and Transport Facilitation Issues in the Baltic States

by Lauri Ojala

On May 1, 2004 Estonia, Latvia and Lithuania joined the European Union. This had a significant impact on day-to-day business and trade practices both with EU and non-EU countries, notably that of Russia. However, the three Baltic States had already largely integrated to the world economy, and from a macroeconomic point-of-view, the EU membership did not dramatically change their trade or Foreign Direct Investment patterns. This also applies to multinational firms with operations in the Baltic States; they expected no major change in operations after May 1, as indicated in a forthcoming survey conducted by the European Logistics Association.

The Baltic economies have grown rapidly during recent years, and since 1998, the annual growth rates have exceeded the EU's average growth rate by 4-5 percent units and the latest forecasts expect the Baltic States' strong growth to continue in the next two years. Today, the EU is the main trading partner: in the first quarter of 2004, 68% of Estonian exports and 52 % of imports 52% was with the EU-15. For Latvia, the figures were 61% and 49%, respectively. In Lithuania, the EU trade covered only 43% of exports 41% of imports.

Interestingly, very few problems with trade documentation and border crossing practices in intra-EU trade were reported to our TTFBS team (see box below). Much of customs clearance work disappeared in intra-EU trade. As a consequence, many customs, customs brokers and freight-forwarding staff have become redundant. Persistent border crossing delays affected the trade with EU countries in late 2003, but the change to EU customs procedures was smooth in Estonia and Lithuania, but less so in Latvia.

The main trade, transport and border crossing problems are with Russia, and to lesser extent with some other CIS countries. Solutions to these problems are often political, and thus beyond the means of individual firms or authorities. The principal areas needing improvements are (i) border crossings with Russia (notably the Terehova and Grebneva border crossing points in Latvia) and Belarus where excessive delays occur; (ii) data exchange systems between ports and custom warehouses; and (iii) improved customs relations between the Baltic countries and Russia.

The key logistics problems of EU-Russian trade relate to dealing with Russian authorities, such as customs clearances, goods inspections and border crossings. International transport between the EU and Russia was perceived as being less of a problem. The new Russian customs code that came into force in January 2004, has markedly improved the situation. It provides a framework for feasible border crossings, transiting goods under customs bond, bonded warehousing services and customs clearance services. However, it remains to be seen how well the reform will be implemented in the Russian Customs, with approximately 63 000 staff.

Transport, storage and communications is an important sector in all current and new EU countries, but its share of Gross Domestic Product (GDP) is the highest in the Baltic States. In 2002, 15.5% of the Gross Value Added (GVA) in Estonia, 14.5% in Latvia, and 13.7% in Lithuania was produced by the transport, storage and communications sector. About 35% of the sector's GVA is produced in transport, 35% in storage and the remaining 30% by communications. In other words, transport and storage contributed from 10% to 11% of the countries' GDP in 2002.

Transport services trade is important for the Baltic States. Latvia has the highest net cash flow from trade in transport services, a situation mainly attributable to transit flow of oil and related products by railways and pipeline. By contrast, Estonia has the highest value of transport services sold to and bought from other countries, indicating the high degree of internationalisation of the Estonian transport sector. In 2003, trade of transport services generated a positive net flow of USD 595 million for Latvia, USD 470 million for Estonia, and USD 414 million for Lithuania.

The demand for transport grows rapidly in the Baltic States. In particular, demand for consolidated transport services, such as scheduled road transport and related terminal service, has grown fast. Moreover, privatisation has been widely used as a vehicle to restructure transport and transport infrastructure markets. Public-private partnerships have been introduced as a mechanism for providing good quality transport and infrastructure services at a reasonable cost.

The volume of transit oil and oil products handled at Baltic States and Russian Baltic Sea ports has increased from 50 million tons in 1997 to over 100 million tons in 2004. The economic impact of oil transit traffic through the Baltic States is significant to these countries: transit revenues represent 5 to 8 percent of GDP of the three Baltic countries.

The three countries have invested substantially in their TEN-T transport infrastructure. In 1996-2001, Estonia invested 235 million euros, of which almost half was in ports. In the same period, Latvia invested almost 370 million euros, 2/3 of which went into railways. Lithuania invested 270 million euros, half of which went into roads. For 2002-2010, Estonia and Latvia intend to spend over 600 million euros each; Estonia mostly on roads and ports and Latvia mainly on roads. Lithuania plans to invest over 1 300 million euros, mostly on railways and ports. Combined, this makes almost 2 500 million euros, not even counting the proposed Rail Baltica project.

The main short term activities include enhanced IT systems for ports and airports and regular monitoring of Customs and Supply Chain performance. In the medium term, apart from improving transport infrastructure, the capacity building of transport and trade authorities needs to continue. Other activities, albeit difficult to implement, include the need to enhance the public sector's possibilities to expropriate land for infrastructure projects of substantial public interest at lower than market prices as in the current legislation. A solution to Russia's current rail tariff policy should also be found as soon as possible.

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The article is based on the Trade and Transport Facilitation study in the Baltic States (TTFBS) conducted by Prof. Ojala and his team in April - August 2004 for The World Bank. Further reference in these issues can be found in Ojala et al. (2004) Transport Sector Restructuring in the Baltic States toward EU Accession, downloadable at: <http://wbln0018.worldbank.org/ECA/Transport.nsf/ECADocBynid/5FC55219E4D31FC685256E76005E27B4?Opendocument>

Poland in the Baltic Sea Rim - Challenges Ahead

By Stanislaw Stebelski

On 1 May this year, the EU ultimately transcended a line that once artificially had divided the continent into the East and the West. Following two earlier enlargements of NATO, in 1999 and 2004, the enlargement of the EU by 8 Central and Eastern European Countries, including Poland, Estonia, Latvia and Lithuania, has brought about the final elimination of the past divide of Europe and involved the new members-old European countries in the mainstream of the European integration process with full rights. The Baltic has become quasi an internal sea of the Union. The Eastern border of the Union with Russia and other CIS countries has been extended considerably.

The new member States have not come back to Europe. They have never left it. To Poland and other new members the membership in EU and NATO have constituted the fulfilment of dreams of many generations of freedom and human rights fighters to achieve a permanent and deserved place in the family of democratic European nations. However, challenges lie ahead of both the old and the new member states. And in spite of many fears this is not an extremely expensive enlargement, taking into account the disparity in development and prosperity which exists between old and new members of the Union.

Poland has joined the EU for many reasons, in fact, all relevant to the Union fields of competence: political, security, economic, ecological, social, human and civilisational. According to a study by Polish research institutes on the consequences of Poland's membership in the Union, the developmental gap separating Poland from EU Member States will significantly narrow. In 2004, Polish GDP per capita constitutes approximately 21% of average GDP in EU-15 at current exchange rates and approximately 41% at Purchasing Power Parity (PPP). By 2014 Poland shall attain a GDP level equal to 31% of average GDP in UE-15 in the same period at current exchange rates and approximately 55% at PPP.

For a few years after accession an investment and consumption boom is expected. Trade with the EU members will further increase. Already now the turnover with them constitutes ca. 80 % of the total Polish foreign trade. A greater inflow of FDI is foreseen. Simultaneously, Poland will receive increasing transfers from the EU. The described stage of GDP growth should be accompanied by improved macroeconomic stability. After accession to the EU, Poland will accede to ERM II and stabilise the Polish zloty to the euro exchange rate. In the most probable scenario Poland would join the euro zone in 2009-2010.

By doing that Poland will contribute to the further development and security of the Baltic region which can become a nucleus of economic growth in Europe. Already now riparian states represent important economic end technological potential. Further advancement of the new EU countries will reinforce that. However there is still a lot to be done to foster economic relations among countries in the Baltic region.

In spite of her economic potential and sizeable market, Poland attracts less than 2% of Finnish exports whilst providing less than 1% of Finnish imports. Finnish investors occupy the 19th position as foreign investors in Poland, with cumulative investments of about 500 million euros. More co-operation and joint projects are necessary to develop the infrastructure and transport links in the region. The citizens of Finland and other riparian states have still to discover many interesting tourist spots in Poland.

Regional co-operation structures face new opportunities for intensifying their activities. In most cases these organisations have become yet another framework of EU-Russia co-operation, like the Northern Dimension Programme of Action. Since June 2004 Poland has assumed the chairmanship of the Council of the Baltic Sea States to lead it through the first year of activities in a new environment.

Poland will remain a country open to the neighbours of the Union. Due to Poland's geographical location, the eastern neighbours are at the centre of its attention, which, however, does not mean neglecting other dimensions of the EU external relations. As well Poland supports further enlargement of the Union by all those European countries that are willing and ready to do so.

Poland believes that the European Union should have a clear and bold vision of its relations with Eastern Europe. It should consist of two parallel objectives: the establishment of four common spaces between Russia and the EU and the opening of prospects of membership in the Union for Ukraine, Moldova and eventually Belarus. These can be two mutually reinforcing processes. Poland is aware how far away we are at present from accomplishing this vision. The main source of concerns today is the deepening deficit of democracy in the majority of EU Eastern neighbours. Aware of the necessity to foster relations with the eastern neighbours of the Union, Poland already submitted an idea of an Eastern Dimension some years ago.

EU policy towards its eastern neighbours should be supported by relevant assistance programmes. The volume of assistance should be at least maintained at present levels, and wherever possible, it should be increased. Poland supports the European Union's decision for developing the "Wider Europe" concept and creating a new assistance instrument for those neighbours that should be a part of the new financial perspective from 2007 – 2013.

Russia, Ukraine and other eastern neighbours of the Union also represent important potential as economic partners. Poland and Finland have acquired, in particular, a great deal of knowledge on how to carry out commercial and economic operations with their neighbours. Nonetheless, they rarely use that knowledge to undertake joint operations on the eastern markets.

Enlargement has posed serious challenges to the Union itself, such as how to manage its activities and provide for sufficient efficiency of its operations among 25 member states. Poland considers that the European Union can and should be based further on the principles of coherence and solidarity in its activities. This will enable it to take into account the interests of all states, regardless of their demographic or economic potential. Poland wants the Union to be a strong, efficient and effective structure. In order to achieve this, it needs decision-making procedures encouraging compromise, instead of escaping to vote too frequently. Poland assumes that a cautiously weighted balance in the Constitutional Treaty adopted by the European Council several days ago will serve these purposes.

Membership in the European Union has not been an end in itself for Poland. For many years Poles could only witness the benefits arising from full participation in the European integration process. Now, Poland is already anchored in it as well. Making full use of the opportunities offered by it, Poland, together with Finland, wants to contribute to its further development, to the security and prosperity of the participating nations and of the whole Baltic region.

Stanislaw L. Stebelski

Ambassador of Poland to Finland

Foreign Direct Investments in Poland

by Kazimiera Wójcik

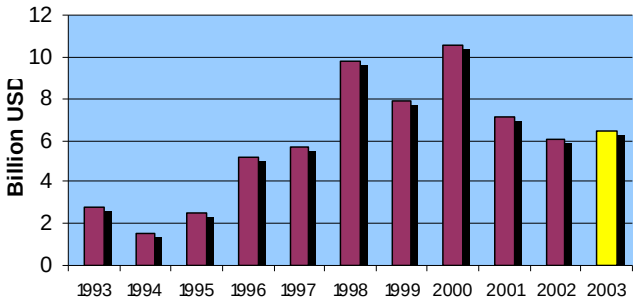
Twelve years into the steady process of economic and political reform, Poland has secured its place among the largest and most stable economies of Central & Eastern Europe. A proven member of NATO and OECD, with the full membership in the European Union, Poland is also a reliable, ever attractive partner for the international business community.

The inflow of foreign capital, initiated at the outset of the 1990's, maintains its pace. Foreign investors – big and small – have already invested over 72 billion US$ in the form of foreign direct investments, elevating Poland to the very top of the Central & Eastern European region in terms of the cumulative value of committed foreign capital.

According to the data of the Polish Information and Foreign Investment Agency (PAIiIZ) the inflow of FDI into Poland amounted to $6.4 billion in 2003. This signifies a strong, over 5% growth, by $360 million, in comparison to 2002, which in turn proves that the tendency of decreasing inflow of FDI into Poland has been overcome.

The accumulated value of FDI in Poland amounted to $72.7 billion at the end of 2003. The investments exceeding $1 million reached the level of $69.44 billion, while the investments below $1 million have been estimated by PAIiIZ at over $3.26 billion.

The inflow of foreign capital into Poland over the years 1993-2003



Source: PAIiIZ

The sector structure of foreign direct investment in 2003 shows that the majority of investments flow into the manufacturing sectors in Poland. Investments in this branch of the economy stood at $2.9 billion, roughly 46% of all investments. This gives an over 12 percentage points increase in comparison to 2002. Most of the investments in this branch of the economy were observed in the chemical and pharmaceutical sectors, which have attracted $570 million in total. The second most popular sector turned out to be non-metal products, which attracted $533 million in FDI. The following position was taken by financial intermediation, which attracted 38% of all investments in 2003.

Taking into account the accumulated values, manufacturing and financial intermediation sectors are still the most dominant, and they are followed by trade and repairs sector, as well as the transportation sector.

France, for the fourth time in a row, remained the largest foreign investor in Poland in terms of accumulated value of foreign investments inflow. French companies have invested, in total, $13.85 billion, which constitutes roughly 20% of all foreign investments in Poland.

The second largest foreign investor in Poland are companies from the Netherlands with their investments totaling $9.86 billion, followed by the United States with $8.69 billion.

The pace of foreign investment remains a valuable, objective measure of our economic development. Knowing and appreciating the importance of foreign capital, the Polish government continues its systematic effort to liberalise and simplify the laws governing business activity in Poland. Today, our country offers would-be business partners a broad array of investment incentives, harmonised with the laws of the European Union.

It has been ten years since Poland applied for membership in the European Union and six years since the accession negotiations began. Poland entered the EU on 1st May 2004.

Already now Poland is in the top 10 of the EU's trade partners. The EU remains Poland's biggest trade partner. The volume of Polish - EU trade turnover totaled over EUR 60 billion in 2003. EU accounts for around 70% of Polish export and import.

Integration with the European Union in 2004 will create new opportunities for foreign investors in Poland:

- They will gain unlimited access to the single market of 500 million customers (present EU, new member states, Norway, Iceland and Liechtenstein).
- Infrastructure will be significantly upgraded thanks to the EU structural aid. No matter what the priorities of the structural policy will be after the reform, Poland will be the single largest beneficiary of EU aid among the acceding countries.
- Polish law will be further harmonized with *acquis communautaire* thus making the legal environment fully compatible with Western standards.
- Membership in the EU will also be a guarantee of stability and dynamic development. The examples of Ireland and Spain show how the membership contributes to a country's rapid economic development and a massive inflow of investment.

Rank	Country of registration	Capital invested (USD mln)	Plans (USD mln)
1	France	13857	1 733
2	The Netherlands	9863	1 263
3	USA	8689	2 898
4	Germany	8415	1 373
5	Italy	3837	1 113
6	United Kingdom	3690	280
7	International	3162	237
8	Sweden	3062	260
9	Belgium	2048	350
10	Denmark	2111	461
…	…	…	…
19	Finland	479	179
	Investments exceeding $1 million	69 441	12 058
	...not exceeding $1 million (est.)	3 265	
	Total	72 706	

The accumulated value of FDI in Poland

Source: PAIiIZ

Kazimiera Wójcik

Head of the Press Center, Information Department

Polish Information and Foreign Investment Agency (PAIiIZ)

The Challenge Ahead - Estonia's Vision

By Matti Maasika

As of May 1, 2004, Estonia becomes a member of the European Union. First and foremost this means a new opportunity for Estonia to proactively contribute together with other member states in the work of further developing the European Union. As a member we would have to put our interests in the broader context of the European Union, in particular those of increasing European competitiveness. Success in this challenge also depends on the ability to find like-minded partners. These goals constitute the essence of Estonia's policy in the European Union, outlined in the document *Estonia's EU policy concept for 2004-2006*.

Estonia wishes to contribute to building a more wealthy and powerful Europe through achieving more open trade, the further development of the internal market, as well as further exploring the ways to reduce excessive regulation.

Estonia has wholly oriented herself to trade with the EU and Acceding countries — for several years already their percentage in the total trade of Estonia is around 80%, the inevitable increase has been ever continuous. Hence, in the light of this long experience we view Estonia's membership in the EU as a natural developmental stage.

We expect sustainable development towards a considerable rise in the competitiveness in the world markets — more precisely, there is a need for continued efforts to achieve economic power and favourable trading conditions worldwide. In this context we deem important our contribution to the development of the Baltic Sea Region as well as the new neighbours initiative. It may be of interest to point out here that the legal framework of trade relations between Estonia and Ukraine is currently more favourable than what would be available in the EU-Ukraine Partnership and Cooperation Agreement. On the other hand, there is a far-reaching offset coming: the terms and conditions of the EU-Russia PCA provide Estonia wit fair conditions to trade with Russia for the first time in a decade.

Concerning changes in the forthcoming largest trade area in the world, we believe that the accession of new members would add momentum to the Lisbon process. Four years after its initiation we have to admit that the EU as a whole has fallen short of the goals set. In preparation for membership Estonia has taken the Lisbon goals as a benchmark in the development of economics, societal and environmental thought — to facilitate economic development, the programme *Estonia's Success 2014* outlines instruments and actions to encourage transfer to a knowledge-based economy.

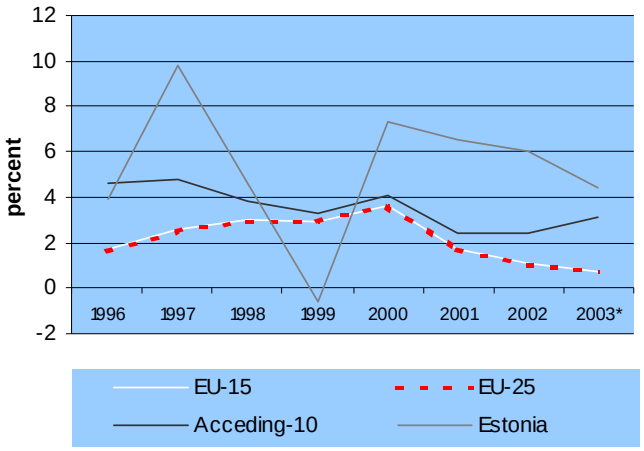
In order to subscribe to more ambitious goals of economic growth in the European Union we consider it important that all four key freedoms of EU — the free movements of goods, services, capital and people — functioned in the internal market without any restriction. Therefore, Estonia supports the strengthening of the role of the Commission in the supervision of the timely harmonisation of internal market acquis by member states.

Matti Maasikas

Ambassador of Estonia

Estonian Embassy in Helsinki

GDP at constant prices, annual growth rates



Expenditure components of GDP, 2002

	Estonia	EU-15	EU-25	Acc-10
Private final consumption	**57,3**	58,3	58,4	60,6
General government consumption	**19,7**	20,6	20,6	19,9
Gross fixed capital formation	**28,5**	19,4	19,5	21,7
Changes in inventories	**2,9**	-0,1	0,0	1,1
External balance	**-9,4**	1,7	1,5	-3,3

Gross value added by industry, 2002

	Estonia	EU-15	EU-25	Acc-10
Acriculture, forestry and fishing	**5,4**	2,0	2,1	3,5
Industry, including energy, water	**22,8**	21,4	21,6	25,2
Construction	**6,6**	5,6	5,6	6,2
Trade, transport and communic.	**31,5**	21,5	21,8	27,8
Business activities and fin. services	**15,8**	27,4	26,9	17,2
Other services, incl. public services	**18,0**	22,1	22,0	20,0

Employment breakdown by industry, 2002

	Estonia	EU-15	EU-25	Acc-10
Acriculture, forestry and fishing	**6,8**	4,0	6,0	17,0
Industry, including energy, water	**24,7**	18,3	19,2	23,7
Construction	**6,5**	6,6	6,6	6,6
Trade, transport and communic.	**26,9**	25,7	25,3	23,2
Business activities and fin. services	**8,9**	15,0	14,0	8,5
Other services, incl. public services	**26,1**	30,3	29,1	21,8

Source: Eurostat 2004

Figures compiled by editor

Finnish Firms Look Forward to Growth Prospects in the New EU Countries

by Kari Alho, Ville Kaitila and Markku Kotilainen

Finnish firms have been active in the new EU countries' markets. In the future, the firms want to continue to primarily reap benefits from the enlarged Internal Market. Also, lower costs will lead to the relocation of business activities there.

Economic development in the new EU member countries has been relatively favourable, but from a global perspective not outstanding. Their price and wage levels are still low, although rising as convergence proceeds. However, due to low initial levels, it is likely that it will take a quarter-of-a-century until real incomes and the cost level will reach 75 per cent of their respective levels in the EU-15 countries.

Of the new member countries, Estonia and Poland are the most important trading partners for Finland. Economic growth has been rapid in Estonia, but the country has to pay close attention to keeping its large external imbalance in check. Estonia is very dependent on inward FDI flows, which so far have enabled the country to finance its current-account deficit without need to raise foreign debt. It is uncertain how long such a process can continue. From the point of view of the stability of Estonia's macroeconomic development, this also forms a risk to the Finnish firms operating there.

According to the results from a questionnaire sent to Finnish firms already operating in the Baltic countries and Poland, firms still aim to expand their operations in the new EU countries. The most significant form of expansion is exports as 55 per cent of the responding firms aim to do so. The next most important forms are subcontracting and the expansion of their own production units in these countries.

Some 30 per cent of the firms aim to shift some of their production to the new member countries. The most important form in this respect is production, the second in importance being customer services. It is noteworthy that no firm will move their R&D activities or their parent company with any degree of certainty.

On the other hand, we reached the important result that the bigger the planned rise in FDI into the new member countries is, the bigger is the expected growth in exports from Finland to these countries. So, in this sample of firms, exports and FDI complement each other, and are not substitutes, as is sometimes feared. At the moment only less than 3 per cent of the total FDI stock of Finnish firms is located in the accession countries, whilst these countries' share in Finnish goods exports is 7 per cent. The investment made into the new member countries has also been more profitable than outward Finnish FDI on average.

Growing markets in the new member countries is the most important factor enhancing business conditions in these markets. The next most important factors are low costs and the expansion of the Internal Market. On the other hand, the main handicap for business is the deficient quality of public administration.

Intensified competition on the part of new member countries' firms is not considered to be a severe threat in third markets. This is based on the fact that the goods structure of the exports of the accession countries and that of Finland are dissimilar. On the other hand, Finnish firms expect to face more competition in the markets of the new member countries.

EU enlargement will create some adjustment problems for the Finnish economy. At the same time, by operating actively in the markets of the new member countries, Finnish firms can increase their overall competitiveness, which they can then use in their operations in their major export markets. This advantage should neutralise the burden of the initial adjustment as to the overall level of employment in Finland.

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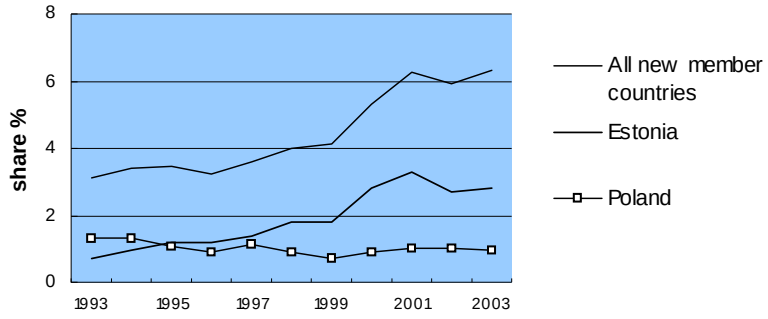
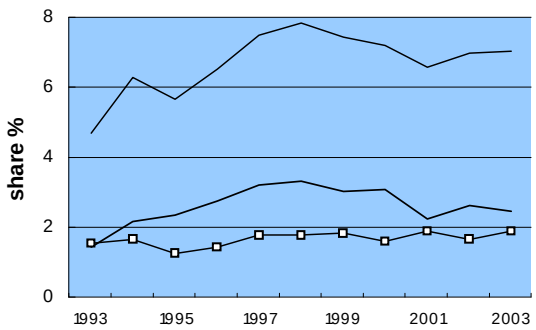
New EU countries as Finland's trade partners

In Finland's imports



In Finland's exports



The EU accession of the Baltic States and Poland creates an integrating bridge between the East and the West

by Kari Liuhto

On the 1st of May, four Baltic Rim economies – Estonia, Latvia, Lithuania, and Poland – join the European Union, and with their integration into the Union the borderline between the EU and Russia almost doubles. Their EU accession creates a rather peculiar situation in EU-Russian relations, as the Russian-Estonian and the Russian-Latvian borders have not yet been ratified by the Russian parliament. The Russian relations of Lithuania and Poland becomes emphasised especially due to Kaliningrad, a small Russian enclave (half the size of Belgium) located between them.

After the next enlargement, eight out of nine countries surrounding the Baltic Sea belong within the European Union. Hence, the Baltic Sea becomes almost the inner sea of the EU, excluding only the regions of the Russian Federation i.e. the City of St. Petersburg and the Leningrad Oblast surrounding it, and the Kaliningrad Oblast. The inner sea status of the Baltic Sea and the EU-Russian energy dialogue aid in tackling logistical and environmental challenges concerning Russia's rapidly growing oil shipments via this northern water way, which is covered by thick ice for several months a year.

The political significance of the Baltic Rim within the EU may increase. Nevertheless, it remains to be seen whether four old and four new EU members around this sea share common objectives. Should all the Baltic Rim countries stand united, they have a better chance in shifting the Union's policy focus from the Mediterranean Sea towards the Baltic Sea.

Along with the EU accession of four new Baltic members, regional attractiveness improves in the eyes of foreign investors since this region provides high economic growth, stability, wealth, and a sea access to Russia's vast natural resources. According to the UNCTAD World Investment Report, the foreign direct investment stock of the countries surrounding the Baltic Sea has almost tripled since 1995. Then, the FDI stock of these nine countries was $ 270 billion, whereas seven years later it already reached $ 750 billion. The increase around the Baltic Sea region was higher than in the rest of the world, indicating improved investment possibilities in the northern part of Europe. The investment inflow probably accelerates after the next enlargement, which is only two months away.

The European Union's next enlargement only moves the dividing Iron Curtain towards the East unless the new member states undertake an integrating role between the enlarged EU and its new eastern neighbours – especially Belarus and Ukraine. Besides, the new members, the Baltic States and Poland in particular, have an important task in further integrating the Russian economy closer towards the EU.

Although the EU covers almost 40 per cent of Russia's foreign trade, Russia is a relatively small trade partner for the Union. Even if Russia accounts for less than five per cent of the external trade of the EU15, she is, due to her oil and natural gas deliveries, a strategic partner for the Union. In the future, Russia's strategic importance as an energy supplier grows; roughly a half of the EU25's gas imports and a quarter of its oil imports will arrive from Russia.

Along with enlargement, the importance of the Russian economy ascends as the new EU members have much more intensive trade relations with Russia than the majority of old ones. Russia is an important trade partner for Estonia, Latvia, Lithuania, accounting for 3-10 per cent of their exports and 8-22 per cent of imports. In addition to Russia, the rest of the Baltic Sea region is of strategic importance. The whole Baltic Rim covers clearly over half of the foreign trade of the Baltic States. The respective figure for Poland is some 40 per cent, which is close to that of Finland.

Though the Baltic States and Poland have not invested so much in Russia, nonetheless, Russian firms have landed there. Russia accounts for 1-5 per cent of the total FDI stock in these four aforementioned countries, her proportion being smallest in Estonia and highest in Latvia and Lithuania. Just as an example, the Russia's share of the Finnish inward FDI stock is one per cent.

Currently, the Baltic States and Poland create a bridge for Russian companies towards the EU rather than a foothold for Western companies to the East. However, along with the improvement of their Russian relations, these countries may become a two-way bridge between Old Europe and Russia, i.e. they may become an important gateway to the vast Russian market, and perhaps, an integrating zone for Belarus and Ukraine. Hence, one can argue that the Baltic States and Poland play a much more strategic role in the EU than the pure economic indicators would reveal.

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Exports and imports by groups of countries

	Estonia	Latvia	Lithuania	Poland*	Estonia	Latvia	Lithuania	Poland*
January-November 2003	Exports to (share %)				Imports from (share %)			
EU-15	**68,6**	**62,3**	**42,2**	**68,7**	**53,7**	**50,8**	**44,8**	**61,4**
EU-25	**82,5**	**79,6**	**61,5**	**80,5**	**64,9**	**75,2**	**56,7**	**69,1**
Baltic Rim (9)	**70,9**	**55,9**	**47,7**	**45,4**	**55,4**	**63,4**	**55,5**	**38,7**
Estonia	***	6,5	4,3	0,3	***	6,5	1,4	0,1
Latvia	7,0	***	9,6	0,7	2,4	***	1,6	0,1
Lithuania	3,8	8,1	***	2,4	3,5	9,7	***	0,4
Poland	1,1	1,5	3,4	***	2,8	5,1	5,2	***
Finland	26,0	2,7	1,5	0,7	16,1	7,4	2,4	1,5
Sweden	15,2	10,6	4,0	3,7	8,8	6,3	3,5	2,6
Denmark	4,0	6,0	4,7	2,5	2,2	3,4	2,9	1,5
Germany	9,8	15,2	10,0	32,3	11,2	16,0	16,2	24,5
Russia	4,0	5,3	10,2	2,8	8,4	9,0	22,3	8,0
Ukraine	1,9	2,0	2,3	2,8	4,4	1,7	1,4	1,1
Belarus	0,1	1,4	3,1	0,7	1,2	3,7	1,4	0,6

Source: Statistical authorities in Estonia, Latvia, Lithuania and Poland *data by individual countries 1-9/2003

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