Baltic Rim Economies

Estonia – Latvia – Lithuania – Poland – Baltic Russia
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ECONOMIC REVIEWS:

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Estonia

GDP surged over 11% in the fourth quarter

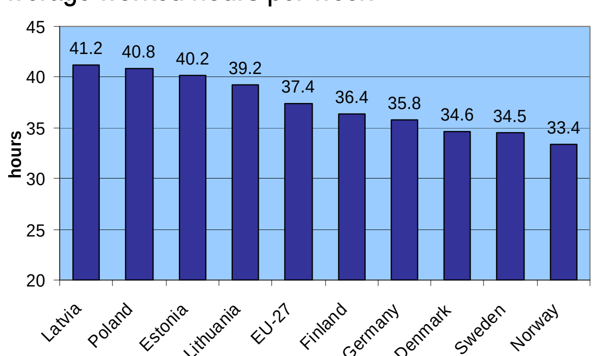
The Estonian economy sustained a high level of GDP growth throughout 2006, reaching a yearly growth of 11.5%. Booming consumption, a boisterous real estate market and cheap loans were the main catalysts behind the stellar growth last year. According to the preliminary estimate, the Estonian economy expanded by 11.2% over the fourth quarter of 2006. It is Estonia's seventh straight quarter of double-digit growth, a record for economic development currently matched in the EU only by neighboring Latvia. According to Statistics Estonia, the main drivers of the surge in the fourth quarter were the growth of manufacturing, wholesale and retail trade activities. Transport, logistics and financial services also contributed significantly to the economic growth. Inflation continues to plague Estonia, where in 2006 the increase in the consumer price index was 5.1%.

The stellar growth has raised concerns about overheating once again, because Estonia's economy is booming on household consumption, cheap loans and soaring real estate prices. On the other hand, the private borrowing boom that reached its peak last spring is showing signs of slowing down. Last year banks in Estonia lent EUR 1.5bln more to private persons and corporations than in 2005. Due to the housing boom, the price level of real estate has risen and fewer people can afford to acquire real estate in Estonia, although wages have been growing at a substantial speed.

Gross wages up by 17.5% in a year

For the first time average monthly gross wages of full-time and part-time employees in Estonia crossed the 10,000 kroon mark. In the fourth quarter, average monthly gross wages rose to EEK10,212 (EUR 653), up by 17.5% y-o-y. The average hourly gross wages were EEK 60.28 (EUR 3.85), up by 19% y-o-y. Compared to the 4th quarter of 2005, the average monthly gross wages and salaries increased most in the fishing sector, up by 77% and the least in financial intermediation, only by 2%. The average gross wages and salaries were EUR 611 in October, EUR 633 in November and EUR 713 in December.

Average worked hours per week



Source: Eurostat

In the 4th quarter of 2006 the employer's average monthly labour costs per employee In Estonia were EUR 878, while the average hourly labour costs were EUR 5.6. Compared to the 4th quarter of 2005, the average monthly labour costs per employee increased by 17% and the hourly labour costs increased by 18%. In absolute terms, the highest wages were paid in the financial intermediation sector, where the average wage stood at EUR 1,011. Public administration employees earned an average of EUR 853, and real estate workers earned EUR 758.

Exports expanded by 23%, imports 26% last year

Estonia's foreign trade turnover increased rapidly over 2006. A significant increase was noticed in both exports, which went up by 23% y-o-y, and imports, up by 26% compared to 2005. Estonia's trade deficit increased from the previous year due to strong domestic consumption. The value of imports reached EUR 10bln, whilst exports were worth EUR 7.6bln. Finland remained in its position as Estonia's most important trade partner.

Estonian companies' fears abating competitiveness

Estonian companies fear that they may lose competitiveness because of rapid economic growth is starting to affect prices. Products made in Estonia are losing out and are no longer as competitive as they were before. High inflation, a chronic lack of workforce and the constantly climbing prices of raw materials and services are making products more expensive and imported goods are becoming more competitive. Furthermore, foreign investors are increasingly troubled by rising labour costs and inflation, and some are reportedly considering relocating production to Belarus and Ukraine, where costs are significantly lower.

Some business highlights

- Oliver Kruuda, chairman and large shareholder of candy maker Kalev, bought 100% of Estonian music TV station Eeter, when the shareholders of Santenori agreed to sell its shares.
- Estonia's largest real estate developer Arco Vara has acquired all the shares of a Latvian construction company SIA Dinema Buve.
- Three shareholders of Arco Vara have paid EUR 12mln to Hansabank and bought back the shares they issued to the bank in 2005 for EUR 10mln.
- Balbiino, an Estonian ice cream producer has acquired the Latvian ice cream producer Margota. The deal makes Balbiino the second largest ice cream producer and seller in Latvia.
- Estonian state power company Eesti Energia has set up a subsidiary in Lithuania by the name Lumen Balticum. It was founded with a view to sell electricity on the open Lithuanian energy market. It concentrates on supplying energy to corporate customers.
- NewYorker, the German outfitting chain, is expanding their business to Estonia.
- Estonian car dealer AS Viking Motors takes over Latvian car dealer E&S Auto. E&S Auto will stop selling Kia cars but plans to start to sell Cadillac, Corvette, Hummer and American Chevrolet versions. E&S Auto is an authorised Saab dealer in Latvia.
- Tallinn Airport has launched a EUR 7.7mln project to rebuild the runways and the passenger terminal.
- Estonian developer Uus Viru has defended its plans to build an extension to the Viru Hotel, despite a continued lack of support from Tallinn city authorities, who have reportedly told UNESCO that the hotel project has been annulled. The developer has reiterated that the city had no legal grounds for refusing to issue a building permit for the hotel expansion. A decision is expected from the appeals court in March.
- A group of businessmen plan to build Tallinn's highest sky scraper at Haabersti in the Tallinn suburbs. The 32-storey 120-metre-skyscraper would be built next to the Saku Arena.
- Individual income tax rate fell to 22% from 1st January 2007.
- Eesti Paevaleht daily writes that several construction contractors in Tallinn are hiring Finnish workers since they are more professional than Estonians and demand less pay. Thousands of Estonian construction workers are working in Finland, Norway, UK and elsewhere

Estonia - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	as of
GDP (y-o-y %-growth, constant prices)	7.9	6.5	7.2	6.7	7.8	9.8	11.5		1-12/2006
Industrial production (y-o-y %-growth)	14.6	8.9	8.2	11.0	8.0	9.7	7.0	0.7	1/2007
Inflation (CPI, end of period, y-o-y %-change)	5.0	4.2	2.7	1.1	5.0	3.6	4.4	5.1	1/2007
General government budget balance (% of GDP)	-0.6	0.3	1.5	2.6	1.7	1.6			1-12/2005
Gross wage (period average, EUR)	314	352	393	430	466	555	653		Q4/2006
Unemployment (% end of period, LFS data)	13.9	11.9	11.3	9.3	8.5	7.0	5.4		Q3/2006
Exports (EUR million, current prices)	3 445	3 698	3 642	4 003	4 770	6 212	7 631		1-12/2006
Imports (EUR million, current prices)	4 615	4 798	5 079	5 715	6 704	8 192	10 347		1-12/2006
Current account (% of GDP)	-5.5	-5.6	-10.2	-12.1	-12.7	-10.5	-12.8		1-9/2006

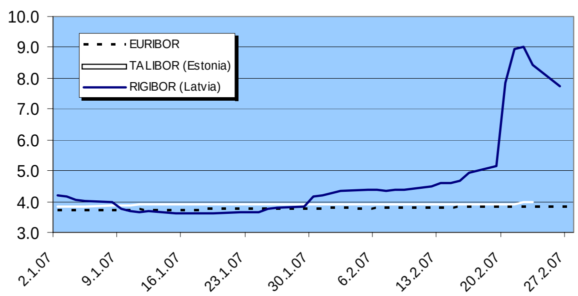
Source: Statistical Office of Estonia, Bank of Estonia, Eurostat, author's calculations

Latvia

Latvia's GDP growth highest in the EU

In the fourth quarter of 2006 Latvian GDP expanded by 11.9% y-o-y, which was the fastest growth rate in the EU. Latvia also posted EU's fastest economic growth in Q1 and Q3 while Estonia was the fastest in Q2. Latvia's record high GDP growth was mostly generated by strong domestic demand, fuelled by the fast growth of credit; by the end of September lending to households was up by 80% y-o-y. GDP per capita has been expanding rapidly for several years because of strong growth in the retail, construction, real estate and telecommunication sectors. However, economists, including the country's central bank, have warned of possible overheating. The economy is running a large positive output gap and is developing imbalances, including the alarmingly wide current-account deficit, which reached 24% of GDP in the third quarter of 2006 (up from 13% in the same period of 2005) and amounted to 19% of GDP in the first nine months of 2006. In addition, Standard & Poor's lowered the outlook for Latvia's long-term sovereign debt from stable to negative at the end of February. Interest rate has also gone up sharply in February.

Three month interbank interest rates



Source: Bank of Latvia, Bank of Estonia and ECB

Inflation record high

High inflation continues to plague Latvia, recent figures show that consumer prices increased by 7.1% in January, one of the highest rates in the EU. Inflation was mainly affected by the increase in administrative regulated prices as well as inflation expectations. Latvia raised excise duty and electricity tariffs. Furthermore, entrepreneurs are expecting inflation to rise so they are automatically increasing prices. Moreover, in January 2007 the growth of producer prices in Latvian industry increased to a ten year record high, on average by 16% y-o-y. Such a trend shows that the slowdown of the consumer price index is not expected in the forthcoming months.

Latvia's imports grew fastest in the EU

In the first eleven months of 2006, Latvia's imports increased by 30% to EUR 8.1bln, which was the steepest import growth in the EU. At the same time the export growth of Latvia took only 9th position in the EU over the same period. In the first eleven months of 2006, Latvian exports grew by 18% to EUR 4.4bln y-o-y. According to the data of Eurostat, Estonian exports increased by 21% to EUR 6.8bln and Lithuanian exports increased by 20% to EUR 10.3bln in the first 11 months of 2006.

According to Central Statistical Bureau, the total foreign trade turnover in 2006 was 23% or almost EUR 2.5bln higher than in the previous year. The highest increases in exports were observed in the products of the chemical and allied industries 37%, for plastics and plastic products 33% and for base metals and articles of base metals 28%. The steepest increases in imports were for transport vehicles, up by 61%, for miscellaneousmanufactured articles (including furniture) 45%, for articles of stone, plaster, cement, glassware and ceramic products 35% and for base metals and articles of base metals 34%. Commodity imports exceeded exports substantially, by 92%. Currently Lithuania is the main export partner to Latvia with a 15% share, while Germany is the most important importer with a 15% share, up by 41% y-o-y.

Latvia posted the highest retail trade growth figure in the EU in December, up by 27% y-o-y. Latvia was followed by Estonia 19%, Poland 12%, Sweden 11% and Lithuania 7%. Such growth shows that Latvian's have more money to use. Increase in the number of jobs and lack of workforce has led to a rapid growth in wages. Average gross monthly wages and salaries in 2006 rose over 20% compared to the corresponding month in 2005. Number of employees earning at least LVL 300 (EUR 423) in a month grew; in October, 35% of Latvian salaries exceeded LVL 300, whilst a year earlier the corresponding figure was 24%. The number of employees receiving minimum monthly wages decreased from 12% in 2005 to 9% in 2006.

Latvia's construction costs up one fourth

Construction costs in Latvia were the highest in 12 years. In Q4 of 2006 the average rise of construction costs was 25% y-o-y. The rise was affected by a rapid increase in labour costs (up by 41%) and a price rise for equipment and construction materials. In January the prices of apartments in Riga have increased by 2.4% m-o-m. The average price of an apartment in Riga on the secondary market reached EUR 1,603 per square metre. The most expensive apartments in the Baltic countries are being sold in Riga. Arco writes in its report that the most exclusive apartments in central Riga cost around EUR 5,000 per square metre.

Some business highlights

- Owners of the Riga Passenger Terminal announced that they may invest up to EUR 300mln in modernising the terminal, which currently does not meet EU standards.
- Several currency exchange bureaus in Latvia ran out of euros, US dollars and pounds at the end of February, because of speculation that LAT will be devaluated.
- Banks registered in Latvia totalled profits of EUR 36.6mln in January 2007, up by 40.7% in comparison with the same month last year.
- Car dealer SIA Baltic Motors in Riga opens a new 4 hectare warehouse in Riga. It has space for about 1,500 vehicles, thus it cuts delivery times down in the future. Before, new cars were sent to Latvia from Finland.
- According to the European Payment Index from Intrum Justitia, Latvia has the lowest payment risk in CEE countries. Furthermore, Latvia ranked even higher than countries such as Germany, Italy, Belgium and the Netherlands. The survey included more than 20 European countries and was carried out in autumn 2006.
- The Latvian Embassy opened a consulate in Kaliningrad in mid-February. It provides consular assistance to Latvian nationals and permanent residents of Latvia. It is also expected to open new opportunities and create contacts for both Latvian and Russian entrepreneurs.
- Liepaja City Council decided on their new capital investment programme, this year over EUR 56mln will be invested in Liepaja. The project is expected to make Liepaja's new modern 21st century image.
- Daugavpils City Council has prepared the concept for building an international regional airport in Daugavpils by 2013.
- Registration of new passenger cars in Latvia increased by 95.3% in January, the highest increase in Europe. In Lithuania, the corresponding figure was 62.8% and in Estonia 46.1%, according to ACEA.

Latvia - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	as of
GDP (y-o-y %-growth, constant prices)	6.9	8.0	6.5	7.2	8.5	10.2	12.0		1-12/2006
Industrial production (y-o-y %-growth)	3.2	6.9	5.8	6.5	6.0	5.6	4.8		1-12/2006
Inflation (CPI, end of period, y-o-y %-change)	1.8	3.2	1.4	3.6	7.3	7.0	6.8	7.1	1/2007
General government budget balance (% of GDP)	-2.8	-2.1	-2.3	-1.2	-0.9	0.2			1-12/2005
Gross wage (period average, EUR)	268	282	297	298	314	350	436		Q3/2006
Unemployment (% end of period, LFS data)	13.3	12.9	11.6	10.3	10.3	7.8	6.2		Q4/2006
Exports (EUR million, current prices)	2 020	2 232	2 416	2 559	3 204	4 086	4 594		1-12/2006
Imports (EUR million, current prices)	3 453	3 910	4 284	4 634	5 671	6 879	8 828		1-12/2006
Current account (% of GDP)	-4.8	-7.6	-6.6	-8.1	-12.9	-12.3	24.2		1-9/2006

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

Lithuania

Lithuanian economy expands 7.4% in 2006

Lithuania's gross domestic product surged 7.4% last year on strong performance in the construction, manufacturing, real estate and financial intermediation sectors, with approximately 50% of gross value added coming from these four sectors. GDP per capita was EUR 6,964 at current prices, up by 8.1% y-o-y. Numbers demonstrate that Lithuania's economy is growing at a relatively safe pace, unlike Latvia and Estonia, where last year' economic double digit growth has triggered fears of overheating. In the fourth quarter alone GDP ascended by 6.6%y-o-y. Overall trend is deceleration: In previous months the borrowing boom, which has been the main driving force of economic growth, is slowing down. The Lithuanian economy is expected to increase at over 6% pace this year. Domestic demand remains the main engine behind further growth.

In January, monthly inflation was zero and annual inflation was 4% y-o-y. Average annual inflation was 3.8% in 2006 but for year 2007 rate is expected rise to 4.7%. Lithuania pursues to stabilise factors as soon as possible so that the country could adopt the euro in 2010. Inflation in the eurozone last year amounted to 1.9% according to preliminary data.

Foreign trade import-led

Rapid increase in Lithuania's foreign trade continued during 2006, driven by strong domestic demand. Compared with 2005, export increased by 18% and imports by 23%. Robust growth of imports of goods reflected a sharp rise in domestic demand. Trade deficit widened by 37% y-o-y to EUR 4.1bn. Over 50% of all exported and imported goods were intermediated goods where consumption goods were second major group. Last year, competitiveness of Lithuanian exports declined slightly due to inflation, very strong growth of wages and slightly stronger USD in relation to the litas. Moreover, the export of vehicles increased by 60%, plastics and articles thereof 76% and export of capital goods by 42% y-o-y. Import of vehicles also grew strongly by 54%.

In 2006, the most important partners in exports were Russia 13%, Latvia 11% and Germany 9%. The most significant partners in imports were Russia 24%, Germany 15% and Poland 10%.

Latvia's current account deficit has amounted to EUR 2.7bln at the end of October, up by 82% y-o-y. More importantly, the deficit accounted for 11.6% of GDP increase over the three first quarter of previous year. Due to continuously increasing foreign trade deficit, current account deficit is expected to stay over 11% this year.

FDI flow up by 4.6% in first nine months of 2006

Lithuania's foreign direct investment stock totalled EUR 7.2bln or 2135 per capita at the end of September 2006. The FDI stock grew by 4.6% from the beginning of the year. One fifth of the investments came from Russia, while almost 70% came from EU-25. One third of the investments were made to manufacturing industry, and 18% to financial intermediation and 12% to transport, storage and communication. According to the Bank of Lithuania, the increase in the FDI flow mainly resulted from the sale of the Mazeikiu Nafta refinery.

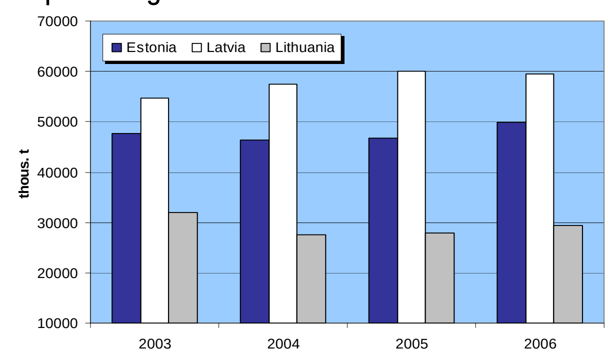
Lithuania's FDI abroad increased rapidly during the first three quarters of 2006. Direct investment stock abroad amounted to EUR 0.9bln, whilst in the corresponding stock was below EUR 0.6bln at the beginning of the year. In this period, one third was invested to Latvia and 14% to Russia.

Lithuanian state is not doing enough to attract foreign investments according to an article of Baltic Business News. Public officials, representatives of business associations and financial analysts were interviewed. They were asked to assess the activities of the Lithuanian Development Agency which is directly in charge of FDI inflow and export promotion. All the respondents agreed that Lithuania needed clearer priorities and policy guidelines on FDI and export promotion and more coordination of the activities of various public bodies.

Baltic ports betting on a bright future

Growing trade in Baltic countries has raised the importance of logistics centres. Currently the biggest part of container traffic in Baltic ports is designated for the local market, but all large ports see the expansion of container trade as a key to future growth. The Port of Tallinn, Riga Free Port and Klaipeda State Seaport are planning to expand to attract more container cargo. Furthermore, the turnover of Russian cargo in Klapeida has been growing steadily since 2004 and in 2006 it handled 8% more cargo in tons than a year earlier. The Klaipeda Port also plans to build the port of Sventoji for leisure boats and for shops servicing the Butinge oil terminal.

Shiploaded goods in Baltic countries



Source: Statistics Lithuania

Some business highlights

- Norwegian Orkla Foods group has acquired a Czech oil manufacturer Setuza and plans to move some production to Vilniaus Margarino Gamykla (VMG).
- SEB Enskilda, the investment bank that belongs to SEB Group, has officially started operations in the Baltic countries. The bank has around 500 employees of which 5 are in Estonia, 5 in Latvia and 6 in Lithuania.
- Mid Europa Partners, a leading private equity fund in Central and Eastern Europe, bought telecommunication group Bite for EUR 0.45 billion.
- Construction materials manufacturer Stimeksos Grupe is planning to invest up to EUR 1.5mln this year and launch a new metal constructions and armed mesh manufacturing facility.
- Finnish retail leader Stockmann aspires to open a commercial centre in Lithuania.
- Finnish fast food chain Hesburger will open first three restaurants in Lithuania. The investment is worth EUR 1.6mln.
- Baltic states and Poland have agreed in principle to build a nuclear power plant in Lithuania by 2015 to ease their energy dependence on Russia. The price of the new nuclear plant may rise up to EUR 6bln.
- Lithuanian officials have expressed interest in helping build a liquid natural gas terminal in Poland as a means a diversifying its energy supplies.
- Germany's Douglas Holding, one of the largest cosmetics and fragrance retailer in Europe, has announced a plan to open some 50 new stores across Europe, which some in Baltic countries.

Lithuania - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	as of
GDP (y-o-y %-growth, constant prices)	3.0	6.4	6.8	10.3	7.3	7.6	7.4		1-12/2006
Industrial production in sales (y-o-y %-growth)	2.2	16.0	3.1	16.1	10.8	7.3	8.9	0.7	1/2007
Inflation (CPI, end of period, y-o-y %-change)	1.4	2.0	-1.0	-1.3	2.9	3.0	3.8	4.0	1/2007
General government budget balance (% of GDP)	-2.5	-2.0	-1.4	-1.2	-1.4	-1.5			1-12/2005
Gross wage (period average, EUR)	263	274	293	311	335	421	479		Q3/2006
Unemployment (% end of period, LFS data)	16.9	17.9	13.0	11.6	10.6	7.1	5.7		Q3/2006
Exports (EUR million, current prices)	3 841	4 778	5 526	6 158	7 478	9 502	11 250		1-12/2006
Imports (EUR million, current prices)	5 650	6 767	7 943	8 526	9 959	12 446	15 384		1-12/2006
Current account (% of GDP)	-5.9	-4.7	-5.1	-6.8	-7.7	-7.0	11.6		1-11/2006

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

Poland

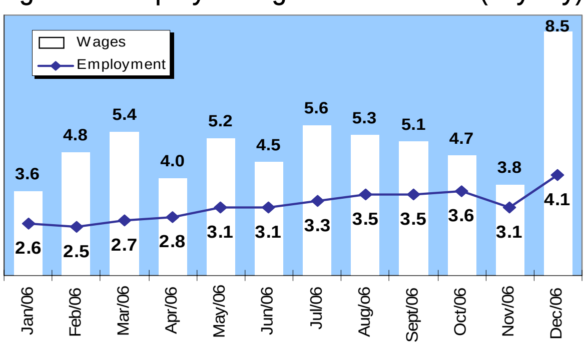
GDP growth highest in nine years

In 2006 Poland was among the fastest growing economies in Europe. The fourth quarter GDP growth alone amounted to 6.3%, being the highest growth figure in nine years. Gross domestic product grew at an annual rate of 5.8%, up from 3.5% in 2005. The strong economic growth resulted from increased consumer spending and rising exports. Such results come as a surprise, since most Polish and foreign financial institutions had forecasted less than 5% growth.

Investment spending was also a major growth driver and its strong growth surprised many. According to the statistical authorities, investment spending increased by 16.7% last year. In the Q2, investment was 14.4% higher in real terms than a year earlier, and in the third and fourth quarters it grew by almost 20%. Most investments came from foreign companies to the Polish market. Growing investments contributed to the development of the construction industry, which recorded the highest growth rate in years, being 17.5% y-o-y. Visible growth in investment spending resulted from entrepreneurs' increased willingness to take investment risks, after a significant drop in the value of investments in 2001-2003.

The high growth of investments and companies' development would not be possible without increased domestic spending. Households increased their spending by 5.2%, whereas in 2005 it was only 1.8%. Increased spending resulted from the fact that Polish salaries were growing at a rate unseen in years. In 2006 the average gross monthly wage in the enterprise sector increased by 5.1% y-o-y. Furthermore, rapid acceleration in economic activity has been accompanied by market growth and labour demand. December's employment growth rate was the highest since the beginning of the 1990s and the unemployment rate dropped below 15%.

Wages and employment growth in Poland (% y-o-y)



Source: Central Statistical Office of Poland

Foreign direct investments up

The year 2006 was a very successful year for Poland in terms of foreign direct investment and FDI inflow was the largest in its history. Especially the 14 special economic zones attracted more investments than ever before. FDI in Poland reached EUR 11.7bln, up by 46.6% from the EUR 7.71bln in 2005. The figure was higher than expected and, for example, the National Bank of Poland forecasted FDI to reach EUR 10bln in 2006. Three-quarters of FDI came from the EU, but Asian investors such as Sharp, Bridgestone, Toyota, Toshiba and LG are playing a more prominent role and Japanese companies made the largest investments to Poland in 2006. The investment boom and economic growth are expected to continue although not as robustly as in the previous year. However, entrepreneurs are optimistic about the future and some are planning to invest even more than in the previous year. According to Lewiatan Business Index as many as 38.5% of companies have new investment plans for the first quarter.

Current account deficit worse than expected

Poland recorded a current account deficit of EUR 915mln in December 2006 versus an expected EUR 514mln deficit, according to the Central Bank of Poland. In December, Poland's exported goods and services went up by only 8% y-o-y, while imports grew by almost 17% y-o-y. After numerous months of export growth above 20%, a growth of 8% was a disappointment, but exports should grow in the coming months as the situation of the main trade partners is still good.

Budget deficit at PLN 25 billion in 2006

The Polish parliament (Sejm) approved the 2007 budget bill, setting government receipts at EUR 58bln. Poland's budget deficit should stand at EUR 7.7bln, which is approximately 2.7% of GDP. The budget deficit in 2006 amounted to EUR 6.4bln, which is approximately 82% of the budget target, according to estimated data from the Ministry of Finance. Last year's results were better than anticipated, due to higher than expected revenues and lower expenditure.

For 2007 the European Commission is pressuring Poland to reduce its public finance deficit. Poland has to prove by August 27th to the European Commission that it is taking efficient steps to limit public finance deficit to 3% of GDP set by the Maastricht criteria. According to the latest EC prognosis, Poland's budget deficit will amount to 3.7% of the GDP without reform of public spending. According to Ministry of Finance Poland should meet its planned public finance deficit of 3.4% of GDP in this year.

Some business highlights

- Poland produced 715,000 cars in 2006, including 609,000 passenger cars (up by 15.5% y-o-y) and 106,000 vans (up by 25% y-o-y). 96.3% of the production was exported. Fiat remains Poland's #1 passenger car with 282,000 manufactured cars, followed by Opel with 187,000 and Volkswagen with 89,000 pieces.
- The European Investment Bank (EIB) is opening an office in Poland, its first branch in Central and Eastern Europe. By opening an office in Warsaw, the EIB hopes to intensify contacts with its Polish partners.
- The British corporation Tesco, will invest a further EUR 154mln to Poland this year by opening 50 new stores and 10 petrol stations. Tesco already operates over 200 stores and petrol stations in Poland.
- Toyota will build a third plant in Poland. The new plant will be located in the Wałbrzych Special Economic Zone. The Japanese carmaker plans to invest EUR 138mln in the project and employ 255 new workers.
- Cemex, Mexican cement and aggregate producer will invest approximately EUR 50mln on revamping its cement plants' production lines in Chelm and Rudniki.
- Neinver, a Spanish developer, has launched its construction plan of the Galeria malta shopping centre in Poznan. The investment is estimated to be worth EUR 125mln and will open its doors to customers by the fourth quarter of 2008.
- Deutsche Telekom intends to open an ICT centre in Wroclaw or nearby. The centre will employ approximately 200-300 programmers at the beginning but the number may eventually rise to 1,000.
- The net financial result of Poland's banking sector in 2006 stood at close to EUR 2.7bln, which is 17% higher than a year earlier. The result was the sectors' best since the beginning of the free market economy in Poland. Growth was largely powered by recovery on the lending market.
- The Consumer Confidence Index stood at over 104 points in January, which means that the index is at the highest point since 1997.

Poland - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	as of
GDP (y-o-y %-growth, constant prices)	4.2	1.1	1.4	3.8	5.3	3.5	5.6		1-12/2006
Industrial production (y-o-y %-growth)	6.7	0.6	1.1	8.3	12.6	4.1	5.7	15.6	1/2007
Inflation (CPI, end of period, y-o-y %-change)	8.5	3.6	0.8	1.7	4.4	0.7	1.4	1.7	1/2007
General government budget balance (% of GDP)	-0.7	-3.7	-3.3	-4.8	-3.9	-2.5			1-12/2005
Gross wage (period average, EUR)	472	557	544	497	505	591	692		Q4/2006
Unemployment (%, last survey in the year, LFS data)	16.0	18.5	19.7	19.3	18.0	16.7	14.9		Q4/2006
Exports (EUR billion, current prices)	34.4	40.4	43.4	47.5	59.7	71.4	72.9		1-12/2006
Imports (EUR billion, current prices)	53.1	56.2	58.3	60.4	71.4	80.6	83.7		1-12/2006
Current account (% of GDP)	-6.0	-2.9	-2.6	-2.1	-3.5	-1.2	-1.9		1-11/2006

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

St. Petersburg

Temporary slowdown or long-term restructuring?

St. Petersburg economy faced certain new trends in 2006, which might change its economic performance in the long run. The significant change was observed in the industrial sector, which seems to be very significant for the St. Petersburg's economy. The industrial sector experienced its first substantial decline since 1999, when economic growth in Russia began. The reason for that decline is the fall in machine-building which takes 40% of manufacturing sector's total output.

Dynamics of regional economic development

	2005	2006
Industrial production, y-o-y,%	4.2	-7.0
Manufacturing	3.9	-8.7
Energy, gas and water production*	1.7	8.3
Construction, y-o-y	-8.3	35.6
Transport, y-o-y, %	27.5	20.9
Communication, y-o-y, %	27.0	38.3
Retail trade, y-o-y, %	20.2	14.5

Source: Petrostat, 2007
*- also includes distribution of energy, gas and water

In the 20th century the city developed as an industrial city while Moscow was an administrative capital and Leningrad (now St. Petersburg) served as an industrial "capital". The city's infrastructure was primarily created to serve the industrial sector, which occupied the bulk of municipal land. This trend has changed St. Petersburg specialisation more towards a service sector city and the industry proportion has been decreasing.

St. Petersburg has a construction boom, as most of present construction projects in central districts of St. Petersburg are linked with removing industrial enterprises out to the suburbs to the neighbouring Leningrad Province. A shortage of land within the City's boundaries grows together with real estate prices, which jumped up from EUR 986 per square metre on December 30, 2005 up to EUR 1978 on January 1, 2007. It is not clear, whether this trend of rising prices continues, or was just a temporary growth.

Economic growth in Russia generally, and particularly in St. Petersburg diminishes the competitive advantages of the traditional industrial sector, which is facing increasing costs for all its production factors, especially labour and land.

Positive dynamics in the communication sector reflects the growing revenues of telecom companies due to increasing volumes of services consumed and new types of communication services introduced. In previous years the basic reason for increasing revenues for the telecom sector was the growing number of subscribers. During 2006 the subscriber base expanded by 19.9% y-o-y, while in 2005 the corresponding figure was 33.8% y-o-y.

Regional budget: prominently good performance

In 2006 St. Petersburg's budget experienced a record high increase of tax revenues. In January-November 2006 they grew by 50% y-o-y. While VAT (traditionally the easiest to collect in Russia) payments remained at the same level as in the corresponding period of 2005. Furthermore, income tax revenues from the regional budget more than doubled. That increase of income tax payments is mostly due to a gradual transfer of businesses: the grey economy and other unobserved fields on economy are diminishing and turning business towards more legal set-ups. Companies, including small and medium enterprises, have to become more transparent, due both to repressive measures of the state and to the liberal Tax Reform (which considerably reduced tax rates in Russia). Development of the banking system, especially in St. Petersburg, allows companies to take larger and more long-term loans. But that becomes possible only for legal and transparent businesses.

Social sector becoming more attractive

In 2006 the average wage of a Petersburgian increased by 14.5% y-o-y. This growth was related to all industries and sub-industries of the regional economy. A new phenomenon was commonly a high salary increase in the social sector and industries related to it. Education, science, social and communal services experienced an annual wage rise of nearly 40% (higher professional education had a 38% salary increase). The growth could be partly explained by very poor prior financing of social and related sectors. These changes might lead towards a more equal income distribution of the St. Petersburg's residents. Indeed, the constantly growing Gini coefficient showed a slight decrease from 0.465 down to 0.462 in the third quarter of 2006.

Rapid growth of foreign investment and exports

In January-September 2006 foreign investment to the regional economy tripled and foreign direct investments (FDI) grew by 190%. This extremely high growth of FDI is partly linked with plans to create a new oil exchange in St. Petersburg (alternative to LPE and other global oil exchanges) and a re-registration of certain oil companies into the City.

Exports increased 1.5 times due to growing oil exports, which increased four-fold. Growth was also related to constantly growing military exports to China, which grew 1.5 times. This unexpected growth of exports might be a temporary phenomenon, but if growth persists it could shift the City's relations with its trade and investment partners abroad to a higher level.

Some business highlights

- In June 2006 the state's oil and gas giant Gazpromneft re-registered itself and started to transfer its office to St. Petersburg. For accommodating this company the City Administration began to build a skyscraper near Smolny cathedral. The decision to change the radically traditional Petersburg landscape faced many protests, but regional government proceeded with this ambitious project.
- In January-September 2006 certain industries enjoyed a huge investment inflow and growth was more than 150% y-o-y. For example, the hotel industry (two hotels and one hotel complex were finalised), medicine, transport machine-building and the oil industry (surplus of 320% y-o-y). Only one of these four industries belongs to the traditional structure of the regional economy (namely machine-building), the three others are rather new emerging sectors.
- Nissan became the second Japanese car builder opening its production plant in St. Petersburg. Now the plant is under construction, while the factory of Toyota will be finalised rather soon.
- In the first 9 months of 2006 St. Petersburg finally turned into a region attractive for foreign portfolio investors. In January-September 2006 portfolio investment from abroad totalled EUR 26.0 million while during the same period of 2005 the figure was just EUR 3.9 million. Thus, portfolio inflow grew almost seven-fold.

St. Petersburg - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	as of
Regional GDP (y-o-y %-growth, constant prices)	10.5	4.5	17.7	8.4	7.2	8.4	8.4		1-9/2006
Industrial production (y-o-y %-growth)	26.2	0.2	31.4	5.8	14.1	4.2	-7.0		1-12/2006
Gross average wage (monthly, EUR)	n/a	n/a	217.1	209.3	284.9	344.5	406.9		11/2006
Unemployment (% average annual)	7.9	4.4	3.5	4.3	2.8	2.4	2.4		1-12/2006
Exports (EUR million, current prices)	2736.1	2133.8	1839.3	2428.5	3209.7	3953.1	3882.0		1-9/2006
Imports (EUR million, current prices)	2692.9	4422.7	5158.0	5122.9	5559.5	8081.3	6868.0		1-9/2006
FDI inflow (EUR million, current prices)	158.4	126.8	88.9	62.1	90.0	200.5	381.9		1-9/2006

Source: Petrostat, Rosstat, Central Bank of Russia, European Central Bank, author's calcul
In 2002 and 2004 average wage is for December of corresponding year

Leningrad region

Impressive growth

In 2006 the Leningrad Province experienced impressive growth in almost all sectors of its economy. The growth was based primarily on construction and industrial production, which are the most important sectors of the Province.

Dynamics of regional economic development

	2005	2006
Industrial production, y-o-y,%	26.9	5.9
Construction, y-o-y, %	80.0	7.9
Transport, y-o-y, %	16.9	20.1
Agriculture, y-o-y, %	-0.7	8.2
Communication, y-o-y, %	-1.3	15.7
Retail trade, y-o-y, %	11.0	22.0

Source: Petrostat, 2007

The most prominent result was achieved by the construction sector. That could be partly explained by the growth in real estate prices, which followed the rapid increase of the square metre price in St. Petersburg. In general, development of the Province's real estate sector strongly depends on the same development in St. Petersburg. Nevertheless, the volume of constructed residential space increased by 26% in 2006, which is one of the best figures for the last 20 years. A year earlier the same figure grew only 4%. This high-rate growth might be a result of the implemented so-called National housing project. The first step of this project was making mortgage loans affordable for the middle class. That stimulated not only a real estate price boom, but also growth in construction.

Significant changes occurred in the industrial sector of the Leningrad Province in 2006. Leadership in the industrial structure of the regional economy during the last 10 years shifted from the fuel sector towards machine-building. Kinef oil refinery in Kirishi, is the largest single refinery in the North-West of Russia and almost the sole supplier of the St. Petersburg petroleum market. In 2006 this process accelerated: the sub-industry of transport machine-building almost doubled its production. As a result, the processing sector of regional industry increased by 30%, while extraction grew just by 10% and energy generation and distribution even fell by 1%. The basic contribution to this impressive change was proffered by the Ford Motor Company, which expanded its production in Vsevolozhsk in Leningrad Province. Plastics production grew by 2.5-fold, demonstrating the largest result among all regional industries and sub-industries. However, this industry has a much smaller share in total industrial output compared to machine-building, and this growth is less significant for the regional economy.

The most important change was observed in fuel pricing. In 2006 fuel prices grew moderately compared to booming in late 2005. Gasoline prices in 2006 increased by 11%, and diesel fuel became just 5% more expensive in December 2006 than it was in December 2005.

Inflation decreases

The CPI rate in the Province is slowing down. Inflation of producer's prices in 2006 was even smaller than the CPI and accounted for 9%. The most important change was observed in fuel pricing. In 2006 fuel prices grew moderately compared to booming in late 2005.

Wage growth significantly higher than inflation

Growth of wages in 2006 in Leningrad Province was exceeding inflation. As a result, the real average wage in November 2006 increased by 14% compared to the corresponding period for 2005. The growth of wages went along with the revaluation of the rouble, towards the US dollar and the euro. Thus, in these currencies the wage increase is more impressive.

The maximum salary growth in 2006 was observed in the mineral extraction industry, the financial sector and manufacturing, where the average wage grew by 29%, 27%, and 26% correspondingly.

The unemployment rate in the Province is constantly decreasing, and in 2006 it was twice as low as in 2000. In 2006 the unemployment in the region was still higher than in neighbouring St. Petersburg (2%), but already lower than in many European countries.

The external sector becomes less significant for regional economy

The external sector, namely foreign trade and foreign investment, was considered as the basic stimulus for rapid economic growth in the Leningrad Province since 1999. The regional administration created a favourable investment climate which was considered to be even better than in St. Petersburg and one of the best nationwide. In 2004-2006 the situation changed. Economic growth was driven primarily by domestic demand, not by FDI and exports, as it had been before. The trade balance which was huge in 1999-2000 was decreasing in 2004-2006. FDI inflow grew fast (by 60% in 2006), but not as rapidly as other foreign investment such as long-term credits which more than tripled.

Some business highlights

- The Regional Parliament of the Leningrad Province in 2006 adopted a new law that introduces certain restrictions on the initially liberal investment climate. Substantial tax reliefs will be received by investors who come to mainly undeveloped districts of the Province. For the others tax reliefs become much less favourable.
- In January-November 2006 the total investment in real assets in Leningrad Province grew by 42%. Most of the investments were made towards agriculture and trade.
- The proportion of foreign investment was rather high in 1999-2000 (almost 65%). In 2004-2006 that share fell down to 30-35%. However, in absolute terms foreign investment in Leningrad Province was increasing constantly.
- Leningrad Province started its first international environmental project The Terra Renata, together with Finnish partners Häme Environmental Centre and Lahti Business and Science Park. The planned investment is equivalent to EUR 0.3mln. 80% of this sum is granted by the European Commission.
- A channel from the deep water part of the Finnish Gulf to Ust-Luga new seaport and the zone of the new coal terminal was finalised in 2006. The launch of this seaport opens a new export route that reduces Russia's dependence on transit via the Baltic States.

Leningrad Province - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	as of
Regional GDP of (y-o-y %-growth, constant prices)	12.8	8.5	16.3	14.6	8.8	8.3	8.0		1-9/2006
Industrial production (y-o-y %-growth)	26.8	10.7	35.6	20.9	10.3	5.9	26.9		1-12/2006
Gross average wage (monthly, EUR)	105.5	141.3	151.7	173.2	189.7	259.1	324.1		11/2006
Unemployment (% average annual)	12.7	10.8	9.6	9.2	7.5	7.8	6.2		1-12/2006
Exports (EUR million, current prices)	1786.5	2349.7	2301.1	2579.7	3886.5	4861.9	4013.5		1-9/2006
Imports (EUR million, current prices)	328.1	810.0	939.0	1061.4	1371.9	2561.9	1995.2		1-9/2006
FDI inflow (EUR million, current prices)	222.5	266.0	121.9	104.5	106.6	178.7	178.8		1-9/2006

Source: Petrostat, Rosstat, Central Bank of Russia, European Central Bank, author's calculations

Kaliningrad region

Kaliningrad’s economy growing at a record level

Kaliningrad’s economy has been growing very rapidly in 2006. Industrial production increased by an impressive 67% in the first eleven months of 2006 y-o-y, being the highest growth rate in Russia. The main factor that pushed the growth rate so high was the start of operations at the large Kaliningrad power plant at the end of 2005. It increased electric power generation by a factor of 6.3 over the first eleven months of 2006. The manufacturing sector, after a slump in the first half of the year, started to expand rapidly in summer and autumn – it grew by 34% in the year to December. The growth was driven by vehicle and transport equipment manufacturing: output in this sector increased by 240% in Q3 compared to the corresponding quarter of the previous year. Growth in the mining sector was slower (18%), but high oil prices during the year ensured that the sector’s profits made up 70% of the total profits of the corporate sector.

Against this background investment in fixed capital was disappointing: it increased only by 0.4% in the first eleven months y-o-y. On a more positive note, fixed investment started to show signs of life in the third and fourth quarters, after a fall by 17% in the first half of year. Uncertainties related to the change of regional governor and to the implementation of a new federal law on the special economic zone in Kaliningrad apparently took their toll on investment - they caused some companies to take a break until the “rules of the game” and business climate become clearer before making any significant new investment in Kaliningrad.

However, a federal law “On the Special Economic Zone in Kaliningrad Oblast” that came into force on April 1st 2006 should help to make Kaliningrad a more attractive investment location in the near future by providing tax benefits for companies, which will invest at least 150 million roubles (EUR 4.4mln). Already 30 companies have become residents of the Kaliningrad SEZ and can enjoy tax breaks for income and property tax. Planned investments in Kaliningrad are approximately worth 15 billion roubles (EUR 440mln) in total or about 66% of all investment in fixed capital in the year to December.

Wages increase sharply

Wages have been growing rapidly in 2006 and the growth even accelerated in the third quarter. In October 2006 the average gross monthly wage in Kaliningrad was 10,213 roubles (EUR 301) and the real wage went up by 26% over the same month in 2005.

Rapid growth of household income fuelled a real consumer boom on the Kaliningrad market. Retail trade and the consumer service sector grew by 17% and 21% correspondingly in the year to November. However, the most visible signs of the consumer boom were on the real estate market. Supplies of newly built residential properties in the first eleven months increased by 76% but it did not stop residential property prices from a rapid rise: they increased in Kaliningrad city by more than 50% over the same period.

Inflation declines

Despite rapid increases in household income consumer inflation in Kaliningrad Oblast eased in 2006. In November, Consumer price index in Kaliningrad was 7.1% (to December 2005). It was less than the CPI in Russia which stood at 8% in the same period. Housing and foodstuff prices grew faster than the CPI – by 12% and 9% correspondingly. Inflation declined compared to 2005 as the growth in housing costs, which usually contributed a lot to the fuelling of the CPI growth before, was restrained by authorities. Another factor that helped to keep consumer inflation in check was an appreciation of the rouble over 2006 that kept imports prices down.

Lower inflation gave enough confidence to the Central Bank of Russia to decrease its refinancing rate by 50 basis points twice in 2006 (from 12% to 11%) and then again in January 2007 by another 50 basis points to 11%.

Foreign trade: exports grew faster than imports

During the first nine months of 2006, exports of goods increased by almost 51% (in USD) y-o-y outpacing imports, which grew by 27% respectively. The value of exports amounted to EUR 1.6bn, already exceeding the total value for 2005. Increased oil production, a growing use of the Kaliningrad port terminals for exporting oil from other Russian regions and high oil prices made Kaliningrad exports heavily dominated by the mineral products (predominantly crude oil) representing almost 75% of the total value of exports

Import growth slowed down in the first half of the year but started to gain momentum in the third quarter as the manufacturing sector was expanding its production and increasing imports of machinery and equipment. Import growth in Q3 was 44% over the same quarter in 2005 and 27% y-o-y. Imports from China were growing particularly fast and China became the third largest importer to the Kaliningrad Oblast after Germany and Poland.

Some business highlights

- The Federal Ministry of Economic Development and Trade approved applications from seven regions, including Kaliningrad Oblast to create Special Economic Zone for tourism and recreation. One in Kaliningrad is planned to be set up on the Curonian Spit with the focus on environmental and recreational tourism. Starting in 2008 it should get about 1.5 billion roubles of investment from the federal budget. The zone will grant its residents tax holidays and concessions for profit, property and payroll taxes.
- In December 2006 President Putin signed a new federal law ordering all gambling companies in the Russian Federation to be closed or relocated into four gaming zones by July of 2009. One of these four zones will be created in Kaliningrad Oblast.
- Kaliningrad Regional Duma adopted a new program for socio-economic development of the Kaliningrad Oblast for 2007-2016. The program expects to sustain gross regional product growth of at least 7% pa and to achieve investment growth of 15-20% pa.
- Federal budget will finance expansion of the ferry line between Kaliningrad and St. Petersburg by investing 7.7 billion roubles in 2007.
- Regional authorities announced that Gazprom will build a spur from the North-European gas pipeline to Kaliningrad.
- A new technological park was opened in Slavsk (small town in Kaliningrad Oblast). So far it includes two companies with Swedish investment: Markisol and Orbit One. The first one manufactures curtains and the second one - electronic components.

Kaliningrad - main economic indicators	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**as of**
Regional GDP (y-o-y %-growth, constant prices)	15.2	3.4	9.5	9.4	12.9	13.0	n/a		
Industrial production (y-o-y %-growth)	32.4	12.9	10.2	4.7	26.6	18.9	67.1		1-11/2006
Inflation (CPI, end of period, y-o-y %-change)	18	21	10	18	12	11	7		11/2006
Gross wage (period average, EUR)	67.3	98.8	124.7	136.8	155.2	192.8	286.9		Q3/2006
Unemployment (% end of period, LFS data)	15.6	10.6	7.1	7.5	6.4	5.9	5.9		Q2/2006
Exports (EUR million, current prices)	514.3	508.4	497.1	507.5	875.9	1 470.3	1 556.3		1-9/2006
Imports (EUR million, current prices)	946.6	1168.7	1700.7	1894.2	2418.6	3282.7	2772.2		1-9/2006
Exports (sales) to Russia (EUR million, current prices)	458.9	691.1	801.7	988.7	1449.4	n/a	970.0		1-6/2006
FDI inflow (EUR million, current prices)	7.1	3.6	6.3	12.4	18.0	15.1	12.4		1-6/2007

Source: Kaliningrad Statistical Office, RosStat, Central Bank of Russia, author's calculations

Energy Policy for Europe: Current Energy Issues in the Baltic States

by Andris Piebalgs

Nowadays Europe faces numerous challenges for its security of supply, competitiveness and sustainability. Rising global demand for oil and gas, depletion of natural resources, dependence on handful of suppliers, insufficient investment in energy production, highly volatile energy prices – these are just few challenges for Europe's long-term supply security and competitiveness. Climate change, fostered by increased CO2 emissions, is another one, putting pressure on our stability and sustainability.

The situation in the Baltic States is not an exception. On a business-as-usual scenario, the energy demand in the Baltic States is set to increase by 50% by 2030. Demand for gas alone is expected to grow by 60% during this period. Increasing demand together with rising fuel prices, the oil and gas dispute between transit countries and Russia, the energy market reform and the pressure of new environmental legislation – all these factors have increased the strategic importance of energy issues in the Baltic Sea region. Moreover, the Baltic States remain an "energy island" largely cut off from the rest of the EU and linked only with third countries, such as Russia and Belarus.

The challenges of secure, competitive and sustainable energy can not be sufficiently met by individual Member States alone. Therefore the European Commission has proposed a new Energy Policy for Europe. This integrated energy and climate change package aims at cutting greenhouse gas emissions by 20% compared to 1990, increasing the share of renewable energy sources to 20% by 2020 and saving 20% of energy consumed by 2020. Besides it, the package introduces numerous measures for effective and competitive internal market in energy. Such a policy, which combines internal market integration, diversification of energy sources and energy efficiency, can reduce substantially the dependency of Europe from outside supplies thus fostering its energy security.

For the Baltic States energy security is particularly important. Given their isolation and dependency on one major supplier, currently there are few issues to pay more attention to.

The first one is energy interconnections. The isolation of the Baltic States is not only a challenge for security of supply but also for proper functioning of the internal market in energy. Therefore integration of electricity and gas networks of the Baltic States into the wider European network is one of the Commission's priorities for this region. The EU is helping the region through its Trans European Networks Programme for Energy. Since its creation in 1995, the TEN-E Program has supported more than 30 studies in the Baltic Sea Region with a total contribution of about 30 million euros. Two projects, Estlink and the Polish Lithuanian interconnector, have been identified as priority infrastructures for the Baltic States. In December 2006, Estlink, the underwater electricity cable that links Estonia and Finland, connected the electricity grid of the Baltic States to Nordel, the Nordic transmission grid, thus putting an end to the electric isolation of the region. It is the first and so far the only electricity connection of the Baltic States with other Member States of the EU. The Poland-Lithuania interconnector will link the Baltic States to the continental European electricity network. After significant difficulties over the years, the study phase is expected to be completed in 2007 and the line is scheduled to start operating by 2013.

In addition to interconnections, some Baltic Sea region countries have important assets which are interesting for the whole region, such as the Inchukalns gas storage in Latvia. The Commission will fund a geological and economic study on another possible underground gas storage development.

The second issue is diversification of energy supplies. In general the Baltic region has the benefit of a relatively good diversity of energy sources. Lithuania has a nuclear tradition, Estonia has oil shale. The use of renewable energy is growing slowly, due to small and large scale hydro as well as the production of bio-energy (including biofuels) from agriculture and forestry. Nevertheless, the Commission's Renewable Electricity Report identified that deployment of green electricity in the Baltic region is very modest due to the lack of a stable support systems in this area. It will need to be improved in the future. Besides it, oil and gas from Russia has traditionally made up for low domestic opportunities. Given its relative position, it is economically reasonable to say that most of the region's gas will continue to come from Russia for the foreseeable future. Through the European network, however, alternative suppliers may be found as far as Norway or Algeria. Liquid natural gas is also an alternative worth studying.

Investment is needed in new electricity capacities. In the Baltics, old power plants are being phased out, while demand is rising. With the closure of Ignalina, the Baltic States will lose a major power producer. The Commission's Energy Policy for Europe underlines that it is up to each Member State to decide whether or not to rely on nuclear electricity. Though I welcome the commitment of the three Baltic States to collaborate in a feasibility study for a new nuclear plant in the region, nuclear power generation must meet the highest safety, security and proliferation standards, while important issues such as waste management and decommissioning funds should be correctly managed.

The third issue is energy efficiency. The potential for energy savings in the Baltic States is enormous, given the energy intensity of their industries, which is still one of the highest in the EU, and low energy efficiency in buildings, transport sector and district heating systems. Though partly energy inefficiency stems from the use of out-dated Soviet technologies and insufficient investment, high consumption of energy is also related to its low price, which discourages more responsible consumer behaviour. Therefore the Commission pays particular attention to awareness rising of the people, especially at the local level, as well as provides funds for improved energy efficiency through its Intelligent Energy - Europe Programme.

In conclusion, the Baltic States have the potential to become one of the most integrated regions within the European Union, bringing greater stability and prosperity to Europe as a whole. By implementing the policy, which aims towards greater security, competitiveness and sustainability, we will not only benefit the people and industry of the Baltic Sea Region but the future energy system of the European Union as a whole.

Andris Piebalgs

Member of the European Commission in

Charge of Energy

Lessons from the Finnish presidency of the autumn 2006

by Mauri Pekkarinen

Last autumn's Finnish Presidency is now over. As the dust settles, we can already take stock of what happened in the economic and competitiveness fields. What was achieved and what lessons can be learned from this intensive six-month period at the helm of the EU? What can the EU do to help address the future competitiveness challenges facing the continent?

The EU is facing an increasingly competitive external environment. In recent years, the rapid economic expansion of emerging market economies has profoundly altered the world's economic geography. Production has increasingly shifted towards Asian economies and the production practices of multinational companies have continued to change. These structural changes have opened up a host of new opportunities, but are also creating pressures in terms of competitiveness.

One should be aware that the term, competitiveness, is itself a somewhat precarious concept. Europe and its economies need to be competitive against other regions of the world, but most of all, we should ensure that we have the public policies in place that most effectively promote sustainable economic growth and employment. In this way, competitiveness is about competing against ourselves in making Europe the most attractive location in which to do business.

Since the Constitutional Treaty failed in 2005, there has been a strong sense that the EU is stagnant and has been brought to its knees. However, this mood conceals one undisputable achievement of the EU – its recent enlargement. This has been a huge success story, even when examined from the viewpoint of competitiveness ministers. As the recent Commission's study on the economic effects of enlargement shows, it has helped create strong economic growth through multiplying trade and investment as well as increasing macroeconomic stability. Overall, this is a good beginning for a process which will bring increased prosperity to all EU Member States.

Furthermore, some important EU level projects have recently been concluded, namely the Services Directive and the EU's Framework Programme for Research.

A common legal framework for the provision of services across the Union will no doubt give a boost to the European economy. During the heated debate on this item of legislation, some claimed that the end result had been seriously watered down. In reality, the Directive adopted will create a genuine level-playing field for service providers across the Union, allowing access to service markets in other Member States on considerably improved and harmonised terms.

I believe that this will not only bring about more affordable services and improved quality, especially in the "old" Member States, but also create a host of export opportunities across the Union. In other words, everybody stands to gain. Now is the time, following the final adoption of the Directive, for all Member States to focus seriously on its effective implementation.

The EU's Framework Programme for Research received its final seal of approval from the EU competitiveness ministers and the European Parliament in December 2006. This hugely important financial instrument for assisting cross-border research has a budget of Euro 76 billion for the period 2007-2013. The Programme will provide considerable help to Europe in improving its innovation and R&D performance.

However, it is evident that these measures alone are not sufficient to turn Europe into the most competitive region in the world, as envisaged in the Lisbon Strategy in 2000. More effective common action is needed to bolster the European economic agenda. In a globalised economy, knowledge and innovation capacity must form the cornerstones of European competitiveness. We can only prosper if we can jointly ensure that top-level research remains in Europe. In addition, we need a regulatory framework and the financial means to translate this knowledge into innovative products and services.

In the future, joint work at European level must focus on policies and measures that truly create added value for all Member States – and for the Union as a whole. Major potential remains in two policy fields: the EU's internal market and common EU action on innovation and knowledge.

The four freedoms - the free movement of people, goods, services and capital - is already a remarkable achievement. Nevertheless, there is considerable scope for improvement. In fact, intra EU trade in goods has been diminishing during the recent decade. The ongoing review of the internal market can show us the way to improve and modernise internal market rules: ensuring effective enforcement and taking account of the global market place will form the central tenets of the future internal market regime. Furthermore, vigorous competition is another key element in the EU's common market. Strong competition at home implies success in global competition.

In December 2006, the EU Competitiveness ministers agreed on Strategic Priorities, i.e. what needs to be done at EU level to promote innovation. There is no magic bullet and no single instrument will suffice. A package of measures is required that addresses a variety of areas.

The 7th Framework Programme will be of great help in improving innovation financing. Another challenge is to create a regulatory environment that genuinely spurs innovation. Above all, the IPR framework is crucial in this respect. It is almost inexplicable that, to date, no European solution has been found for patenting.

Public policies can also – if we act wisely and without interfering with market forces – do a great deal to stimulate demand for innovation. We need to advance European industry-driven co-operation on specific technologies through the new instruments of private-public partnership, i.e. the so-called Joint Technology Initiatives. Speed is of the essence here, in order to get initiatives started through which we can still secure European leadership. Areas such as innovative medicines and embedded computing systems appear to be the most mature candidates for the moment.

Europe also faces the huge task of bringing together businesses, universities and research institutions. The initiative for the European Institute of Technology has the potential to show the way. Universities in Europe need reform, with modern and effective co-operation with businesses as its key element.

These are examples of a blueprint for innovation action that has now been defined. Such innovation priorities have been integrated into the Lisbon Strategy. These issues are vital to the whole of Europe, and Europe must now be relentless in pursuit of their effective implementation. At the same time, the Baltic region in particular stands to gain enormously from this European co-operation. The Baltic region has proved to be rather alert in exploiting new opportunities and quick in responding innovatively to new challenges. For this reason, I believe that the European response to the globalisation challenge may also help bring about a true Baltic success.

Mauri Pekkarinen

Minister of Trade and Industry, Finland

The Baltic Sea gas pipeline – power or partnership?

by Heidi Hautala

Energy is power. Russia assumes a new role in world politics and wants to secure its oil and gas transports through the Baltic Sea instead of certain countries which cause trouble to it.

So far, the project can also be seen as failure of all multilateral institutions in the Baltic Sea Region: CBSS, the Helsinki Commission for the protection of the marine environment - and of course the European Union.

After the EU enlargement it has been assumed that Baltic Sea cooperation would be raised to a new level now that, with the exception of the Russian Federation, all riparian states are now Members in the European Union. The achievements of the Northern Dimension of the EU were supposedly to be the very best in its environmental partnership.

The Baltic gas pipeline shows that when national interests are at stake, even the EU parties are following their own basic instincts. Germany's bilateral deal with Russia is of concern to its EU Baltic Sea partners. The Baltic Sea Region is again divided after 15 years, this time by the Baltic gas pipeline. The pipeline is inevitably a part of Russia's foreign policy and a part of its top sensitive logistical infrastructure.

The politics of the pipeline tells of the lack of confidence between Russia and a number of countries in the so-called post-Soviet space. One can ask why the EU could not do more to help to heal the phantom pain caused by the divorce of Russia and its former parts? Brussels has taken cool distance to the uncompleted border agreements of Estonia and Latvia with Russia, rather than facilitating them.

Even more difficult will it be to help the Ukraine to define its place between Russia and the EU, not to say anything about White Russia. This problem is now a direct cause of the need of Russia to find new channels for its gas and oil exports, notably the Baltic Sea routes. A rational approach to common challenges in the Region is not possible until the larger political picture will be clear.

To come to a conclusion on the European Energy Charter on the basis of mutual rights and obligations is a matter of high importance. Europe should have the courage to realise that Russia is at least as dependent on Europe as vice versa. A democratic Russia is what makes true partnership possible. The European Union must continue to discuss energy and values at the same tables, at the highest level.

A test on common rules

Russia is going to double its oil exports from its harbours on the coast of the Gulf of Finland. The Baltic gas pipeline has reached the stage of the international environmental impact assessment. At a time when zero tolerance as for the pollution into the Baltic Sea is called for ever more often, we are entering into new risk levels.

Many of the environmental arguments against the pipeline have been put forward to amplify other, more directly political concerns. The environmental impact assessment may yet prove to be the only instrument to deal with these "larger" aspects of the pipeline. Few understand that the process requires looking into several alternatives to the plan. These include land-based alternative routes either via Latvia, Lithuania and Poland or via White Russia and Poland. Even so-called "zero" option must be analysed with the view to the final decision.

The Espoo Convention on environmental impact assessment of transboundary projects is facing its biggest test in our Region so far. The Russian Federation has not ratified the Convention, though it has announced that it will fulfil its requirements. This leaves the other parties to rely upon the good will and arbitrariness of a major party to the project. This may suit the notion of "sovereign democracy" but not that of reliable partnership.

It is not surprising that the EU Member states have not found unanimity for EIB loans to the project. The transparency of the project is suffering from claims that Nord Stream has already chosen the producer of the pipes, without a tender. Full disclosure of the financial flows and expected economic feasibility is also necessary to ensure is generated for the future financing of environmental costs.

As the main partner to the gas pipeline, Germany has a special responsibility to interpret the applicable law to Nord Stream and its major stakeholder Gazprom. Germany must emphasise that a global power must adapt to international law rather than trying to circumvent it.

The wake-up call to the risks of excessive dependency on Russian gas and oil has been sudden. There should be no illusions about becoming totally free of such dependency, as energy is a global commodity in a global business environment. The energy cooperation should be seen as an exercise to argue for common rules, based on common values. Chancellor Merkel's statement that the pipeline benefits the whole of the European Union deserves many critical questions.

Towards energy efficiency

At the time of V.I. Lenin electrification was the synonym of socialism. The inheritance of this idea is that Russia is probably the least energy-efficient economy in the industrial world. Many see the low energy prices as the equivalent of the low bread prices of 1917. A social policy would be a good alternative to subsidised energy prices.

Russia will be able to save many megawatts ("negawatts"), as energy prices move towards market values. Market pricing is a real power switch to a sound energy economy, irregardless of the political system. Industrialisation and economic growth have gone hand in hand with increased consumption of energy. Decoupling the two is the most important path to environmental sustainability, with clear benefits for competitiveness and security of supply.

Lenin had unfortunately no monopoly to this fatal idea of connecting growth of the economy to the increase in energy consumption. The whole industrial world has suffered from it. Now efficiency is a key component of the new "post-industrial energy revolution" which the EU Commission's President Jose Manuel Barroso is calling for. Russia and the EU are both bound by the commitments of the Kyoto Protocol to reduce their climate-affecting emissions. This commitment is yet another reason to argue for a strengthened energy cooperation based on common values.

Heidi Hautala

The chairperson of the Green parliamentary group in the Finnish Parliament and the founding member of the EU-Russia Centre

St. Petersburg – the leader of Russian modernisation

by Valentina Matvienko

St. Petersburg is the largest metropolis in northern Europe, with more than 4.5 million inhabitants, making it the fourth most populated city after London, Paris and Moscow. The city on the Neva is a world cultural treasure trove, a museum under the open sky. At the same time, St. Petersburg is a large transport and industrial centre, one of the leaders of the growing Russian economy as on rates of economic development and volume of investments involved and on increase of people's standard of living.

In recent times, St. Petersburg has attained exceptional success in social and economic development. For the last three years we have tripled the city's budget. Such an increase in revenues has not been seen in any other part of the Russian Federation. This has been possible thanks to the stable work of industry, the development of small and medium-size businesses and the influx in the city of the largest national and international companies with internationally recognised names.

Our budget is socially orientated and furthermore, this is a budget for the development of the city. Funds are invested primarily in the implementation of the largest infrastructural projects, the reparation of housing and the equipment of housing courtyards. They are also invested in supporting social programmes, modernising and replacing engineering and electrical systems and communications and the restoration of historical buildings. As the budget increases, the level of our citizens' prosperity grows and raises people's standard of living.

One of the main components of the success of the St. Petersburg economy is the rising level of investments. We have made all possible to create favourable conditions for investors. In 2004–2005, investment rates in the city's economy rose by 40% a year, and in the first half of 2006, foreign investments in the real economy increased by 3.5 times. At the same time, foreign direct investments have doubled in volume. In 2005, global credit rating agencies raised St. Petersburg's investment rating in four times. Today St. Petersburg investment climate is quite rightly considered the best in the country, having won in the All-Russia competition for Lowest Investment Risk and Best Social Climate. In 2006, the city was rated first for effective governance of the region, and was victorious in the National Ratings for Transparent Acquisitions supported by the State Duma's Anti-Corruption Commission, the Federal Antimonopoly Service and the Audit Office. At present we like to say that if Russia is perspective market for investors, then St. Petersburg is the best place for entering that market.

We understand that the city's investment attractiveness is not limited to a system of concessions for investors. It also includes transparency of city finances, competitive tenders for real-estate and land, the stability of city socio-political life, a readiness to adhere to investors' exact strategic guidelines for the city's development and the development of new areas. In 2005, the new St. Petersburg General Plan was accepted for the period until 2025 becoming the fundamental strategic document for the city-planning development.

St. Petersburg is a multifunctional centre with a differentiated economic structure. Ship-building and metal-working industries, manufacturing of electronic components, food industry, pharmaceuticals and many other sectors are flourishing in the city. We are carrying out a serious reconstruction of the economy with an accent on modernisation, development of the science-driven and high-tech sector and unveiling modern enterprises. Only recently, seven new high-tech enterprises were built and operated by large domestic and foreign companies including Gillette, Elcoteq, Knauf, Izhorsky Trubny Zavod, Russky Standart. Also in the pipeline are projects from Bosch and Siemens, Technopolis and Alkan Packaging.

We would be right to call St. Petersburg the leader of Russian modernisation, a centre for progressive ideas, an example which today serves as the model for mutual relations between Russia and the West. Under the decision of the Federal Government the country's first special economic zone for the development and implementation of innovative technology, Russia's first Technology Park has been created in the Neva's city. Global brands are ready to be participants, including companies from the Baltic States. The town of Peterhof, famous to all as one of the architectural jewels in St. Petersburg's crown, has been given the status of Science Town.

Our city is the 'European Gateway' of Russia, one of the largest ports in the Baltic and a crossroad of the most important transport routes. St. Petersburg is an essential part of Greater Europe, a fully legitimate participant in international cooperation, above all, with the Baltic States. This is precisely why we are promoting the most significant infrastructural projects with the cooperation and support of our partners, with particular importance given to projects in the fields of transport and logistics, tourism and innovation and energy and municipal services. The South West Wastewater Treatment Plant ecological project put into operation in St. Petersburg is now ranked as the best ecological project in Europe. It has been recognised a bright and unique example of partnership in the framework of the Northern Dimension Environmental Partnership (NDEP). The opening of the South West Wastewater Treatment Plant has allowed a twofold reduction in the pollution load to the Neva and the Gulf of Finland and brought its water purity up to 85%. After the commissioning the modernisation of the Northern Collecting Sewer, the disposal of waste water will stop almost completely.

St. Petersburg collaborates very closely with many associate-towns from the Baltic States. Our city holds the chairmanship of the Union of Baltic Cities' Commission on Information Society, created on our initiative. We are also collaborating with the Council of Baltic States. St. Petersburg is a member of the international Baltic Metropoles Network (BaltMet). At the recent Mayor's Meeting in Helsinki the major St. Petersburg projects in the fields of innovation, transportation infrastructure and ecological security received approval and support from the eleven BaltMet cities. Three of St. Petersburg's largest projects were on the BaltMet's list of 26 focal infrastructural projects: The construction of the Western High-speed Diameter, the Orlovsky tunnel under the river Neva and also the completion of the Northern Collecting Sewer drainage system. Their realisation, without a doubt, will benefit not only St. Petersburg but also our Baltic neighbours, opening greater development prospects for the Baltic States in Pan-European and global development.

Furthermore, the implementation of a high-speed railway service on the Moscow - St. Petersburg - Vyborg - State Boarder line could become one of BaltMet's priority projects and our Finnish colleagues are particularly interested to support it. It is suggested that it will be possible to travel from St. Petersburg to the border in an hour and a half, significantly shortening travel time to Helsinki.

Since 1997 St. Petersburg's Government has been collaborating with the Finnish Advisory Group, an informal alliance of large Finnish companies. St. Petersburg together with Leningrad Oblast is actively working with Finland's South-East regions under the EU's INTERREG South-East Finland – Russia programme.

A whole range of large infrastructural projects have been launched in St. Petersburg and are being carried out through the direct participation and active support of the Federal Centre. They add a completely different dynamic to the development of the city. This year, the eastern half of the ring road around St. Petersburg was opened. At the same time the construction of the Western half has been started with the aim to complete the entire ring road by 2008. The ring road is not only extremely important for the city, as its final completion will help to significantly improve the transport situation in the city. The ring road is an important part of the Moscow - St. Petersburg – Helsinki federal highway and an essential part of the Ninth Intermodal Corridor between Europe and Asia.

In addition to this, there is the construction of 'Baltic Pearl' a multifunctional complex of residential, commercial and administrative buildings on coast of the Gulf of Finland, the construction of a new, modern football stadium, the reconstruction of the unique architectural heritage of New Holland Island, the construction of a second stage at the great Mariinsky Theatre and many other projects that characterise the scope of our work in modernising the city's amenities. Furthermore, we held a best concept-design tender for the Gazprom-City administrative-business development where the world's leading architectural firms took part.

We are also starting the construction of the Western High-speed Diameter, a motorway that will link the north and south of St. Petersburg and allow the constant flow of traffic through the city. After an eighty year break it will become the first in Russia to be built on the basis of a concession agreement. This is a major project not only for St. Petersburg and Russia but also for our close neighbours on the Baltic coast. A number of foreign and domestic consortiums have shown their great interest in the concession agreement and are ready to take part in the investment tender. The World Bank has given this project an outstanding score and is prepared to provide its financing. Our project enjoyed a great popularity in the held not long ago exhibition of the largest international infrastructural road show in London. The winning bidder for the construction of the Western High-speed Diameter will be chosen at the beginning of 2007.

For the first time in the history of St. Petersburg, a new aspect was brought to the city's economy in 2006 – automotive construction. Three global automotive giants, Toyota, Nissan and General Motors, have announced their decision on locating their factories in the area. This is more than a statistical sum of investments, taxes and quality of new work places. It is a vivid example of the build up of competitive advantages in the city.

Today, with the assistance of the federal centre we are working on 15 high-priority infrastructural projects. One of our main tasks is the modernisation of the energy infrastructure. On the list of the largest objectives is the construction of the South-Western Thermal Power Plant, the first private Thermal Power Plant in Russia, and new electrical substations. The Government of St. Petersburg has signed a very important agreement with RAO UES of Russia for the modernisation of St. Petersburg's power supply and power complex development. The extent of this investment in the city's power supply until 2010 constitutes more than ten billion Euros.

We have embraced St. Petersburg's development Programme as a tourist centre from 2005 to 2010. This was created on the basis of research of the Boston Consulting Group, commissioned by the federal government. In that research, a system of measures is outlined, aimed at realising an important goal – to become one of the top five tourist centres in Europe by 2010, attracting up to five million tourists a year to the city. On the list of basic undertakings, amongst others, is the development of Pulkovo Airport; the construction of new hotels, modernisation of museums, the creation of a network of tourist information sites and the development of congressional tourism. We have already built a range of new hotels. The realisation of the large-scale project for developing Vasilevsky Island is proceeding at full speed with the construction of a passenger terminal and with the prospective rapid development of cruise tourism. This year saw the introduction of a Tourist Angels – volunteers assistants helping city visitors. This will be followed shortly by the launch of an information 'hotline' for tourists.

This year, with the help of the federal centre, St. Petersburg has been accorded institutional status. Deputies of the State Duma took the decision to move the Constitutional Court of the Russian Federation to the banks of the Neva. Henceforth, St. Petersburg is Russia's second capital, not only de facto but also de jure. This event of great historical significance will undoubtedly give a new dynamic to the development of the city, bringing about substantial growth of all our foreign-policy and foreign-economic links. Furthermore, the national television station Channel 5 is based in and broadcast from our city, enhancing St. Petersburg's capital status.

Realising our historical mission, we have opened our city to the whole world. We happily await and welcome our friends and partners. Those who have still not come to Russia to do business can begin their journey in the city-on-Neva. You can rely on the full support of the Government of St. Petersburg. Welcome to St. Petersburg!

Valentina Matvienko

The Governor of the City of St. Petersburg

Protection of the Baltic Sea urgent task: Local actors have key role in EU maritime policy

by Aleksi Randell

The role of regions and cities in the upcoming maritime policy of the EU is pivotal. They are between policy and delivery. The European level and the nation al level shall have a natural role in drafting common policies. But regions and cities shall have the main responsibility to ensure that the policy lines are put into concrete actions.

Of course the European wide maritime policy includes elements that shall be put into practise and monitored by the European institutions and national administrations. But there are dimensions that shall fall into the responsibility of local actors as well. Delivery of best practises and the surveillance of policy elements are in the responsibility of local and regional actors.

The division of labour in the maritime area follows the logic of subsidiarity. Coastal areas and coastal authorities certainly have the best knowledge of condition of maritime regions under their administration. They have the best expertise. No doubt local authorities must be able and willing to exploit all the outside expertise they enjoy in their regions.

Protection of the Baltic Sea is our most urgent task. We have drastic evidence that joint action must be undertaken to stop the degeneration of this Sea which is so important for all of us. Increasing traffic of oil tankers is one of the potentially greatest dangers.

Cleaning of the Baltic Sea requires action by all stakeholders - from local levels to national governments, the Baltic Sea Region organisations to the EU. Here, the local and regional authorities can play a crucial role. More funding from national and EU sources must be channelled to them, ensuring at the same proper coordination between various actors. There is a strong will but insufficient tools to tackle this most important question.

Specifically, we need to ensure that the Baltic Sea will receive its own place and budget line in the EU decision-making.

The challenges that cities and regions face in the delivery of the common European maritime policy demands new actions and new thinking. The City of Turku, as the centre and key actor of a wide coastal region in South-West Finland, is fully aware of this. Our answer to the challenges has been the creation of a regional maritime cluster. In this framework we aim at putting together all the maritime expertise that is available in the region.

Our cluster is based on a combination of strong shipbuilding tradition and expertise present in the region. Turku is also turning into the most important administrative centre of maritime affairs in Finland. For instance the Headquarters of the Finnish Navy shall move to Turku. The third key element of the cluster is a strong input of research and development, both on marine environment and maritime issues. This gives us strength and excellence in maritime expertise.

Recently this was recognized by the Finnish state. Turku maritime cluster was nominated as one of the national centres of excellence. The latest step in strengthening of the maritime expertise was the decision to establish a high school specialising in maritime issues.

I believe that Turku is well prepared to take its share of the delivery of the common European maritime policy. One important notion should be made, however. Maritime issues are divided in coastal regions. Therefore a great emphasis is needed to increase and enhance cooperation between maritime centres, nationally and internationally. Cooperation between the coastal cities of West-Coast Finland has recently been activated.

Five West-Coast cities have established, together with the three Turku-based universities, the Centrum Balticum - foundation. It has established a think tank specialised in promoting activities in the Baltic Sea Region. Maritime policy has a high priority in the activities of this newly established center. (www.centrumbalticum.org).

Turku also wants to expand cooperation in maritime policy issues in the wider framework of the Baltic Sea. Our primary instrument there is the Union of the Baltic Cities (UBC), which is currently formulating its own policy paper on this subject.

As a vice-president of the UBC I am convinced that that this organisation shall develop into a major actor in the maritime issues of the region.

Aleksi Randell

Chairman, City Executive Board of Turku

Vice-president, Union of the Baltic Cities (UBC)

Let´s save the Baltic Sea!

by Jari Luukkonen

The Baltic Sea is one of the youngest seas on our planet, emerging from the last ice age some 10- 15 000 years ago. It is also the world's largest brackish water system with freshwater species living together with saltwater species. Compared with the oceans, the Baltic Sea is very shallow and thus very vulnerable to human activities. Many scientists say the Baltic is the most polluted sea in the world. Today all countries around the Baltic except Russia are members of the European Union.

The Baltic Sea is a truly unique place. Where else can you find as beautiful and diverse archipelagos with thousands and thousands of islands varying from large ones with thick forest cover to small treeless skerries? Where else can you find freshwater fish and other species inherited from lakes and over 200 rivers empting into the Baltic Sea together with numerous saltwater species inherited from the Atlantic Ocean? Where else can you walk and even drive cars on the ice and then a few month later sail and swim in the same waters? Where else can you find millions of migratory birds flying above and stopping over at the sea and its shores twice a year? The Baltic Sea and all its natural features are well worth to protect.

Although the Baltic Sea is quite large, the water content is much less than one could expect because of its shallowness. The average depth is only 55 metres, compared with e.g. the average dept of about two kilometres in the Mediterranean Sea. The water catchment area of the Baltic Sea is much larger than the Sea itself and 85 million people are living within it. Their activities, be it agriculture, forestry, traffic, industry or something else, influences the Sea in many ways. When we add to that the activities at Sea, vessel traffic, ever increasing oil transports, fisheries, aquaculture etc. as well as airborne emissions from the power sector and traffic, we began to realise that the Baltic Sea is under severe pressure.

Eutrophication, caused by overload of nutrients from human activities, is one of the most severe environmental threats facing the Baltic Sea. The situation is so severe that we experience large-scale toxic algae blooms almost every summer. Large areas of the bottom of the Sea have also severe oxygen deficiencies and large parts of these bottoms are biologically dead all year round or part of the year. This situation causes severe harm to the marine ecosystem and has its implications to humans in many ways – boating in thick layers of algae blooms is not a nice experience, people cannot swim on hot, sunny days because of the algae blooms, the reproduction of fish is impossible on dead bottoms which effects fishermen's life etc.

Oil transportation from Russian harbours, along the Gulf of Finland and through the Baltic Sea proper to harbours around the world, is ever increasing. The Baltic Sea, except Russian territorial waters, is declared a Particularly Sensitive Sea Area by the International Maritime Organisation IMO. This gives a good base for different measures to mitigate the risk of oil accidents, but the more oil is transported and the more other vessel traffic there is, the bigger is the risk that a severe oil accident will happen. Not a single country around the Baltic has at the moment enough oil combating capacity in case of a huge spill.

Many scientists say that the Baltic Sea is the most polluted sea in the world. It is clear that the threats facing the Baltic are enormous. We cannot afford to loose the Baltic – therefore the actions to save the Sea must start now.

All actors and sectors must live up to their responsibility, but to get that started we need strong political leadership. The severe environmental problems facing the Baltic Sea are not yet understood by the EU as a whole, nor the understanding that the political decisions of the EU are of utmost importance for the future of the Baltic Sea.

The EU member states around the Baltic, in addition of doing whatever they can nationally to save the Baltic Sea, should put in extra efforts to increase the awareness about the Baltic Sea within the EU and to put the well-being of the Baltic Sea high on EU's political agenda. The need to radically decrease the nutrient flow to the Baltic Sea should be taken into account in all EU policies and funding mechanisms affecting the Baltic, like the Common Agricultural Policy CAP. Likewise the severe situation in the Baltic should be taken into account when the EU develops its marine strategy – The Baltic Sea should have on own strategy and own budget lines to be able to coup with the huge challenges the Sea is facing.

Last but not least, investments in improving existing and building new wastewater treatment plants in St Petersburg and smaller Russian cities in the eastern Gulf of Finland should be a top priority when it comes to EU's cooperation with Russia. EU should also cooperate with Russia to improve the security of the oil-tanker traffic, to halt the rapid increase in oil transportations and to improve the capacity of oil combating, in case of severe oil accidents.

Jari Luukkonen

Conservation Director

WWF Finland

The effect of labour shortage on Estonian enterprises

by Madis Habakuk

In the 1990s, the birth-rate in Estonia, Latvia and Lithuania fell by nearly a half. Compared to the annual birth-rate at end of 1980s, which stood at approximately 25 thousand in Estonia, it decreased to as low as 12-13 thousand by the second half of the 1990s. In Latvia, the birth-rate underwent similar decline, but in Lithuania the decrease was smaller. The problem grew worse due to emigration, which intensified after the countries joined the European Union. Emigration figures were the highest in Lithuania and the smallest in Estonia.

The current article focuses on the effects of labour shortage on Estonian enterprises since compared to other countries and areas this topic has been more extensively researched. In Latvia and Lithuania the processes differ only marginally from those in Estonia. The effects of labour shortage could be divided into two groups – the so called hard side, which is simpler to quantify and the soft side, where qualitative indicators prevail (Figure 1).

Starting with the hard side, it must be pointed out that depending on the economic field, salaries in Estonia increased by 10-25% in 2006. A similar increase for the year 2007 has been forecasted. Since the significance of salaries in Estonia´s GDP is slightly less than 40%, we may safely claim that during 2006 and 2007, such a salary increase will result in an 8-20% rise in the cost-price of products. The latter will decrease the competitiveness of enterprises on both domestic and foreign markets, the turnover and profit of a number of companies will fall and as a result the already negative balance of payments will deteriorate even further. Following this, not all companies will be able to continue and will therefore go bankrupt. For the country's financial state it means both decreasing income and increasing expenditure (bankruptcy costs). However, a positive result of the negative process is that a certain amount of workforce remains unemployed and labour shortage will decrease.

The soft side of labour shortage will start with the increasing flow of labour, deteriorating attitude to work and decrease in quality and productivity, all of which contribute to the declining competitiveness. Research conducted by Tartu University (R. Eamets) and Estonian Institute of Future Studies show that as a result of the abovementioned difficulties a number of enterprises will intensify their innovation processes, employing potential reserves – a situation which would not occur under usual circumstances. Changes in management, technologies and motivation systems are but a few that improve attitude to work, labour flow, quality and productivity.

It is difficult to forecast what will happen, when and to what extent. The effect of the decreasing birth-rate will not influence the labour market until year 2009, after which companies will need extra 2-3 thousand people each successive year. Due to demographic reasons, labour shortage will be 2-3 thousand people in 2009, 4-6 thousand in 2010 etc. Such a decrease will last until the middle of the next decade and the decrease is, in its turn, accompanied by emigration figures of approximately 3-4 thousand per year.

The situation will gradually improve from the middle of the next decade. The birth-rate in Estonia is on the increase. Compared to the rock-bottom, we are today witnessing a 20% increase. In addition to the abovementioned efficiency increase, other sources to compensate for labour shortage include immigration and inclusion of pensioners into work processes.

Madis Habakuk

Rector

Estonian Business School

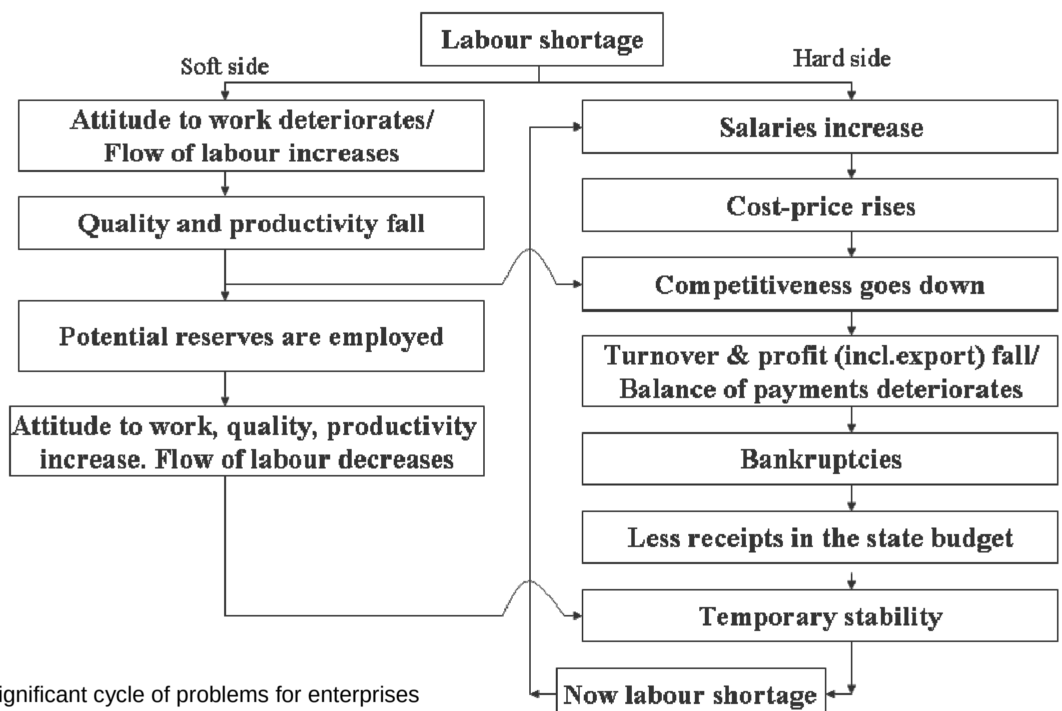


Figure 1. Significant cycle of problems for enterprises in the Baltic States for the coming 10 years

The economy of Saint-Petersburg – recent trends

by Stanislav Tkachenko

During previous several years we are witnessing sharp increase of the Saint-Petersburg's role in political and economic life of Russia. Partly it can be explained by a number of remarkable events that attracted to the city attention of the whole world: celebration of 300 Anniversary of Saint-Petersburg and 2006 G-8 Summit. Every summer the city is transforming for several weeks into diplomatic capital of the country due to numerous economic forums and congresses attended by the heads of states and governments of different European, Asian and other countries. All of that reflects significant growth of the city's economy and help to receive even more investments into industry, services and infrastructure of the city.

Successes

Saint-Petersburg is keeping for last several years the status of the most attractive Russian region for investments, both domestic and foreign. Good geographical location and capacity of the city's market are just two reasons for that. Quickly growing gross regional product has reached in 2006 the level of € 30 billion with industry as the leading sector of local economy. There is impressive record of political stability in the city, especially since autumn 2003 when Valentina Matvienko was elected as the Governor (the head of the city's executive body). She was able to create effective team of young managers with experience both in business and public sector. In December 2006, she was re-elected by local Parliament (the Legislative Assembly) for another five years, providing additional guarantee of stability and continuity for investors and businesses of the city.

Complete lack of any natural resources push regional authorities to construct economic model of modern global city. Development of infrastructure for attraction of investments into real sector of city's economy, construction, services and, especially, transport and tourism, is, by far, the most important priority for government of the city nowadays.

Russian and foreign investors characterize Saint-Petersburg as having low risk and the highest potential among all Russian regions. They point out considerable advantages that region offers to the potential investors, such as valuable industrial and intellectual potential, the benefits of access to the Russia's second most important consumer market and financial centre. In 2006, inflow of foreign investments doubled to previous year and reach annual level of US$ 3 billion. In 2006 Saint-Petersburg had impressive surplus of the city budget – about € 1 billion (RUR 32 billion).

In 2006, giant RAO EES, headed by Anatoly Chubais, and Government of Saint-Petersburg have signed a program of development of electricity sector of the city, both production of electricity and construction of new electric grids. The reason is quite obvious: now first time since the collapse of USSR Russian economy has shortage of electricity and other energy sources for fast development with Moscow and Saint-Petersburg, as well as several other regions. The aforementioned program is for 2006- 2010, and during this period of time about € 2,4 billion will be invested into the city electric grids and power stations by federal, regional budgets and private investors.

Growing number of developers' projects in Saint-Petersburg confirm new trend of improving investment climate in the city. The total income to budget of Saint-Petersburg is about € 7 billion in 2006. The city government has increased five times spending for infrastructural development of several industrial zones for inflow of investments just for last three years (2004-2006). The project "Baltic Pearl" is, probably, the most remarkable due to the fact that it is the largest oversees Chinese investment up to now. About $ 1,4 billion are to be invested into construction of apartment houses, recreation zones, business centers and transport infrastructure. Other projects to be mentioned are:

Apartment complex of 1 million square meters with investments of about $ 900 million by Industrial Building Corporation (Israel) in southern district of Saint-Petersburg.

Sea-Port Passenger Terminal as well as business offices and apartments houses are now under construction in Western part of the Vasilievsky Island on about 477 hectares of new land, which will be taken from the Baltic Sea in coming 7 years.

Gazprom City Project for the head-quarters of the oil branch of the Gazprom, which will be moved to Saint-Petersburg in 2012 with total costs of € 2 billion.

New Holland Island - Creation of the new modern culture center, commercial and residential zones on the New Holland Island with budget of $ 500 million.

Currently, several foreign trust funds are investing into the development of several city's districts in suburbs: Baltic Property Trust of Nordic countries, US-Russian Alfa Capital Partners, as well as London and Regional Properties

In 2007, the city budget will direct € 1,7 billion for development of infrastructure in preparing several city's districts for further direct investments into local economy.

Investments of foreign car-making companies in recent few years have transformed Saint-Petersburg into Russian Detroit. There are Japanese companies Toyota and Nissan, as well as US General Motors now constructing their production sites next to successful Vsevolozsk assembling facilities of the Ford Company, which invested $ 230 million into regional economy. Currently the Ford-Vsevolozsk Company is considering a possibility to double production up to 150 thousand cars per year and invest another $ 250 million. It is important to strengthen that just 10 years ago car-making sector was non-existent in Saint-Petersburg.

Saint-Petersburg is the largest road junction of Russian Federation. The network of transport ways involves 12 railways, 15 highways, the biggest sea port located in the eastern part of Baltic Sea, 2 airports, 5 railway stations, as well as 405 bridges, 35 viaducts, 25 tunnels, 152 km of strengthened embankments. The most far-reaching infrastructural projects in Saint-Petersburg are currently in the area of construction of multimodal transport links and networks. The largest project of this type for the whole Russia is Western High-Speed Diameter, a motorway, which goes from Northern districts of the city to industrial South-western part of Saint-Petersburg via quickly growing and overused Saint-Petersburg Sea Port. It will be for-pay high-way, whose total costs are exceeded € 2,5 billion with shared investments from federal budget of Russia (50%) and private investors (50%). Currently, about 19 million tons of cargo is served at the Saint-Petersburg Sea Port by auto transport. In five years, the figure will reach 63 million tons and without modern system of high-ways, connecting Saint-Petersburg with Finland, Baltic States and Central Russia there will be impossible to provide such dramatic increase of turnover of the port. That is also part of the larger problem – about 35% of whole Russian import (costs about $ 99 billion in 2005) goes via Saint-Petersburg, bringing traffic jams and environmental damage right at the historical center of the city.

The reconstruction of the existing port facilities, improving the infrastructure and the level of services, the construction of new terminals, warehousing and custom premises became the priority of the strategic development of the city. Efforts have been made to improve the road connections from Russia to Finland and from Russia to Europe via the Baltic States. The intersection of the sea, river, rail, auto, air and pipe routes turn Saint Petersburg into a prominent transportation junction. However, this advantage is not fully realized due to the underdevelopment of the multimodal communication, which is one of the main problems to be tackled in order to turn the city into a truly modern and convenient communication centre.

Problems of the city's economy

Despite of the successful economic development of the city in recent yours, there are several political, economic and social problems, which still have to be solved. Coming elections to local Legislative Assembly (March 2007), to State Duma (December 2007) and the Presidential elections in March 2008 will pose a challenge to stability of local political institutions. Any turmoil in Moscow or other parts of Russia will effect Saint-Petersburg and loyalty of investors to local market.

There is growing shortage of labor force in Saint-Petersburg. Some professions, including software engineers, construction workers, tourist industry specialists, etc. are in huge demand. Labor force in Saint-Petersburg is quickly becoming "expensive" and that probably will result in loosing attractiveness of the city for some investors.

Recently adopted legislation on migration may pose another threat to labor market of the city. Currently hundreds of thousands low-skilled workers are illegal migrants in the city and their "legalization" may lead to outflow of them to another regions of Russia or even to home countries. That may have disastrous immediate effect for local economy in Saint-Petersburg.

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BalticStudyNet – promoting Baltic Sea region higher education worldwide

by Carsten Schymik

In a recent article for Baltic Rim Economies (see Bimonthly Review 6-2006), Tapio Reponen, Rector of the Turku School of Economics, called for more 'well-functioning networks between Baltic Sea area Universities' in order to strengthen the overall quality of higher education and research while coping with such problems as recruiting 'good students' and 'the most talented faculty possible'. A concrete example in this context is the BalticStudyNet network, which was established in 2005 as part of the European Union's Erasmus Mundus programme.

As a regional network of higher education institutions, the BalticStudyNet unites all Baltic Sea countries. The participating universities include Copenhagen, Södertörn, Turku, Tartu, Latvia (Riga), Kaunas, Gdansk and the Humboldt University of Berlin, which is also coordinating the programme, as well as two associated partner institutions in Russia (St. Petersburg State University of Telecommunications and the Institute of Europe of the Russian Academy of Science, Moscow).

BalticStudyNet is funded through the so-called Action 4 scheme of Erasmus Mundus, which is designed for measures enhancing the attractiveness of Europe as an educational destination. BalticStudyNet is thus a networking programme for the global promotion of higher education and research in and on the Baltic Sea Region. Its academic focus is on the social sciences and the humanities in general, and on Baltic Sea Region Studies (BSRS) in particular. BSRS is an English-taught study programme on Master level comprising history, politics, economics and cultural studies. It is offered as a Joint Master Degree at the universities of Turku, Tartu, Latvia (Riga) and Kaunas, or through similar programmes at the other BalticStudyNet universities.

The BalticStudyNet is one of seven projects that have initially been selected by the European Commission under Action 4. Its main activity during the first programme period, which ended in December 2006, was to collect information about academic training and research programmes on the Baltic Sea Region, and to make this information available to global audiences. An internet portal was established at www.balticstudy.net to offer comprehensive information about relevant study programmes and to provide links to higher education institutions both inside and outside the Baltic Sea Region. Other activities included conferences, workshops and an international summer school in Baltic Sea Region Studies titled 'Mare Europaeum' and followed by 22 graduate students from 13 non-EU countries during a two-week trip around the Baltic Sea, with classes held in Copenhagen, Lund, Turku, Tallinn and Berlin.

The basic idea underlying these activities was to bring about a fundamental change of perspective – away from intra-regional and towards extra-regional and truly global approaches to the Baltic Sea Region. It was therefore important to find out more about how the region is seen through the eyes of a distant outsider: How is the Baltic Sea region perceived when viewed from, let's say, Canada or Peru? What, if anything, would an Indian student find typical, extraordinary, or even unique when looking at the region?

The two-year programme yielded valuable experience, and some answers. The most fundamental must be that, for the world at large, the Baltic Sea Region has not yet become a visible and separate entity, neither in politics nor as a market place, let alone as a higher education area. It still appears to be a white spot on the global map.

How can this white spot hen become visible on a global scale? An analysis of 'Perceptions of European Higher Education in Third Countries', carried out by the Academic Cooperation Association (ACA) in 2006, provides some clues. A key finding of the study is that Europe is perceived by non-European students and scholars as an entity in general terms and as an economic union, but not with regard to culture and higher education. Moreover, knowledge of Europe is limited to a few big countries, namely the UK, France, and Germany, whereas smaller countries can only gain visibility as a group, e.g. the Nordic countries. The study also concludes that Europe's single major disadvantage vis-à-vis the US and Australia is that English is not the universal mother tongue, while English-taught study programmes at universities in non-English speaking European countries are hardly known.

The ACA study implies at least three far-reaching consequences if one wants to design a global promotion strategy to the benefit of higher education in the Baltic Sea Region. To begin with, the region's lack of visibility necessitates an even stronger commitment to transnational networking and structured cooperation among Baltic Sea universities. Only joint action will enable a region like the Baltic Sea, which primarily consists of combarably small countries, to build up a globally recognisable reputation. Secondly, the Baltic Sea Region must present itself in the larger context of Europe – and not just the European Union. The Baltic Sea Region provides more than just one example of regional integration in the framework of the EU. Its study also offers insight into the complex relationship of the EU with one of its most influential neighbours: the Russian Federation. Thus the Baltic Sea should not be portrayed as an EU inland sea but a European inland sea. In fact, it is the European sea region – a genuine Mare Europaeum. Thirdly, it must be a central message to the outside world that living and studying in the Baltic Sea Region does not require proficiency of the various local languages. The widespread use of English as a lingua franca is a particular strength of the region and asset for its potential attractiveness.

In January 2007, the BalticStudyNet entered its second programme period made possible by a new three-year grant from the European Commission. Building on the experience of the first programme period, the new BalticStudyNet will shift the focus from information to promotion. A travelling exhibition about the BSR as a region of high-quality higher education will be designed for show at universities in North America, Russia including Central Asia and the Caucasus, China, India and Australia. The exhibition will go along with 'promotion lectures' given by members of the partner universities. Seminars for so-called multipliers from international higher education institutions will be held in the summers of 2008 and 2009. A third tool will be the production of a textbook for Baltic Sea Region Studies especially designed for students in third countries. Ultimately, BalticStudyNet sets out to develop a trademark for higher education in the Baltic Sea Region. Hence a meaningful contribution to the creation of an attractive brand for the region as a whole.

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Saving the Baltic Sea: Small acts more crucial than grand speeches

by Kari Liuhto

According to a UN study, the countries surrounding the Baltic Sea have attracted some EUR 1000 billion in foreign direct investments (FDI), a sum that exceeds the FDI stock of Brazil, India and China even calculated together. Despite the fact that more money has been invested in the countries surrounding the Baltic Sea than in these 'economic drivers' of the emerging world, the Baltic Sea economic area cannot rest on its laurels.

A significant amount of the FDI in countries around the Baltic does not directly serve the Baltic Sea economic area. This is because only a fraction of investments made in Poland, Germany or Russia actually end up in the northern parts of Poland or Germany or the St. Petersburg and Kaliningrad regions, which are the Baltic portions of the countries. Although Poland, Germany and Russia are much more than just Baltic Sea economies, involving them in closer Baltic Sea cooperation would be advantageous to the whole economic area.

Now, Baltic Sea cooperation appears to have a unique opportunity, as EU Commissioner for Regional Policy **Danuta Hübner** is Polish, German Chancellor **Angela Merkel** was born in Hamburg and Russia President **Vladimir Putin** is from St. Petersburg. Emphasising the importance of Baltic Sea cooperation to these leaders should not be a difficult task.

Although the Baltic Sea region has succeeded in attracting more foreign capital than many of its competitors, the region's foreign investments have a structural problem because a company operating in another Baltic Sea country is often behind the investments. In practice, this means that capital is being transferred from one Baltic Sea area to another, in which case the total amount in the region does not increase.

Along with the small amount of capital from outside the Baltic Sea region, another problem is the fact that companies in our region invest more capital outside the region that we can attract here. Only the former socialist countries have been able to attract more investments to their countries than what companies inside the countries invest internationally. However, this is likely to be changed in the future, when their companies become more prosperous and ready to invest abroad.

In addition to the mutual dependence in investments, the mutual dependence of foreign trade in Baltic Sea countries is amazingly strong. The strong mutual dependence of foreign trade adds to the importance of a functional transport system. The majority of foreign trade in small Baltic Sea countries takes place with other countries in the region. For example, Germany, a commercial giant, does one-tenth of its foreign trade with countries surrounding the Baltic Sea. Baltic Sea countries are also exceptionally important trading partners for Russia; a fifth of its foreign trade takes place with countries in the Baltic Sea region.

Transport of Russia oil through the Baltic Sea has increased rapidly and these transports add to the pressure to develop a functional and safe transportation system in the region. Some 130 million tons of Russian oil was shipped to the west from Gulf of Finland ports, which is a seven-fold increase over the amount in the mid-1990's. At the end of this decade, oil shipments on the Gulf of Finland are expected to reach 150-200 million tons.

The gas pipeline (Nord Stream) being built under the Baltic Sea will further strengthen the Baltic Sea's position as one of the most important transport routes in the EU. In the beginning of the next decade, the pipeline is expected to carry more than 50 billion cubic metres of natural gas from Russia to Germany every year. At the moment, Germany imports via Belarus and Ukraine annually some 40 billion cubic meters of gas from Russia.

When examining energy cooperation between the EU and Russia it is essential to remember that Russia currently accounts for one-third of oil and half of natural gas imports to the Union. Russia's shares are expected to grow in the future, which will also increase the strategic importance of the Baltic Sea.

Hopefully, groups fighting against the Russian State will not consider Baltic Sea oil shipments or the gas pipeline being built on the sea floor to be a potential means of sabotaging Russia's export income, over 60% of which comes from oil and natural gas.

Industrial and community waste are more likely to threaten the Baltic Sea than terrorism. Within the framework of Northern Dimension Environmental Partnership, about EUR 200 million has been invested in the St. Petersburg Northern Wastewater Treatment Plant, but this is not enough.

Baltic Sea states should be more active in terms of saving the Baltic Sea. Rather than simply being on the EU Presidency agenda of just a few countries, protection of the Baltic Sea should addressed and promoted by every Baltic country in the EU. In conjunction with this fact, it is worth remembering that Germany took over the EU Presidency after Finland. Sweden will have the Presidency in 2009, Poland in 2011, Denmark in 2012, Lithuania in 2013, Latvia in 2015 and Estonia in 2018. If all the EU countries around the Baltic Sea furthered Baltic Sea protection in a systematic and coordinated manner, our common sea would be in better shape in the future. Also activation of Russia in terms of environmental protection is also essential, both financially and morally.

Besides state level actions, private measures are needed. It has given me great pleasure to see how certain companies have begun to invest in Baltic Sea protection. For example, The John Nurminen Foundation has initiated the Clean Baltic Sea project, aimed at reducing euthrophication in the Baltic Sea. Along with companies, individual persons have recently made significant donations to Baltic Sea protection. In early 2006, Swedish investor **Björn Carlson** donated more than EUR 50 million to Baltic Sea research and protection.

People do not necessarily have to donate millions to Baltic Sea protection: it would be a good start if every person who has ever swum in or travelled by boat on the Sea donated the change in their pocket to Baltic Sea protection. Small, individual donations soon become tens of millions of euros, and everyone benefits.

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