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Baltic Rim Economies

Estonia – Latvia – Lithuania – Poland

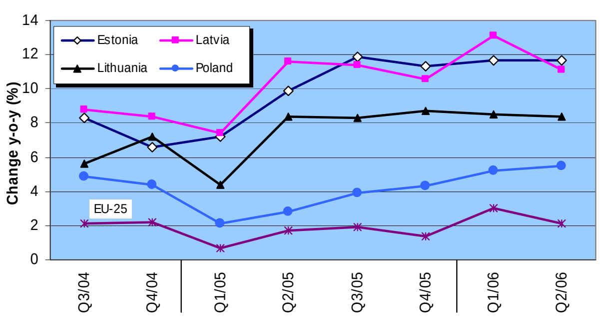
Bimonthly Review 5▪2006

Estonia

Estonia's GDP in Q2 rocketed

The Estonian economy grew by 11.7% in the second quarter of this year compared to the corresponding quarter in 2005. The growth rate was same as in the previous quarter. This is a record level for Estonia and also the highest amongst the EU countries. Growth was fuelled mainly by domestic demand and by the growth of the value added by the non-financial corporations sector. Regarding economic activities, as in the previous quarter, the growth of GDP was mainly influenced by real estate, renting and business activities, manufacturing, the wholesale and retail trade and transport, storage and communication. Gross fixed capital formation expanded by 10% and private consumption by nearly 15%. Exports increased by 16% and imports by 15% compared to the second quarter of 2005.The Estonian economy is expected to also grow in the forthcoming quarters. Furthermore, the Estonian Ministry of Finance expects the annual growth to reach 9.6% this year.

GDP growth quarterly during the last two years



Source: National statistical authorities, Eurostat

Inflation unrelenting in Estonia

According to Statistics Estonia, the consumer price index increased by 3.8% in a year in September. September's figure was better than August, when inflation rose 5% y-o-y. In Q3 inflation was 4.4% y-o-y. CPI was mainly influenced by changes in the prices of motor fuel and an increase in the expenditures on housing. Estonia's annual inflation is expected to remain at 4% until the end of this year due to robust domestic demand. Due to rampant inflation, the introduction of the euro would likely be postponed until 2010.

Current account deficit at 12.4% of GDP

During the first eight of months this year, Estonia's exports increased by 29% y-o-y, whilst imports grew by 32% in this period. The value of foreign trade increased by 22% compared to August 2005 and increased by 7% compared to July. Estonia's external balance improved a little in the second quarter of this year. The current account deficit in Q2 amounted to 12.4% of GDP, which still indicates a strong, persistently domestic demand. In the corresponding period a year earlier, Estonia's current account deficit was nearly 11% of GDP.

Finland has retained its position as Estonia's most important trade partner. In August the Finnish share of exports was 18% and imports 20%.

Of the Estonian residents surveyed in September, 11% viewed the economic changes over the past 15 years as very good, 40% as good and 40% as satisfactory. 5% considered the changes to be unsatisfactory and only 1% saw the last 15 years as very unsatisfactory.

Net sales of enterprises increased by one fifth

According to Statistics Estonia, the net sales of enterprises in Q2 of 2006 were 21% larger than in the same period of the previous year. Net sales increased in almost all activities, especially in enterprises engaged in construction, real estate, renting and business activities, energy and mining. The growth of the net sales of enterprises has lasted a whole year; furthermore the positive direction is expected to continue for the forthcoming timeframe.

Lack of labour force challenge for Baltic growth

According to the Estonian Labour Market Board in October, unemployed workers accounted for 1.5% of the working age population in the country. The figure is 3.3% smaller than the previous month and 44.8% smaller than year ago.

A new World Bank report cites labour shortage as a long term problem for the Baltic economies, as more and more Balts move to Western European countries in search of a higher income. Since the opening of EU labour markets, the Baltic States in particular experienced an exodus of their working age populations. The highest numbers are in Lithuania, where 3.3% of the working aged leaves for greener pastures. The corresponding figure for Estonia is 1% and for Latvia 2.4%.

According to Eurostat, the hourly labour cost in Estonia increased by 10% in Q2 y-o-y. The highest annual rises in the EU were found in Latvia 23% and Lithuania 21%.

Some business highlights

- Eesti Energia bought Solidius, a Scandinavian energy trading consultancy with EUR 1mln. It was Eesti Energia's first acquisition outside Estonia and became an authorised clearing representative to operate in the Finnish market and beyond.
- Estonian casino operator Olympic Casino started trading on the Tallinn Stock Exchange. Following the start of the trading, the price of the company's share shot up by 25%.
- Baltica, Estonia's largest garment maker has signed a contract for a new production building in Tallinn. The transaction price is EUR 0.7mln.
- Tallinn Technology Park Tehnopol plans major expansion to become the leading technology park in the Baltic region and Eastern Europe by 2015. The total investment for the development of Tehnopol is estimated to reach EUR 150 mln.
- Estonia's government has decided to start supporting the shipping industry in the same way as it is done elsewhere in Europe.
- JP Air, a new Estonian charter flights operator announces it is ready to start offering charter flights in Estonia in November. The company has already leased a Boeing 737 and has started hiring procedures.
- Olympic Entertainment Group is buying Poland's third largest casino operator - OEG's Armin Karu. A preliminary agreement has already been signed.
- Tallinna Kaubamaja Kinnisvara has signed a declaration stating it would buy twenty-two properties in Latvia that belong to Lidl Latvija SIA.

Estonia - main economic indicators	1999	2000	2001	2002	2003	2004	2005	2006	as of
GDP (y-o-y %-growth, constant prices)	0.3	7.9	6.5	7.2	6.7	7.8	9.8	11.7	1-6/2006
Industrial production (y-o-y %-growth)	-3.4	14.6	8.9	8.2	11.0	8.0	9.7	8.9	1-6/2006
Inflation (CPI, end of period, y-o-y %-change)	3.9	5.0	4.2	2.7	1.1	5.0	3.6	3.8	9/2006
General government budget balance (% of GDP)	-3.7	-0.6	0.3	1.5	2.6	1.7	1.6		1-12/2005
Gross wage (period average, EUR)	284	314	352	393	430	466	555	609	Q2/2006
Unemployment (% end of period, LFS data)	12.9	13.9	11.9	11.3	9.3	8.5	7.0	6.2	Q2/2006
Exports (EUR million, current prices)	2 239	3 445	3 698	3 642	4 003	4 770	6 212	4 955	1-8/2006
Imports (EUR million, current prices)	3 224	4 615	4 798	5 079	5 715	6 704	8 192	6 670	1-8/2006
Current account (% of GDP)	-4.4	-5.5	-5.6	-10.2	-12.1	-12.7	-10.5	-12.4	1-6/2006

Source: Statistical Office of Estonia, Bank of Estonia, Eurostat, author's calculations

Latvia

Double-digit growth persists

GDP growth pace declined in the second quarter of this year. In Q2, GDP in real terms increased by 11.1% compared to the corresponding quarter of 2005. During the first half of this year the Latvian economy expanded by 12% y-o-y. Q1 GDP expansion is a record high for Latvia, and also the second highest amongst the EU countries. The expansion was driven by an 18% increase in retail trade, which counts for more than a fifth of GDP. As before, growth is also based on a rise in the manufacturing industry 7%, an increase in construction 17% and in transport and communication 9%. GDP per capita, based on Q2 data, was EUR 1,216 in constant prices, which is approximately 47% of EU average. The Ministry of Economy has revised its annual growth forecasts to 11% for 2006.

Latvia's August retail sales were the highest amongst the Baltic countries. The turnover of retail trade enterprises increased by an annual 21% compared with August 2005. The economic boom has increased demand in all the main enterprises. Above all, the increase in sales of motor vehicles grew by 101% in August y-o-y, the national statistic bureau announced. Within the second quarter, domestic trade grew by 19% y-o-y.

This stellar growth continues to have an impact on the consumer price index, and Latvia maintains the highest rate of inflation in the EU. In September prices were up 0.7% from the previous month and annual inflation reached 5.9% y-o-y.

Latvia's current account deficit is at a worrying level

The total foreign trade turnover during the first eight months this year grew by 24% compared to the corresponding period last year. The value of exports in August was up by 20% y-o-y, whilst imports grew by 33% in this period. As a result Latvia's current account deficit amounted to 18% of GDP in the second quarter, which is up by 11% points from the corresponding period from the previous year. Usually the deficit increases in the second part of the year which means that worse figures can be expected for Q3 and Q4. The strong domestic demand is due to rise and the real income has been the driving force behind a steep and steady demand for imports. Latvia has had a current-account deficit every year since 1994

Latvian-Russian economic cooperation improves

Latvia's Minister of Economics and the Russian Minister of Economic Development and Trade signed a Latvian-Russian economic cooperation agreement in October. Both ministers agreed to establish an intergovernmental committee for cooperation in the fields of the economy, science and culture. The economic cooperation agreement states that both countries will make efforts to develop economic cooperation to both sides' advantage. The agreement envisages cooperation between small and medium-sized enterprises, chambers of commerce and industry, and other organisations. The meetings will be held at least once in a year.

Minimum wage rises steeply

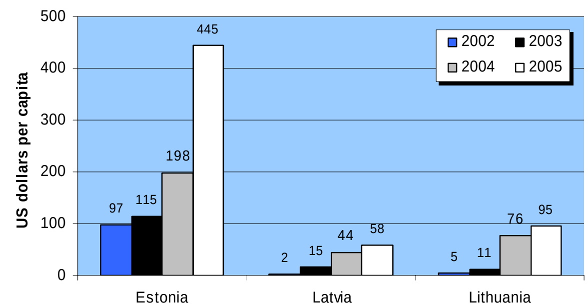
Latvia raises its minimum monthly wage to EUR 171 as of 2007.The present minimum monthly wage is EUR 129. The hourly minimum wage will rise to EUR 1.02 for adults and EUR 1.16 for minors. With the aim of setting the minimum monthly wage in the amount of 50% of the average gross wage in Latvia, the minimum wage would near the norm set by the Europe's Social Charter, which states that an employee's minimum income level must constitute 66% of the national income per one resident, or 68% of the average national wage. In accordance with the Federation of European Employers data, the minimum monthly wage in Latvia is one of the lowest among the EU member states.

Inflation obstructs business flow

The recent World Economic Forum's survey of Latvian businesses regarding their global competitiveness report shows that Latvian businesses see inflation as the largest obstruction to their business operations. Over 12% of the businesses surveyed named inflation as the largest obstacle to growth. Other factors such as tax rates and corruption also figured high on the list.

According to the Global Competitiveness Index, calculated by the World Economic Forum, Latvia ranks 36th this year, up by three places from last year. The Latvian business environment has improved tremendously in recent years. Nevertheless, according to GfK Baltic poll, undertaken in May, 81% of Latvians believe their country is corrupt. When asked about the necessity of bribes in everyday life, only 26% of respondents said that bribes were unnecessary. Almost 85% said that bribes were a part of everyday life and18% said they had offered someone a bribe during the last year.

Yearly outflow of foreign direct investments



Source: World Investment Report 2006, author's calculations

Some business highlights

- The largest privatisation in Latvian history was completed on Oct 6th with a total sale of the Latvian governments 38.62% stake in Ventspils Nafta. The sale earned the government EUR 106mln. The biggest buyer was the international oil company Vitol Group, which now owns 34.5% of Ventspils Nafta.
- Bauhaus, one of Europe's largest building merchants, opens its first store in the Baltic's at the end of 2007 or early 2008. The store will be opened at the shopping centre Alfa in Riga. It is also considering opening a second shop in Riga and possibly one in Tallinn.
- Baltic retail leader VP Market is investing EUR 11mln towards the construction of a new logistics centre in Riga. It will be the largest logistic centre in Latvia with 40,000 m^2. It will be completed by the end of this year.
- The Latvian maritime shipping company, Magnat group, is ready to invest EUR 50mln in a multi-functional development at the Riga Free Port over the next five years.
- According to data from the European Automobile Manufacturers Association, new car sales in September rocketed to 52.4% in Latvia, 46.4% in Lithuania, 11.4% in Poland and 9.7% in Estonia y-o-y.
- Gjensidige Forsikring, Norway's largest non-life insurance company has become the sole owner of Latvia's Parex Insurance company. Gjensidige Forsikring purchased the company for EUR 23 mln.
- GE Money, the global consumer lending unit of General Electric Company has signed an agreement on buying a 98% interest in "Baltic Trust Bank" (BTB) from Russian millionaire Oleg Boiko, who used to be the largest BTB shareholder.

Latvia - main economic indicators	1999	2000	2001	2002	2003	2004	2005	2006	as of
GDP (y-o-y %-growth, constant prices)	3.3	6.9	8.0	6.5	7.2	8.5	10.2	12.0	1-6/2006
Industrial production (y-o-y %-growth)	-8.8	3.2	6.9	5.8	6.5	6.0	5.6	7.6	1-8/2006
Inflation (CPI, end of period, y-o-y %-change)	3.2	1.8	3.2	1.4	3.6	7.3	7.0	5.9	9/2006
General government budget balance (% of GDP)	-4.9	-2.8	-2.1	-2.3	-1.2	-0.9	0.2		1-12/2005
Gross wage (period average, EUR)	225	268	282	297	298	314	350	415	Q2/2006
Unemployment (% end of period, LFS data)	13.2	13.3	12.9	11.6	10.3	10.3	7.8	5.6	Q2/2006
Exports (EUR million, current prices)	1 613	2 020	2 232	2 416	2 559	3 204	4 086	2 567	1-7/2006
Imports (EUR million, current prices)	2 758	3 453	3 910	4 284	4 634	5 671	6 879	4 658	1-7/2006
Current account (% of GDP)	-9.0	-4.8	-7.6	-6.6	-8.1	-12.9	-12.3	17.9	1-6/2006

Source: Central Statistical Bureau of Latvia, Bank of Latvia, Eurostat, author's calculations

Lithuania

GDP growth 6.3% in the third quarter

Lithuania's economic growth continued over the second quarter of 2006, being 8.4% y-o-y. Regarding economic activities, the most vigorous growth rates were observed in construction, which went up 18%, followed by enterprises engaged in manufacturing (15%) and real estate and other activities (10%), transport and communications and financial intermediation, both up by 7% y-o-y.

According to the first estimate by Lithuanian Statistics, GDP in third quarter grew by 6.3%. The figure is a provisional estimate, which was based on available statistical data and econometric models. Growth was expected to be a slightly higher due to a rise in wages and the very good employment situation, both of which have been the main engine behind economic growth.

The Ministry of Finance forecasts that GDP growth will come close to 7.8% this year in Lithuania, whilst in 2007 it could be 6.3%.

Wage level grew nearly 7% in 2005

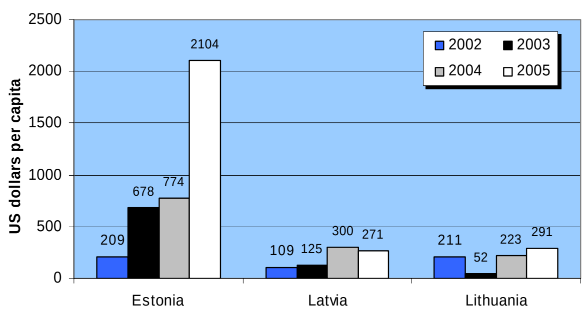
Statistics Lithuania reported that in 2005 the real wage in the national economy, including personal enterprises, grew 6.8% y-o-y. The fastest y-o-y growth of average monthly gross wages in 2005 were in construction 20%, healthcare and social services 19%, real estate, leasing and other sectors 15%. Average monthly pay is estimated to increase by 14.3% to EUR 424 this year, and to reach EUR 484 the following year.

Last year the productivity of Lithuania's labour force increased by 3.4%, as measured by 2000 prices. According to information available from Statistics Lithuania, the highest labour productivity in 2005 was in real estate, renting and other business.

Lithuania's foreign direct investments decreased in Q1

Statistics Lithuania reports that foreign direct investment inflows in Lithuania decreased 1.36% during the first half of 2006. FDI stock stood at EUR 2.014 per capita in the first six months of this year. Major investors were from Russia (21% of all FDI), Denmark (15%), Sweden (12%) and Germany (11%).

Yearly inflow of foreign direct investments



Source: World Investment Report 2006, author's calculations

Lithuania among EU leaders by export growth

Data released by Eurostat show that in H1 2006 Lithuania saw one of the highest export and import growth rates in the EU. Lithuania's exports increased by 31% in the first six months of 2006 y-o-y, outpacing neighbours Latvia 17% and Estonia 28%.The growth rate of Lithuania was the second highest in EU after Luxemburg, 42%.In H1, Lithuania ranked third by import growth 31% in the EU, falling behind Estonia 34% and Luxemburg 33%. In September industrial output grew by 3.2% compared with September 2005 and 6.9% compared with August 2006. According to Statistics Lithuania, exports increased in January-August 28% y-o-y, whilst imports grew almost 30% in this period.

Lithuania aims to adopt the euro in 2010

The euro adoption commission has decided that the next date when Lithuania will seek to adopt the currency will be in 2010. The decision has caused fulmination, because adopting the euro would improve the quality of life and bridge the gap to EU standards in the long term. According to the survey by RAIT in September, 53.8% of Lithuanians support euro adoption, while 42% disapproves. However, the number of those willing to see the euro in Lithuania as soon as possible shrank by 3.5% to 27% in the past six months. Probably the reason is that Lithuania became the first country ever to be rejected from adopting the euro, because it failed the inflation test.

Mazeikiu Nafta damaged in fire

Fire damaged the Mazeikiu Nafta refinery in the middle of October causing millions-strong losses. MN has closed one of its production units and the refinery is now working at 55% capacity. Preliminary estimates show the damages of the accident to be within the range of EUR 18–38 million and reconstruction work at MN may last until July 2007. The Polish company PKN Orlen says it will finally decide on the purchase in the first quarter of next year. The daily Lietuvos Rytas reported that PKN Orlen was considering the possible renegotiation of some purchase terms but not the price. The accident investigation commission reports its findings no later than Dec.1. Representatives of the Russian Duma, claim the sale of refiner Mazeikiu Nafta to Poland's PKN Orlen is an economic mistake. According to them, the refiner will continuously run into oil supply problems in the future.

Some business highlights

- Finnish Wärtsilä and Estonian BLRT Grupp have set up a joint shipyard in Klapeda. The new facility will provide maintenance and repair services to vessels in the Baltic Sea region.
- The largest Baltic hotel chain Reval Hotels is expanding into economy class hotel segment by acquiring the Baltpark hotel chain in Lithuania.
- According to a report by the Creditreform Institute for Economic research, Lithuania had 767 bankruptcies while Latvia had 521 and Estonia 450. In comparison, there were 240 bankruptcies in the German town Mülheim (Ruhr Area) alone.
- Fitch Ratings raised Lithuania's credit rating one step to A from A-, local currency rating was also raised to A+ from A. Fitch's upgrade to Lithuania's sovereign ratings is driven by strong economic growth and real convergence with Western Europe, coupled with fiscal discipline and low government debt levels.
- The Insurance Supervisory Commission (ISC) said the insurance market has grown by 33.6% this year.
- According to the Swiss bank UBS, Vilnius became the cheapest EU capital city this year. In 2003, Vilnius was still ahead of Riga and Prague in terms of the overall level of prices, but this year prices in those cities were a few percentage points higher than in the Lithuanian capital.
- Tele2, the mobile operator, plans to buy a 49% stake of Swedish Spring Mobil telecom company. The contract is expected to be worth EUR 16,3mln.
- Lithuania hopes to persuade Poland, Latvia and Estonia to start the design works of Rail Baltica next year. It wants construction to begin in a few years. Rail Baltica will connect the Baltic States with the European railway network.

Lithuania - main economic indicators	1999	2000	2001	2002	2003	2004	2005	2006	as of
GDP (y-o-y %-growth, constant prices)	-1.7	3.0	6.4	6.8	10.5	7.0	7.5	8.4	1-6/2006
Industrial production in sales (y-o-y %-growth)	-9.9	2.2	16.0	3.1	16.1	10.8	7.3	6.9	1-8/2006
Inflation (CPI, end of period, y-o-y %-change)	0.3	1.4	2.0	-1.0	-1.3	2.9	3.0	3.2	9/2006
General government budget balance (% of GDP)	-5.6	-2.5	-2.0	-1.4	-1.2	-1.4	-1.5		1-12/2005
Gross wage (period average, EUR)	231	263	274	293	311	335	421	440	Q2/2006
Unemployment (% end of period, LFS data)	15.3	16.9	17.9	13.0	11.6	10.6	7.1	5.6	Q2/2006
Exports (EUR million, current prices)	2 583	3 841	4 778	5 526	6 158	7 478	9 502	6 446	1-7/2006
Imports (EUR million, current prices)	4 340	5 650	6 767	7 943	8 526	9 959	12 446	8 454	1-7/2006
Current account (% of GDP)	-11.2	-5.9	-4.7	-5.1	-6.8	-7.7	-7.0	-15.9	1-6/2006

Source: Statistics Lithuania, Bank of Lithuania, Eurostat, author's calculations

Poland

Polish economy developing at a high rate

In the second quarter of this year GDP grew in real terms by 5.5% compared to corresponding period last year. Growth signifies a further acceleration in the economy compared to the previous quarter. Q2 result was primarily due to the continuing surge in household consumption, which grew by 4.9% y-o-y and a significant upturn in gross fixed capital formation, up by 14.4% y-o-y. Rapidly rising exports maintained its positive contribution to GDP growth.

Economic growth is expected to remain robust in the later part of the year. The improving situation in the labour market, low inflation and strong foreign demand confirms favourable growth figures. In the third quarter GDP growth rate is expected to reach 5% y-o-y. According to the Ministry of Finance, Poland's economy may grow by 5.5% this year due to a large increase in industrial production and retail sales. Previous forecasts were under 5%.

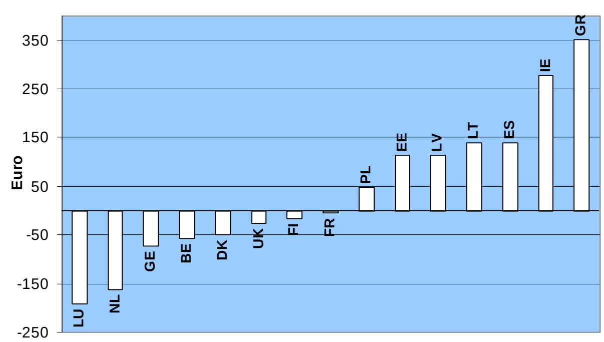
Employment and wages grow

Rapid economic growth has been accompanied by a dynamically growing demand for labour. According to statistical authorities' data from September, employment in the enterprise sector has increased by 3.5% y-o-y. The healthy state of the economy and rapidly rising demand for Polish enterprises, have raised an employment increase of 169,000 people over the last 12 months. According to a Labour Force Survey (LFS), the rate of registered unemployment at the end of August was 15.5%. Positive tendency in labour market is expected to continue in the coming quarters.

The average gross monthly wage in the enterprise sector amounted to EUR 658 in September, being 5.1% higher than in the corresponding month of 2005. The growth of wages in enterprises was lower than the market expected and the growth has been very stable since February this year.

Industrial output in September was 11.7% higher and in August 12.5% higher than in the corresponding period last year. In the first nine months of 2006 industrial output has been approximately 12.3% higher than y-o-y. Strong figures confirm that the economy is still subject to a strong upward trend.

EU membership fees per capita in 2005



Source: European Commission, author's calculations

According to the European Commission's figures, Poland received EUR 1853mln from the European Union. The figure includes paid membership fees and revenues from the EU. Divided by population, the refund was EUR 49 per capita. The corresponding figure for Estonia and Latvia was EUR 114 and for Lithuania EUR 139.

Foreign trade and retail sales increased

The first half of 2006 was marked by continued dynamic growth in foreign trade. In H1 Poland exported goods worth EUR 41,5bln and imported goods worth EUR 46bln. Compared to the corresponding period last year, exports grew by 23.1% and imports by 20.8% respectively. The growth of imports is a by-product of stronger domestic demand. Exports have been fuelled by improvements in the economic situation of Poland's main trade partners.

Retail sales have been growing robustly this year and in the first eight months retail sales climbed 11.3% y-o-y. In August, the figure was 11.5% higher compared to corresponding period last year. This result was better than market expectations and the high growth is expected to continue in the coming months.

Poles positive towards EU

In the recent spring, the CBOS polling centre, along with Eurobarometer conducted a survey in order to measure attitudes towards the EU. The data showed that support for the EU has been on the rise. Nearly two-thirds of Poles believe that their country has benefited from membership, and 62% would like the EU to play a more important role in their lives. Poles are also pleased with open borders, which allow them to find employment abroad. Over one half of Poles perceive Poland as a more secure country following accession, and as many as 60% believe that Poland's status in Europe has improved due to accession.

Some business highlights

- Rewe group, a German concern, which owns the Billa and Selgros supermarket chains, plans to invest more than EUR 130mln in Poland by 2010. The company would like to open new supermarkets and to modernise existing outlets.
- Toshiba, the Japanese tech giant, plans to build an LCD television factory near Wroclaw for EUR 34mln. The factory may offer work for over 1,000 people.
- Ikea will build a 28,000m^2 store along with a commercial park in Lodz. The project will be completed by September 2008. The investment is approximated to be worth EUR 65mln. Lotz will be Ikea's eighth store in Poland. Ikea also intends to build a second factory in Poland to Wielbark. This investment is estimated to be worth EUR 45mln. Poland is the second largest producer of furniture for the Ikea chain, right after China.
- ZenSar, one of the largest IT firms in the world, has decided to open its own central office for the Central and Eastern European region in Gdansk. The Indian concern will provide employment for 500-1000 people.
- Dell has decided to build its own plant in Lodz. The investment is estimated to be worth EUR 120mln. Up to 1000 people will find work at the Lodz plant and several thousands will be employed by partner firms.
- Since the beginning of this year 16 investors have been granted licenses to operate in the Katowice Special Economic Zone (KSSE). They have announced plans to invest a total of PLN 240mln and create nearly 2000 new jobs.
- Tian Yu, a Chinese realty firm, intends to build a hotel-residential complex in Szczecin. In implementation the investment settles between EUR 0.5-1bln.
- UPS, American parcel and package distributor, is set to transfer its settlement and clearing centre from Great Britain to Wroclaw. The investment is estimated to be worth several millions of dollars. The centre creates 300 new jobs in Poland.
- Rockwell Automation, an American manufacturer of industrial automation solutions, intends to build its own plant, software engineering centre and customer service unit in Katowice. The investment may create 500 new jobs.
- In 2007-2013, the European Union will give Poland EUR 30mln for the promotion of tourism and EUR 165mln in subsidies for tourism-related investments. The funds will be spent on spas, sewage treatment works, hotel chains and the modernisation of tourist trails, ski lifts and post-industrial areas.
- In 2005, a total of 798 businesses declared bankruptcy in Poland, an improvement of 30% y-o-y. Poland performed best among European countries with only two bankruptcies per 10,000 companies.

Poland - main economic indicators	1999	2000	2001	2002	2003	2004	2005	2006	as of
GDP (y-o-y %-growth, constant prices)	4.5	4.2	1.1	1.4	3.8	5.3	3.5	5.5	Q2/2006
Industrial production (y-o-y %-growth)	3.6	6.7	0.6	1.1	8.3	12.6	4.1	12.5	1-9/2006
Inflation (CPI, end of period, y-o-y %-change)	9.8	8.5	3.6	0.8	1.7	4.4	0.7	1.6	9/2006
General government budget balance (% of GDP)	-1.4	-0.7	-3.7	-3.3	-4.8	-3.9	-2.5		1-12/2005
Gross wage (period average, EUR)	401	472	557	544	497	505	591	616	Q2/2006
Unemployment (%, last survey in the year, LFS data)	15.3	16.0	18.5	19.7	19.3	18.0	16.7	14.1	Q2/2006
Exports (EUR billion, current prices)	25.7	34.4	40.4	43.4	47.5	59.7	71.4	48.2	1-7/2006
Imports (EUR billion, current prices)	43.2	53.1	56.2	58.3	60.4	71.4	80.6	54.2	1-7/2006
Current account (% of GDP)	-7.6	-6.0	-2.9	-2.6	-2.1	-3.5	-1.2	-1.9	1-6/2006

Source: Polish Official Statistics, National Bank of Poland, Eurostat, author's calculations

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 Rimšēvičs

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 unprocessed 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?

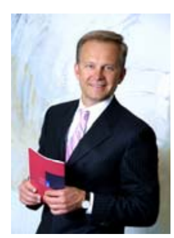
As of January 1, 2005, the Bank of Latvia changed the peg of the lats from the SDR basket to the euro. Four months later, as a consecutive step towards the introduction of the euro, Latvia joined the ERM II, unilaterally retaining the previous +/– 1% fluctuation band around the central rate. As the domestic 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.

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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

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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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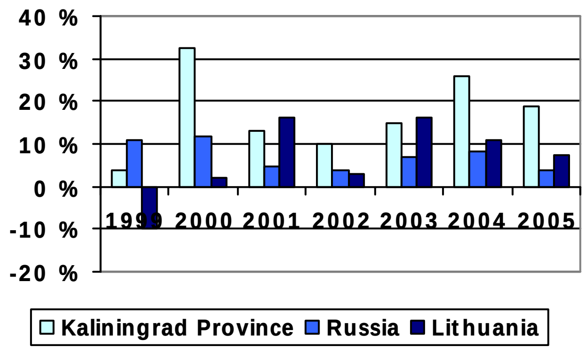
Kaliningrad's Industry – a Double-Headed Bird: Will It Fly?

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 predetermined 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.

[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."

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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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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