Baltic Rim Economies

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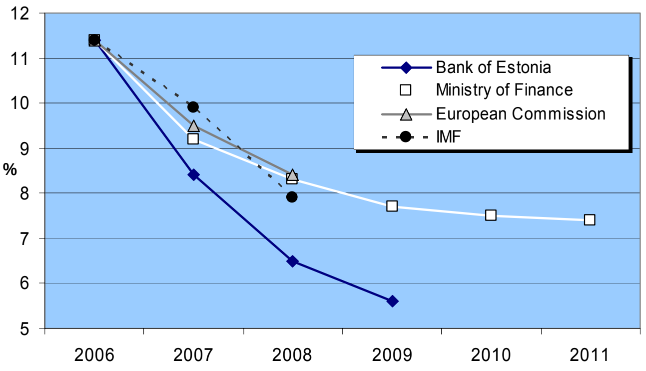
Estonia

GDP grew by 11.4% in 2006

The economic growth in Estonia in 2006 was the fastest in the country's history and the second fastest in the European Union. Estonia's GDP growth was based mainly on robust domestic demand, which grew by 15% at constant prices. The growth of domestic demand was primarily influenced by the fast growth of households' private consumption expenditures and corporation sector investments. Regarding economic activities, GDP growth was mainly influenced by the growth of wholesale and retail trades, manufacturing and transport, storage and communications activities. The share of these activities accounted for approximately 44% of the total value added in 2006.

The Bank of Estonia forecasts an economic growth of 8.4% for 2007, 6.5% for 2008, and 5.6% for 2009. Even with lowering growth indicators, Estonia would still be one of the fastest expanding economies in the EU. According to the forecast of the International Monetary Fund, Estonia's growth for this year will be 9.9%, which Latvia is expected to outpace. However, according to the IMF, Estonia's economic growth will be the highest among the Baltic countries next year with a GDP growth of 7.9%.

GDP growth forecasts



Source: National statistical authorities

All the Baltic economies are showing signs of overheating. After several years of high growth, Baltic countries are facing rising inflation and external debt burdens and tightening labour markets. In the case of Estonia, several economic development outlooks forecast that in the next six months economic growth will slow down and the economy will gradually cool down. Thus, the Estonian economy has a fairly good chance of avoiding a hard landing.

Inflation remains at a high level

In the first quarter of 2007, the consumer price index increased by 5.2% compared to the corresponding period in 2006. Over the quarter, prices increased most in housing, up by 3.6% and food, up by 3%. Construction prices are still rising quickly since they went up by almost 16% y-o-y in the first quarter. This year, the Bank of Estonia expects CPI to rise 5.1%, then 5.6% in 2008. Rising prices cast a long shadow over Estonia's ambition to join the eurozone anytime soon. It is unlikely that the Maastricht inflation criterion will be met in 2009. So far Estonia has not made any action to join the eurozone.

Estonian foreign trade deficit up by 45%

According to Statistics Estonia, the foreign trade deficit was EUR 2.9 billion in 2006. Compared to the previous year, the deficit increased by EUR 0.9 billion or 45%. The value of exports increased by 24% and imports by 29%. The share of EU countries in exports was 65%, down from 78% in 2005. The rampant inflation is a blow to Estonian exporters, who face an increase in production costs, mainly due to growing wages, but are unable to raise prices in foreign markets at the same pace. However, productivity in Estonia's industry enhances the exporters' efficiency: average productivity grew 16% in Q4 of 2006 y-o-y.

Ten main goals of the new government of Estonia

The new government is ready to lead Estonia and new orientations are being settled. The most important goal is to turn the Estonian birth rate to a positive direction. Other important aims are to ensure Estonian independence in energy production. The goal is to maintain the competitiveness of Estonia in the global taxation and entrepreneurship environment. The next major challenge is to move toward an innovative and human capital based economy. The country's aim is to strengthen Estonia's position in the EU and NATO. The next objective is to save and develop Estonian language and culture and promote sustainable and ecological development in Estonia. Another aim is the further development of the social security and health care system. The orientation is to increase the inner security in the country. The tenth aim is to sustain a liberal and open society in Estonia. The cost of the government's four-year program is estimated to be approximately EUR 3bln.

Some business highlights

- Hemtex, the Swedish home textile chain is planning to open 20- 25 stores in the Baltic countries, with the first store opening its doors in Pärnu this summer.
- Estonian casino operator Olympic Entertainment Group acquires 80% of Casino Polonia. The deal is worth approximately EUR 9mln. Olympic Entertainment Group plans to invest EUR 30mln in the Polish market. Polonia's seven casinos will be rebranded under the Olympic Casino trademark.
- The Olympic Entertainment Group announced that its Romanian subsidiary has signed a deal to buy three casinos in Romania for EUR 3.8mln, the company's first acquisitions in the prospective Balkan market.
- Authorities approve the takeover of Horizon Travel by Finnish Aurinkomatkat.
- Tallink Group orders a new EUR 180mln cruise ferry from Finnish shipyard Aker Yards. According to preliminary information, the new vessel replaces some of the current vessels on Turku-Stockholm route.
- Egyptian and British investors bought 80% of the Sikupilli Shopping Centre in Tallinn for EUR 45mln.
- Fujitsu is setting up a call centre in Estonia. It offers employment up to 30 people in the company's new call centre that will serve the Baltic States and Russia.
- Estonian investment firm, Alta Capital has acquired the Latvian construction company Latvijas Energoceltnieks (LEC) from its single shareholder, the price of the deal could reach EUR 4.3mln. The following day Alta Capital announced that it acquired 100% of Graanul Invest, the largest biofuel company in the Baltics. The deal was worth EUR 9mln. Furthermore, Alta Capital Partners, acquired 66% of Polish confectionary concern Mieszko.
- According to Aripaev, several foreign companies including PNJ Eesti, a metal-working company, are considering to stop investing in Estonia because the ongoing lack of a full workforce is making expansion too risky.
- Estonia's largest biodiesel plant will be built in Paldiski in North Estonia. The construction of the plant will be completed at the end of 2007. Investment is worth EUR 19mln. Its capacity of refining vegetable oils and production of biodiesel fuel is up to 100,000 tons a year.

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	11.4		1-12/2006
Industrial production (y-o-y %-growth)	14.6	8.9	8.2	11.0	8.0	9.7	7.0	11.0	2/2007
Inflation (CPI, end of period, y-o-y %-change)	5.0	4.2	2.7	1.1	5.0	3.6	4.4	5.7	3/2007
General government budget balance (% of GDP)	-0.6	0.3	1.5	2.0	2.3	2.3	3.8		1-12/2006
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	5.6		Q4/2006
Exports (EUR million, current prices)	3 445	3 698	3 642	4 003	4 770	6 190	7 647	1 218	1-2/2007
Imports (EUR million, current prices)	4 615	4 798	5 079	5 715	6 704	8 213	10 576	1 610	1-2/2007
Current account (% of GDP)	-5.5	-5.6	-10.2	-12.1	-12.7	-10.5	-14.8		1-12/2006

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

Latvia

Latvia fastest growing economy in the EU in 2006

Latvia's gross domestic product grew 11.9% in 2006. This is the largest overall increase in GDP in the history of Latvia, since the restoration of independence. The growth was based on the rapid value-added increase in all of the main industries. The highest increase was observed in hotel and restaurant services, in finance, and in the business sector, all of which grew around 18% y-o-y. Domestic trade increased by 17% and in the business services sector by 15%. According to the forecast of the International Monetary Fund Latvia's economy expands 10.5% this year and 7% next year.

Latvia continues to exhibit clear signs of overheating after several years of excessively fast growth. A high GDP would be a very good thing if the economy was based on competitive products, but in Latvia growth is mostly based on domestic demand, trade, construction and the real estate business, which does not guarantee a stable growth pace for GDP in the future. Although GDP growth and bank lending might already have peaked, indicating a slight slowing down, a hard-landing scenario cannot be excluded. However, the government has already taken action to tighten fiscal policy.

Government approved a plan to combat inflation

In March, the consumer price index in Latvia increased by 8.5% y-o-y. The rate is the highest since August 1997 when it was 8.6% y-o-y. Over the year, prices increased most in housing and in services, both of which grew around 12% y-o-y and food prices increased by 11%. Construction prices are still rising quickly since they went up by 30% in the first quarter of this year, which is the highest quarterly ascent since 1995. It was largely contributed to by workers' wage costs, which grew by 53% y-o-y.

In March, Latvia's government adopted a series of measures to bring down inflation, which at 8.5 % is the second highest in the EU. Measures include forcing regulated bank-lending through a more stringent application of criteria as to whom and how much banks can lend. This foresees putting the brakes on the current credit boom. Other measures to stem inflation include balancing the budget, regulating and taxing real estate transactions and taxing motor vehicles. Other, softer measures such as increasing productivity and competitiveness will also be encouraged. Inflation-busting measures are expected to reduce the growth of consumer prices to the 2-3% range by 2010-2011.

Current account deficit 21.1% of the GDP in 2006.

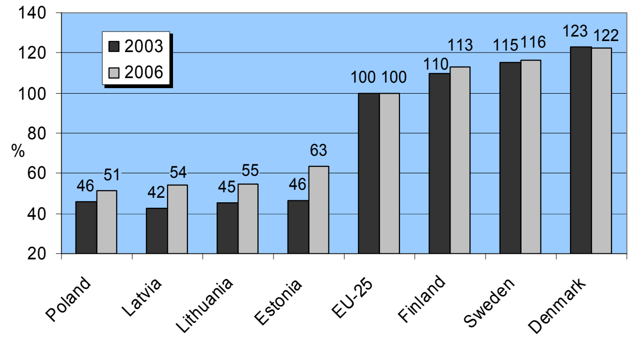
Latvia's external balance weakened last year. Latvia's current account deficit totalled a record high EUR 441mln or 21.1% of their GDP, up by 8.5% y-o-y, being relatively largest current account deficit in the EU. However, last year foreign direct investment in Latvia posted an accelerated growth of 2.5 times, its inflow accounting for 8% of GDP (compared to a mere 5% of GDP a year ago). Inflow of FDI in 2006 covered more than one third of the current account deficit. The rest of the current account deficit was offset by other investments, which, however, increased Latvia's external debt, mostly in the form of long-term loans from parent banks of Latvian commercial banks abroad.

Comparing Latvia with Estonia and Lithuania, in 2006 Latvia reported the smallest volumes of import and export. Latvia's import value made 89% of Estonia's level and 60% of Lithuania's export level, but their export value made 62% of Estonia's level and 43% of the Lithuanian export level.

Baltic countries' convergence fast

Strong economic growth helps whittle away the divide in wealth between the Baltic country and older EU member states. According to Eurostat, Baltic countries are catching old member countries fastest from amongst the new EU-countries. GDP per capita, measured in purchasing power standards, are shown on the figure below. Estonia's convergence towards EU average purchasing power has been the fastest among new member countries.

GDP per capita in relation to the EU average



Source: Eurostat

In 2006 Latvia paid the EU budget EUR 170mln and received EUR 380mln from EU funds (36% of this amount made up of grants to farmers).

According to the Minister for Finance, in the current economic situation, Latvia could introduce the euro sometime between 2011 and 2013. Currently Latvia failed to meet only one criterion for the adoption of euro, which is their vast inflation rate.

Rating agencies change Latvia's outlook to negative

Already three major rating agencies have changed their outlook for Latvia to negative this year. The rating agency Fitch changed its outlook on Latvia's foreign and local currency issuer default rating from stable to negative in April. In February Standard & Poor's had already changed its outlook to negative from stable. Like Standard & Poor's, Fitch cites the huge external imbalances in the Latvian economy and the heightened risk of a hard landing for the economy as the main reasons for its change of outlook.

Some business highlights

- Euronics International, the largest retailer of household electronics in Europe, has announced its entrance in the Latvia market by opening at least two stores in a year.
- Danske Bank AS has taken over Latvia's Sampo Bank from Finland's Sampo Bank Plc as part of its EUR 4bln takeover of Sampo Bank.
- Brabantia, Dutch houseware producer, is preparing to invest EUR 10mln towards a new plant in Liepaja in Werstern Latvia, as part of a move to shift some of its production from Western Europe.
- Optibet, Latvia's biggest sport totalisator, will be sold to Swedish company Redbet Holding AB. Although business undertaking has to be ratified by Latvian side.
- Latvian Prime Minister Aigars Kalvitis and Russian Prime Minister Mikhail Fradkov signed at 27th March in Moscow the Latvian-Russian border agreement, initialled on 1997. The agreement, which now will have to be ratified by both countries' parliaments, recognizes that the former Abrene territory of Latvia (now Pytalovo Oblast) is now officially part of the Russian Federation's territory.

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	11.9		1-12/2006
Industrial production (y-o-y %-growth)	3.2	6.9	5.8	6.5	6.0	5.6	4.8	2.0	1-2/2007
Inflation (CPI, end of period, y-o-y %-change)	1.8	3.2	1.4	3.6	7.3	7.0	6.8	8.5	3/2007
General government budget balance (% of GDP)	-2.8	-2.1	-2.3	-1.6	-1.0	-0.2	0.4		1-12/2006
Gross wage (period average, EUR)	268	282	297	298	314	350	489		Q4/2006
Unemployment (% end of period, LFS data)	13.3	12.9	11.6	10.3	10.3	7.8	6.4		Q4/2006
Exports (EUR million, current prices)	2020	2 232	2 416	2 559	3 204	4 086	4 594	775	1-2/2007
Imports (EUR million, current prices)	3 453	3 910	4 284	4 634	5 671	6 879	8 828	1 589	1-2/2007
Current account (% of GDP)	-4.8	-7.6	-6.6	-8.1	-12.9	-12.3	21.1		1-12/2006

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

Lithuania

Lithuanian economy expands 7.1% in Q1

Lithuania's gross domestic product expanded by 7.1% in the first quarter of this year, according to preliminary estimates from the statistical authorities. The growth figure was substantially equal to earlier expectations. Continued growth is the consequence of vigorous consumer spending, and robust but moderate investment activity. In the first-quarter value added grew at an especially rapid pace in the construction sector.

In 2006 Lithuania's economy enlarged by 7.5% as development stabilised and the country retreated from the hard-landing risks that trouble Latvia and Estonia. Lithuania's growth was fuelled by gains in construction, up by almost 19% y-o-y, financial intermediation and real estate services, both up by 8% and transport and communication, up by 7%. The Lithuanian Ministry of Finance forecasts that Lithuanian GDP will grow 7.2% this year, 5.3% in 2008, 4.5% in 2009 and 5.2% in 2010. It appears that the economy has already peaked and growth will decrease slightly in the forthcoming years.

Wages in Lithuania grew nearly 20% last year and the unemployment rate decreased to a historical low of 5.6%. Thus, the country's unemployment level has almost halved since 2004. As the growing economy keeps creating new jobs and employers have suffered from labour emigration, wages and salaries keeps growing. On the other hand labour productivity has increased only 6.6% in 2006 y-o-y according to Statistics Lithuania.

Lithuania's consumer price index in March rose by 4.6% y-o-y, which is a record high level. The inflation rate was determined by higher prices of foodstuffs, up by 9% y-o-y, housing, water, electricity, gas prices, which rose by 11% y-o-y, hotel, cafe and restaurant services, up by 8% y-o-y. Retail turnover in Lithuania rose 21.5% in January-February

Foreign direct investment up by a fifth in 2006

In 2006, foreign direct investment in Lithuania increased by 20% and amounted to EUR 8bln. Owing to the purchase of Mazeikiu Nafta by Poland's PKN Orlen, the Poles became the largest investors in Lithuania (22% of total FDI in country). FDI from the EU countries amounted to 84% of the total FDI. 40% of all investments went to the manufacturing industry and 16% to financial mediation.

Foreign direct investment in high technologies accounted for just a fraction of the total investment in 2000–2006. A task force set up by the Finance Ministry, proposes profit tax incentives for investment into R&D and a double deduction of costs incurred for R&D investment in high and medium-high technologies. The potential profit tax incentive for R&D investment is aimed at companies developing innovations.

Wages in Lithuania one of the lowest in EU

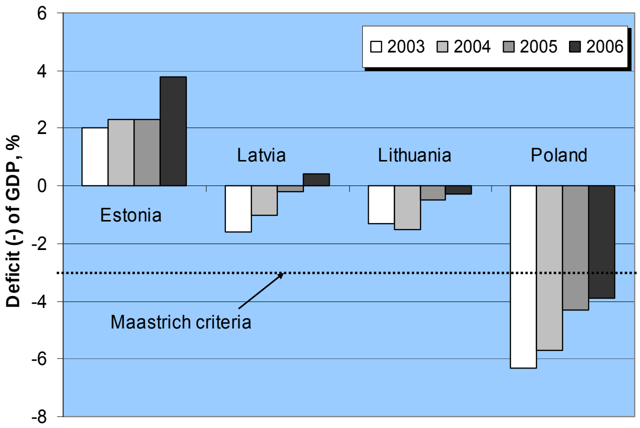
According to the report published by the European Federation of Employers (FedEE), workers in Lithuania are earning one of the lowest average wages in Europe. Only Romanian and Bulgarian salaries are lower in the EU. In terms of the average remuneration for work, Lithuania ranked 39th among 48 countries. Of all the EU newcomers, only Romania (41) and Bulgaria (46) were ranked lower. Neighbouring Latvia was 37th and Estonia 35th.

Lithuanian Cabinet adopts new roadmap to euro

At the end of April the Cabinet approved an updated National Roadmap to the euro, and public awareness and communication strategies related to euro adoption. According to the Cabinet's statement, current estimates show that the most favourable period for Lithuania's accession to the eurozone may begin in 2010. A specific date for euro adoption will be discussed by the Cabinet this autumn. A target euro adoption date indicated in the plan is January 1st, except that the specific year is not yet known.

In December last year, the Government updated the Convergence Programme. One of the objectives under the Programme was the reduction of the general government deficit so that it is not higher than 0.5% of GDP in 2008 and comes into balance in 2009. Due to positive economic development, the general government deficit in Lithuania in 2006 was lower than expected. The deficit was EUR 65mln, or 0.3% of GDP.

General government budget balance in 2003-2006



Source: Eurostat

Some business highlights

- The Lithuanian government is going to merge Lithuanian energy with two other energy companies to form a single mega-utility capable of raising financing for the proposed nuclear power plant that the country hopes to build by 2015 with its Baltic neighbours and Poland.
- Alita, one of Lithuania's largest alcohol makers, is acquiring alcohol wholesaler Daivalda for an unidentified sum.
- Logistic centre Kaunas Terminal has become the first company to operate in the Kaunas Free Economic Zone.
- The Bank of Lithuania has reported that among the commercial banks operating in Lithuania, Medicinos Bankas has boosted its Q1 2007 profit by 200% y-o-y, whilst SEB Vilniaus Bankas profit increased by 159% and Sampo's 109% respectively. All banks in Lithuania operated profitably last year. The total audited profit of the banking sector was EUR 193mln last year, up 88% from 2005.
- The Lithuanian government has decided to open an embassy in Switzerland in place of its consulate general in Geneva.
- Lindex, one of the largest fashion chains in Northern Europe that sells clothing for women and children, plans to open 10–15 stores in Lithuania.
- The Nordic Investment Bank plans to increase funds for project financing in Lithuania, with a focus on energy and social infrastructure. In 2006, the bank issued EUR 53mln worth of loans for Lithuanian entities.
- AS Baltic Trust Bank has been approved as a member on the Tallinn and Vilnius stock exchanges.

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	7.1	1-3/2007
Industrial production in sales (y-o-y %-growth)	2.2	16.0	3.1	16.1	10.8	7.3	8.9	3.0	3/2007
Inflation (CPI, end of period, y-o-y %-change)	1.4	2.0	-1.0	-1.3	2.9	3.0	3.8	4.6	3/2007
General government budget balance (% of GDP)	-2.5	-2.0	-1.4	-1.3	-1.5	-0.5	-0.3		1-12/2006
Gross wage (period average, EUR)	263	274	293	311	335	421	501		Q4/2006
Unemployment (% end of period, LFS data)	16.9	17.9	13.0	11.6	10.6	7.1	5.4		Q4/2006
Exports (EUR million, current prices)	3 841	4 778	5 526	6 158	7 478	9 502	11 250	1 625	1-2/2007
Imports (EUR million, current prices)	5 650	6 767	7 943	8 526	9 959	12 446	15 384	2 050	1-2/2007
Current account (% of GDP)	-5.9	-4.7	-5.1	-6.8	-7.7	-7.0	-10.8		1-12/2006

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

Poland

Polish economy grows unabatedly

In 2006, the Polish economy expanded by 6.1%, which was faster than at any time in close to a decade. The growth rate accelerated from quarter to quarter and in the last quarter of 2006 GDP expanded by a remarkable 6.4% y-o-y. Strong domestic demand, particularly the rapid increase in investment outlays, has been fuelling the growth. In 2006, investment spending grew by 17% y-o-y and domestic demand grew by 7% y-o-y. The Polish economy is in a strong upward trend, which gives credence to the expectations of the GDP continuing to grow equally strongly in the first half of this year.

A growing number of Poles have experienced the results of economic recovery. The improved financial standing of households and reduced concern about unemployment have been reflected in rapid consumption growth. In February, the value of consumer loans grew by 24% y-o-y, while housing loans increased nearly 63%. Retail trade expanded by 17% during the first two month of this year.

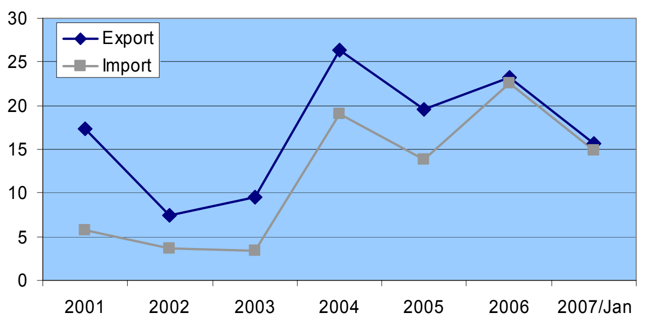
The consumer price index in March totalled 2.5% y-o-y, which represents a significant increase in relation to the previous month. Despite accelerating growth, inflation has remained moderate. One reason is that the impact of wage growth on unit labour costs has been compensated for by an even faster rise in labour productivity. In the industry sector, productivity increased by over 10% in the first two months of this year. In the context of a strong recovery in domestic demand, increasing labour shortages, growing wage pressure and higher prices of raw materials signals that inflation will begin to inch up in the future.

Industrial output increased by 13% in the first quarter of this year compared to the corresponding period of the previous year. Output increased in 24 of the 29 industrial sectors. Of the main sectors, output rose significantly in manufacturing, while it was down in the electricity, gas and water supply sector as well as in the mining-quarrying sector.

Imports growth overtook exports growth

Following several years of exports outperforming imports, the trend reversed in the last quarter of 2006. As a result of strong rise of domestic demand, imports accelerated with a simultaneous slowdown in the export growth rate. As a result, last year's imports expanded by 23.2% and exports by 22.6% respectively. A similar trend has been observed in the beginning of the current year. In January, Poland exported goods and services worth EUR 7.4bln and purchased imports totalling EUR 8.2bln, which represents y-o-y growth of 15% and 16% respectively.

Foreign trade turnover in Poland (% y-o-y)



Source: Central Statistical Office of Poland

Wage growth higher than expected

High economic growth has been accompanied by increasing pressure on wage growth. The average gross monthly wage in the enterprise sector amounted to EUR 734 in March, which was 9.1% higher than in the corresponding month of 2006. In the first quarter of 2007 the average gross monthly wage in the enterprise sector increased by 7.8% y-o-y. The market expected a much lower rate, on average 6% y-o-y. For most of last year, wage growth in the enterprise sector oscillated around 5% y-o-y, but it accelerated sharply in December. This year it is expected to see a further increase in wage pressure, which is the result of rapidly raising demand for workers and the simultaneous mass emigration of the country's labour force.

The registered unemployment rate in Poland fell to 14.9% in February according to the Central Statistical Office, and was significantly lower than the rate of 18% recorded in the corresponding month of 2006. Despite the improvement, unemployment in Poland is the highest among EU countries. The EU average is 7.4%.

Building boom rises

The building sector has recently become a driving force behind the Polish economy. According to Central Statistical Office data, in February the sector's production increased 58% y-o-y, although the exceptionally good weather explains part of the surge. Nearly 138,000 apartments were started to be built last year, which is over 30% more than in 2005. Last year, the supply of apartments built by developers increased by 66%, while individual investors started building nearly 18% more single family houses. Building permits issued last year will enable developers to build 74,500 apartments, up by 69% y-o-y. In the first quarter of this year 26,738 homes were built and made available.

Some business highlights

- Arcelor Mittal, the world's largest steel producer, the owner of steelworks in Krakow, is going to build a new production facility in the city. Investment is worth EUR 0.7bln. Production is due to start in the last quarter of 2007 and the capacity will be 450,000 tons of steel per annum.
- Hilton will build a luxury hotel in the center of Łódź. The project will cost more than EUR 58mln and will be carried out over three years. Furthermore, Hilton Hotels Corporation plans to open at least 11 hotels in Poland in the next five years.
- Rautaruukki, a Finnish producer of steel, will invest EUR 19mln in Poland, which will raise Rautaruukki's Polish staff to 1,260.
- Poland and Ukraine will together host the Euro 2012 football championship, as decided by the executive committee of UEFA. According to the plan presented by Poland, matches will be held in Warsaw, Poznan, Wroclaw and Gdansk.
- Mitsui and J.Power, Japanese energy companies, are to build a wind farm in the Kobylnica municipality in the Pomorskie voidoship. Construction of the 24 wind generators will cost approximately EUR 70mln.
- Starbucks and AmRest restaurant group's Polish subsidiary signed a preliminary agreement to open coffee shops in Poland, the Czech Republic and Hungary.
- Google is planning to open an innovation centre in Wroclaw, which may employ 200 people. The government has decided to support Google in Wroclaw.
- The banking sector in Poland noted a net financial result of approximately EUR 2.7bln in 2006, which translates into growth of 17% y-o-y. In the insurance sector net financial result amounted to EUR 1.7bln, a growth of 29% y-o-y.
- The Electronic Market Institute estimates that 35-38 million TV sets will be manufactured in Poland in 2010 and Poland is becoming a centre for audio-video equipment production and the trade's European leader.

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	6.1		1-12/2006
Industrial production (y-o-y %-growth)	6.7	0.6	1.1	8.3	12.6	4.1	5.7	11.3	3/2007
Inflation (CPI, end of period, y-o-y %-change)	8.5	3.6	0.8	1.7	4.4	0.7	1.4	2.5	3/2007
General government budget balance (% of GDP)	-0.7	-3.7	-3.3	-2.9	-3.3	-6.1	-3.9		1-12/2006
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	12.2		Q4/2006
Exports (EUR billion, current prices)	34.4	40.4	43.4	47.5	59.7	71.4	87.5	15.0	2/2007
Imports (EUR billion, current prices)	53.1	56.2	58.3	60.4	71.4	80.6	100.0	16.6	2/2007
Current account (% of GDP)	-6.0	-2.9	-2.6	-2.1	-3.5	-1.2	-2.3		1-12/2006

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

St. Petersburg

Industry recovers from temporary fall

The new 2007 year for St. Petersburg's economy became a new challenge, as it followed a rather successful and stable period of 2000-2006 and was supposed (according to many experts and the City Administration officials) to continue this growth era. The only threatening result of the previous year was a sudden decline in the regional industrial sector. The economic development during the first two months of 2007 could be determined as a certain correction, leading to more heterogeneous dynamics of basic sectors.

Dynamics of regional economic development

		2006	Jan-Feb 2007
Industrial production, y-o-y,%		-7.0	10.5
	Manufacturing	-8.7	11.1
	Energy, gas and water production*	8.3	9.4
Construction, y-o-y		35.6	4.8
Transport, y-o-y, %		20.90	13.4
Communication, y-o-y, %		38.3	26.1
Retail trade, y-o-y, %		14.5	26.7

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

Despite the fall of 2006, manufacturing remains important for the city's economy. The big industrial newcomers to St. Petersburg, namely world giants General Motors and Nissan started creating production plants which are expected to produce automobiles, not only for Petersburg inhabitants, but for the whole booming Russian market of foreign-made personal cars (sales of these cars increased in 2006 by 65% y-o-y). In February 2007 the city Governor Valentina Matvienko announced, that she expects St. Petersburg GRP to increase by 14% due to these two investors alone. In January-February 2007 gross investment in regional economy increased by 41% y-o-y. However, the investment policy of regional authorities is still based on creating exclusively favourable conditions for large and well-known foreign companies rather than on developing the investment climate and business environment in general.

The main engine of the ongoing investment boom is the increase of demand, driven by incomes. In January 2007 the real average wage increased by 17.3% y-o-y, while real monetary incomes of St. Petersburg households grew by 18.9% in the first month of 2007. This monthly income increase is the highest since December 2005 and surprisingly high for the holiday season.

Construction sector facing slowdown

Rapid growth of real estate prices in 2006 stopped in December 2006. In January-March 2007 the prices remained almost stable, a bit above EUR 2000 per square metre, showing comparatively slow growth along with diminishing demand. However, in March 2007 a Chinese investor of the *Baltic Pearl* project started construction of the first 100 thousand metres of residential space in the South-Western suburb of the city. Several real estate projects of a lower scale were implemented by regional and Moscow builders together with foreign construction companies YIT and Skanska, which came to the St. Petersburg market long ago. As expected, the cooling of a hot market led to more builders shifting towards non-residential construction projects.

Regional budget benefits from transparency

In the first months of 2007 the regional budget continued to grow. But this process goes slower than in 2006, when total tax revenues increased by 53% and profit tax revenues more than tripled. In January-February 2007 tax revenues grew by only 6%; profit tax experienced a less impressive increase than before, just 70%. Moreover, in February a slight reduction (less than 1%) of certain tax revenues was recorded. This slowdown proves that the rapid growth of budget revenues in 2006 was linked with the increase of transparency of regional business rather than with actual economic growth. Vice-Governor Mikhail Oseevsky, who is in charge of regional budgetary policy determined the successful budget performance as a temporary phenomenon and outlined the importance of encouraging investment for the future growth of the regional budget.

Some business highlights

- In February 2007 a large tender on building the Western high-speed road binding around the city across the Gulf of Finland was initiated. The applications were submitted by a number of construction companies, among which are European companies Strabag and Hohtif, Turkish Enka and South African Intertol. The tender will be finalised in October 2007.
- In 2007 the share of real estate purchases using mortgage loans may increase up from recent 10% of the total, up to 15%. The rapid growth of mortgage loans (total volume increased by 340% in 2006) might continue. The basic reason for that is that many banks from other regions (Gasprombank, Uralsib) and foreign giants (Societe Generale, Raiffeisen Bank) entered this market, lowering interest rates by 1% down to 9-10% per year.
- Company Gazpromneft, in addition to creating a large skyscraper in the city centre, plans to invest EUR 230mln in a new large congress centre of European standard. This congress centre will be used for large exhibitions and fairs and should decrease the lack of exhibition areas in the region. Construction starts in summer of 2007 in the Pushkinski district.
- Finnish railway company VR Group Ltd announced that it increases cargo transportation between Finland and Far Asian countries via the Trans-Siberian railroad, in case a planned 35% decrease of Russian transit tariffs takes place. That may raise the transit cargo flow via St. Petersburg transport hub.
- Russian Ministry of Economic Development and Trade and Ministry of Transport finally agreed on uniting Russia's largest shipping companies: Sovkomflot from St Petersburg and Novoship from Novorossijsk. The new organisation will enter the top-five of the world's largest shipping companies, with 128 ships having a total deadweight of 8mln tones (the majority of these ships are tankers).
- Morgan Stanley acquired 25% of RBI holding company, which is one of the leaders of the St. Petersburg construction and development business. The acquisition might help RBI to increase the scale of its projects up to EUR 1bln and to start regional expansion within Russia.
- In 2006 the sales of foreign cargo automobiles (Scania, Volvo, MAN, Iveco) in St Petersburg, for the first time, exceeded the sales of domestic producers (KAMAZ, GAZ). During the year the whole regional market of Europe-made cargo transport increased by 48%. The basic beneficiaries of this record growth were the Swedish producers Scania (30% of total sales) and Volvo (26%).

St. Petersburg region- 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		1-12/2006
Industrial production (y-o-y %-growth)	26.2	0.2	31.4	5.8	14.1	4.2	-7.0	10.5	1-2/2007
Gross average wage (monthly, EUR)	n/a	n/a	217	209	285	344	407	415	1/2007
Unemployment (% average annual)	7.9	4.4	3.5	4.3	2.8	2.4	2.4	2.6	1-2/2007
Exports (EUR million, current prices)	2 736	2 134	1 839	2 428	3 210	3 953	5 499		1-12/2006
Imports (EUR million, current prices)	2 693	4 423	5 158	5 123	5 560	8 081	10 299		1-12/2006
FDI inflow (EUR million, current prices)	158.4	126.8	88.9	62.1	90.0	200.5	512.4		1-12/2006

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

Leningrad region

Industry up again

The temporary decline of 2006 in regional industrial production was followed by comparatively high growth in January-February 2007. The main engines for this growth were small and medium producers focused on domestic market. This is a new trend for the region. During recent years, industrial growth was generated by large enterprises, either exporting their products, or supplying a vast national market. In the first two months of 2007 the growth rate for large enterprises alone was 9.0%, being lower than for the whole industrial sector. Growing incomes of the population, both in the Leningrad region and in St. Petersburg created a demand for locally specialised producers. A sector of wood processing which grew by 22% in the reviewed period may serve as an example. This branch is attracting foreign investment as well: Honka, a Finnish producer of wooden houses, is actively conquering the regional market.

Dynamics of regional economic development

	2006	Jan-Feb 2007
Industrial production, y-o-y,%	5.9	12.4
Construction, y-o-y, %	7.9	2.4
Transport, y-o-y, %	20.1	17.6
Agriculture, y-o-y, %	8.2	2.9
Communication, y-o-y, %	15.7	13.7
Retail trade, y-o-y, %	22.0	20.8

Source: Petrostat

Food and tobacco production, the leading branch of regional industry, reported a decline of 30% in January-February 2007. Tobacco giants today face not only demand reduction, but an announced increase of tobacco excises in Russia, which may lead to a decrease in sales for regional producers, e.g. Philip Morris. Another leader of regional industry, namely transport machine-building, continued to grow rapidly (by 48%). Nevertheless, in February 2007, the successful performance of the main regional automobile producer, Ford Motor Company, was spoiled by a large worker's strike. The strike had a big influence on relationships between employers and employees not only at Ford's factory, but throughout the whole region. The region's investment performance was stable, but a slight decrease of 2.2% was reported.

Incomes continue to grow

Generally positive results from the regional economy were inseparable from increasing domestic spending. Real wages in the Leningrad region grew by 15.5% in January 2007, while household incomes rose by just 8.0%. The major part (88.6%) of incomes is spent on consumption; savings accounted for 13.0% of incomes (expenditures by the region's population frequently exceeded incomes in January). The share of savings in January 2007 was the highest monthly figure for more than a year, marking the increasing attractiveness of bank deposits and some financial instruments for the population.

Constructing infrastructure

A construction boom in 2006 led to impressive results: in February 2007 43,000 square metres of residential space were exploited in the Leningrad region. This result exceeds the corresponding figure for February 2006 by 5.6 times. Regional builders, however, tend to decelerate their activity because of stagnation in the real estate market in January-March 2007. Future development of the sector depends on the square metre price dynamics in the region. Despite the current slowdown, regional construction companies have plans to exceed the results of 2006 in the current year. The largest non-residential construction projects of January-February 2007 were linked mostly with infrastructure creation and repair: new railway lines and terminals for the Ust-Luga seaport, renovation of the municipal infrastructure in Kirishi and expanding the mobile communication network of Vympelkom Company (BeeLine) in the region.

Labour supply decreases

The labour force is becoming more valuable to employers, due to the constant decrease in unemployment in the Leningrad region and the huge workforce demands in neighbouring St. Petersburg. The number of job searching unemployed registered at the Regional Employment Service is decreasing each month: by 13% y-o-y in January and by 17% in February, 2007. An unemployed status was held by only 1.6 thousand in February 2007, which is 33% fewer than a year ago.

Some business highlights

- State company Transneft took a decision to construct a second pipeline from the Unecha, Brjansk region, to Primorsk seaport in the Leningrad region. The new pipeline will transport 50 million tones of oil annually. The capacity of Primorsk oil terminal will be expanded as well. Total investment will account for EUR 2 bln.
- St Petersburg-holding Redevelopment Association invested EUR 6 mln into a construction waste recycling plant in the Janino, Vsevolozhsk district. The project will first of all improve the environment of the Leningrad region. Moreover, the company expects its investment to be compensated by 2011.
- Joint Stock Company Ust-Luga plans to invest EUR 110 mln in creating a terminal for liquefied gas exports in the Ust-Luga seaport. The project is expected to be finalised until 2010.
- Danish company Aller Group invested EUR 9 mln in creating a plant in the Leningrad region. The plant will be producing food for domestic pets in the region and in St Petersburg.
- Russian-holding Renova acquired nearly a 40% stock in Leningradslanets, a shale extracting and processing plant located in Slantsy, Leningrad region. The holding invests EUR 15 mln in renovating the plant, which is located close to the Estonian border. In January 2007 the plant started production. Renova plans to export shale products to the EU market.
- In January 2007 the regional budget surplus exceeded expenditures by 34.2%. This figure reflects a record positive performance for the regional financial sector. The surplus might be spent on developing the infrastructure necessary to attract investors, and on social projects.

Leningrad region - 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	8.1		1-12/2006
Industrial production (y-o-y %-growth)	26.8	10.7	35.6	20.9	10.3	5.9	26.9	12.4	1-2/2007
Gross average wage (monthly, EUR)	105	141	152	173	190	259	324	323	1/2007
Unemployment (% average annual)	12.7	10.8	9.6	9.2	7.5	7.8	6.2	5.8	1-2/2007
Exports (EUR million, current prices)	1 786	2 350	2 301	2 580	3 886	4 862	5 444		1-12/2006
Imports (EUR million, current prices)	328	810	939	1 061	1 372	2 562	2 858		1-12/2006
FDI inflow (EUR million, current prices)	222.5	266.0	121.9	104.5	106.6	178.7	288		1-12/2006

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

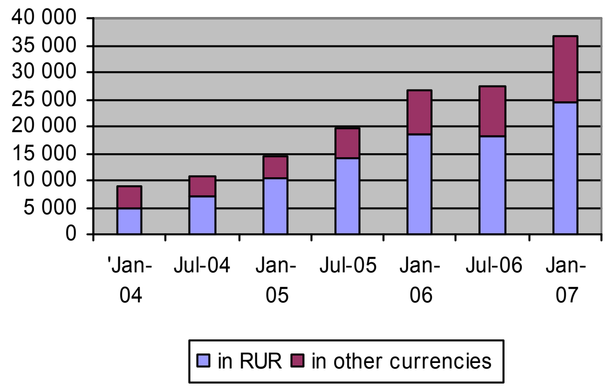
Kaliningrad region

Kaliningrad's manufacturing is at full speed

Industrial production in the Kaliningrad region grew at a breakneck rate (68%) in 2006. Because a major factor behind this growth was the one-off effect related to the start of operations at the large Kaliningrad power plant at the end of 2005, it was expected that the growth would slow down in 2007. However, the beginning of the year brought a surprise: growth actually accelerated (to 75%) and this time the utility sector was not the reason. The main engine of growth was manufacturing industries where output in the first two months of the year increased by 1.97 times over the same period in 2006. Part of this is undoubtedly a result of "low base" effect – in the first three months in 2006 many manufacturing companies had chosen not to rush their production before the new SEZ law came into force. But even accounting for this, growth in manufacturing in the second half of 2006 and the first months of 2007 was impressive.

Growth figures were also strong in other sectors. Construction, helped by warm weather, increased by 49.2% in the first two months of 2007 y-o-y. Investment in fixed assets rose by 28.1% in the same period y-o-y. As investment declined in Q1 2006 by 14% a "low base" effect was again present here but expansion of investment activity in the second half of 2006 and in the first two months of 2007 was strong anyway, as evidenced by the rapid growth in the stock of outstanding loans to the corporate sector.

Stock of corporate loans outstanding in Kaliningrad region, RUR million



Retail trade has also started 2007 with robust growth: in the first two months, retail sales increased by 20% y-o-y.

Inflation speeds up in February

Consumer prices rose by 1.7% in February – the highest rate in the last two years. As usual, a large increase in housing tariffs (by 9.9%) over the first two months of 2006 was the main driver of the CPI growth.

Producer prices rose by 2% over the same period. While manufacturing prices did not change much – they increased by 0.4 to December 2006, prices for raw materials and utility tariffs shot up. Utility tariffs increased by 6.3% in February and prices for mining output by 12.5% in the same month (although they declined by 5% in January).

Foreign trade: exports grew faster than imports

During 2006, exports of goods increased by almost 35.8% (in USD) y-o-y outpacing imports, which grew by 29% respectively. While exports from Kaliningrad grew faster than those from Russia (35.8% vs 25%), imports grew at about the same rate. Kaliningrad is becoming more attractive for Russian oil companies as a transit point for exports – now crude oil and refined products represent 75% of the total value of exports. Latvia suddenly became the largest export destination for Kaliningrad in 2006 with the total value of exports of EUR 370mln as oil companies were sending large volumes of oil and refined oil products there. On the import side, imports from China more than doubled in value in 2006 and China became the second largest importer to the Kaliningrad Oblast after Germany. Most of the imports from China are parts and components for cars, TVs and consumer electronics.

Foreign investment: no big changes

Foreign inward investment to the Kaliningrad Oblast increased to EUR 60.7mln (by 7%) in 2006, but FDI inflow was only EUR 16.9mln. Lithuania and Poland were the largest sources of FDI. The main recipients of FDI were manufacturing, the financial sector (leasing) and the wholesale trade. According to Kaliningradstat, the outflow of foreign investment actually exceeded inflow by EUR 7.8mln in 2006.

Some business highlights

- Shareholders of Victoria, the largest retailer in Kaliningrad, sold a 2% stake in the company to Renaissance Pre-IPO Fund for EUR 16mln, reported Russian business daily Vedomosti. This is a part of the plan for the future IPO for Victoria.
- The second largest retailer in Kaliningrad, Vester, announced its plans to invest approximately EUR 720mln over 2007-2011 in the development and expansion of its retail network in Kaliningrad and other Russian cities.
- British Baltic Oil Terminals is buying a 76% stake in pulp and paper producer Tsepruss for EUR 9mln. The main purpose of the acquisition is to build on Tsepruss' land plot in Kaliningrad city an oil terminal with a monthly capacity of 400 thousand tonnes of oil. Some environmental organisations voiced their concern about these plans.
- Kaliningrad's Avtotor and China's Chery Automobile will soon start construction works on a new automobile plant that will have the capacity to produce 200 thousand cars a year under Chery's brand. Total investment in the plant should amount to EUR 160mln. Investors plan to export a part of the output to the EU, especially to CEE countries.
- Avtotor is also planning to start production of a new model, Kia Cee'd, under agreement with Korean car manufacturer Kia Motors using its existing plant in Kaliningrad in April.
- Kaliningrad TV manufacturer, Baltmixt, signed an agreement with Sony to produce up to 300 thousand Sony LCD TVs for the Russian market.
- The new SEZ law created problems for Kaliningrad truck companies as it prohibits transit transportation of goods between foreign countries and mainland Russia using trucks that are registered in Kaliningrad under the duty-free regime. Custom authorities seized more than 400 such trucks and many companies stopped working, fearing for their trucks.

Kaliningrad region - 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	12.0			
Industrial production (y-o-y %-growth)	32.4	12.9	10.2	4.7	26.6	18.9	68.2	74.7	1-2/2007
Inflation (CPI, end of period, y-o-y %-change)	17.5	21.0	9.8	17.5	11.7	11.1	7.9	8.7	2/2007
Gross wage (period average, EUR)	67	99	125	137	155	193	329		Q4/2006
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	508	497	507	876	1 470	1 973		1-12/2006
Imports (EUR million, current prices)	947	1 169	1 701	1 894	2 419	3 283	4 187		1-12/2006
Exports (sales) to Russia (EUR million, current prices)	459	691	802	989	1 449	1 901	2 471		1.12.2006
FDI inflow (EUR million, current prices)	7.1	3.6	6.3	12.4	18.0	15.1	16.9		1-12/2007

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

The Baltic Sea cooperation

by Danuta Hübner

The Baltic Sea region is an excellent example of the importance of cooperation for economic growth and success as it has developed into one of the most dynamic regions in Europe. It is a region where over decades dozens of networking structures have grown and where the accession of Estonia, Latvia, Lithuania and Poland to the EU added new competitive advantages and opportunities for cooperation. Stability is now a feature of the region and economic development is thriving. It is one of the fastest growing regions of Europe: between 1995 and 2004 its GDP grew by 42%. The Baltic Sea Region is also characterised by a strong cluster base with a rich portfolio of regional clusters operating in traditional and non-traditional industries. Nordic states are front-runners in this respect and provide quality expertise for the other countries of the region.

Baltic Sea cooperation as a role model for other regions in Europe

The Baltic Sea cooperation has become a role model for successful cooperation for many other regions of Europe. EU Regional Policy has significantly contributed to this success and it will continue to do so in the future by providing opportunities for discussion of common issues, possibilities for cooperation and partnership and financial investment for common projects within the financial framework for the period 2007-2013. These have already been the main features of cooperation programmes in the Baltic Sea region during implementation of the INTERREG programmes, which from 2000 onwards have covered, with positive results, all the partner countries, including the then candidate countries and Russia.

This work together has been a great success. It has given concrete expression to the Northern Dimension policy of the EU, through partnership-building and specific projects. Many excellent initiatives supported by EU Regional Policy such as EcoForum Baltica, promoting the development and knowledge of Environmental Management Systems in SMEs and public authorities or the Baltic Gateway, which aim is to pave the way for transport investments in the south Baltic Sea area, should be followed in the future. This obviously requires good coordination between the countries and regions involved. And for this, the Union's Regional Policy, in particular through its cooperation programmes, provides a perfect platform.

The Baltic Sea region has already made major strides in terms of economic growth and job creation. But in order to remain competitive in a global world, countries in the region need to further invest in education systems, research and development and innovation, and have to reinforce the links between universities and industry. The entrepreneurial energy of SMEs by improving their access to finance must be unleashed. Finally, stress has to be put on environmental sustainability as environment in the Baltic Sea area is very fragile and already badly polluted.

Contribution of EU Regional Policy to growth and jobs

Here Regional Policy can be of help. It is the major instrument at Community level to strengthen the competitiveness and innovation capacity of Europe's regions. Across the Union we will invest around €200 billion in areas such as innovation, RTD and the knowledge economy, for promotion of entrepreneurship, infrastructures of European importance and human resources development.

The aim of the new Regional Policy is to create circumstances which will actuate the regions. It is designed to allow regions to discover the comparative advantages which they possess, and to put themselves on the path of sustainable development. An essential part of its design is partnership towards which we have a two-fold approach. First, there is the multi-level involvement of all relevant decision-makers – public authorities at EU, national, regional and local level. Second, there is also a horizontal partnership, which includes the economic and social partners and other bodies representing civil society. Coordination between different partners is a key issue in order to optimise the synergies and to reduce the risk of lost opportunities.

New possibilities for cooperation in Baltic Sea

Territorial co-operation has a prominent place in the architecture of Regional Policy for the period 2007-2013. The financial envelope for co-operation has been increased significantly compared to the previous programming period, taking into account new border regions in the EU. This is a significant indicator of the importance attached to co-operation by the European Union. In the Baltic context, countries like Sweden, Poland, Lithuania and Latvia will all receive significantly more EU funding for co-operation than in the past. This provides both greater possibilities for co-operation and greater responsibility on the partners to ensure the success of projects.

New rules of Regional Policy provide also for a wider geographical scope for cooperation. In fact cooperation across sea borders will be possible up to a distance of 150 kilometres. For the Baltic Sea region, this increases the opportunity to have new programmes across the Baltic Sea.

The new Central Baltic programme will, for example, now include the current Swedish-Finnish Archipelago and Finland-Estonia programmes as sub-programmes. Due to the maritime 150 km rule, the programme area is enlarged to cover parts of Latvia, many Baltic islands, and several additional regions on the Swedish coast, as well as Gotland. This new quadrilateral maritime programme will be a new and exciting experience in a cross-border context.

The new South Baltic programme also offers much new potential for cross-border programmes. It will include coastal regions from southernmost Sweden, Poland, Lithuania, Germany and the Danish island of Bornholm. This means that almost the entire Euroregion Baltic will be included in this programme. Finally, the Öresund-Kattegat-Skagerrak programme will cover coastal regions in Denmark, Sweden and Norway.

On top of this, the new Baltic Sea transnational programme involving all EU Member States around the Baltic Sea plus Norway, Russia and Belarus will promote continued cooperation with St. Petersburg, Kaliningrad and Belarus. This is a major instrument in itself, and addresses vital issues in the most comprehensive way.

The aim of the Commission is to approve these programmes in the course of 2007. We must demonstrate that cooperation programmes can be prepared and launched in good time to avoid unnecessary delays and to avoid discouraging potential applicants. The responsibility for this rests squarely with the countries and the regions of the Baltic Sea region.

Promotion of new forms of cooperation

Another new feature of the future co-operation programmes is that of management structures. The experience with INTERREG has proved more than ever the need for fully joint structures for managing such programmes. To assist programme partners in this regard, a new legal instrument has been created – the European Grouping of Territorial Cooperation (EGTC).

The EGTC is a radical step forward in the management possibilities for cooperation. It offers regional and local authorities the option of creating a cross-border grouping with legal personality. EGTCs will be able to manage individual projects or take on the role of a programme's "managing authority" responsible for the implementation of the whole cooperation programme. In this role, an EGTC would operate just like any other managing authority – with the added bonus that it would be genuinely joint, representing both sides of the border. This solution offers a range of practical advantages, not least simplifying the employment procedures for programme staff.

EGTC should be viewed as a framework tool which has been provided, and it is very much for the implementers to assess how to use it to their advantage, including the cooperation outside the regional policy area.

Boosting exchange of experience and best practice

Finally, European Regional Policy can help in transferring the positive experience of the Nordic countries to other countries of Baltic Sea Region, especially in developing relations between research and business. For 2007-2013, increased funding will provide even more possibilities to speed up the economic development, especially for the new EU member states of the region. The EU provides the political context for cooperation, peace and prosperity around the Baltic Sea. All these factors increase the tremendous endogenous potential of the Baltic Sea Region to become one of the key regions of the European Union which will be able to face the challenges of the globalising economy.

I am convinced that the EU Regional Policy is an excellent instrument to boost the competitiveness of the European territory, especially in the peripheral regions like many in the Baltic Sea Region. First of all, it is enabled through strategic concentration on topics closely linked to the Lisbon strategy such as innovation and entrepreneurship, environment and improved accessibility. Secondly - through its unique delivery mechanism based on shared ownership and partnership between European, national, regional and local actors.

Through our cooperation programmes we can pool resources together to ensure a more efficient and joint management of economic, environmental or social challenges. Our programmes encourage citizens of different regions to work together in order to make their region more attractive, both for job creation and to live in. Thus, people can easily experience the concrete benefits of these projects in their region and in their day-to-day life.

I am confident that the countries and regions of the Baltic Sea Region will make full use of the opportunities provided by EU Regional Policy to reap the benefits of partnerships with other regions. Cooperation programmes, like those in the Baltic Sea area, will be central to this effort.

Danuta Hübner

Member of the European Commission

responsible for Regional Policy

Russia's role in the Baltic region

by German Gref

The Baltic Sea region is one of the most promising regions in Europe in terms of economic growth, competitiveness, rising standards of living of its inhabitants, as well as the overall quality of life.

Cooperation in the Baltic Sea region is a priority for St. Petersburg, a leading city in Russia in the field of social and economic development, and the largest metropolis in the Baltic region with a unique geographical position.

St. Petersburg is a multifaceted city, integrated into the world economy with the potential of increasing economic activity. The role of St. Petersburg as a leading Russian centre between the Baltic region and North-West Russia has been consolidating further.

2006 was a very successful year for the development of external ties. While preserving traditions of constructive dialogue and mutual respect, the city has entered a new era of serious competition with leading European capitals.

External trade turnover in St. Petersburg in 2006 reached about 20 billion dollars. Compared to the previous year, 2005, turnover grew by 30%.

The following countries represent five of the major partners of St. Petersburg in 2006: China, France, Germany, the Netherlands, Finland and the USA. In general, the city's active role in the Baltic Sea region is a positive factor. One third of total trade in St. Petersburg is generated with the countries of the Baltic region.

Economic cooperation, the promotion of industrial know-how and technologies and cooperation between universities will remain major priorities for St. Petersburg in the current year. Public support, as a rule, has been directed at industries that require major investments, produce considerable budgetary revenues, and to hi-tech sectors, all of which ensure sustainable development for St. Petersburg and other regions.

St. Petersburg has been the scene of major international events such as the G8 Summit and the International Economic Forum.

Last year, the 10th International Economic Forum was attended by the President of the Russian Federation, Vladimir Putin, the President of Finland, Tarja Halonen, the President of Slovenia, Janez Drnovšek, and leaders of the Parliaments and Governments of other countries.

The main themes of the10th Economic Forum in St. Petersburg were the competitive advantages of developing countries and the challenges of globalization. The organizers of the Forum managed to invite prominent speakers and to encourage substantial and informal discussions.

The 10th International Economic Forum in St. Petersburg also had significant practical objectives. About a dozen agreements with a total value of 1 billion dollars were signed at the Forum. Several exhibitions were held in connection with the Forum, e.g. Investment Projects, Innovation Achievements and New Fuel and Energy Technologies.

The next, 11th International Economic Forum will be held from June 8 to 10, 2007. The upcoming Forum promises an interesting and comprehensive programme. In addition to the three plenary meetings, round tables, exhibitions and presentations will be held, as well as a traditional meeting between the Russian President and the chief executives of major international companies, an informal meeting of the members of the Government of the Russian Federation with the heads of the world's mass media, a ceremony for the International Global Energy Award, the signing of investment agreements and a cultural programme. I hope the upcoming Forum will be at least as significant as the previous one.

Surrounded by the countries of the Baltic Sea region and not linked to the continental part of Russia, Kaliningrad deserves special mention when reflecting on the role of Russia in the Baltic region.

Among the main development challenges facing the Kaliningrad region are those aimed at sustaining the territorial security of the region and ensuring the general Russian, European and world standards of the civil rights and the standards of living in Kaliningrad, as well as the need to integrate the region into the European Economic area.

Achieving these goals requires a differentiated approach to the problems of the Kaliningrad region as a region with many specific features produced by its historical development. Only in this way can the region's unique character be perceived and a realistic approach to its planning and development be implemented.

Compared to other regions in the North-Western Federal District of Russia, Kaliningrad is developing very fast, being among the three Russian regions with the highest rates of development.

Thus the Baltic Sea region is correctly viewed as being one of the most stable, safe and dynamic regions in Europe and the world. Today, it could be called the locomotive of the entire development of Europe.

German Gref

Minister of Economic Development and Trade

The Russian Federation

Structural Funds and perspectives for Polish science

by Michal Sewerynski

In the financial perspective 2007-2013 Poland will benefit from the inflow of 67 billion euros of structural and cohesion funds. These funds will be used to modernize infrastructure and enhance the productive capacity of human capital in many sectors and across the country. About 6% of this amount, or over 4 billion euros is earmarked for various projects concerned with science sector. On average this represents additional one half of the annual science budget in Poland (at present close to 1.0 billion euros).

While related new opportunities for the Polish science are very promising, the administration is determined that these extra funds will be primarily directed towards raising an innovative capacity of the science sector and intended to help the industry to create increasing demand for innovation.

One of the fundamental weaknesses of the Polish R&D lies in lacking of sufficient links with the economy and society. This situation is rooted in multiple causes, such as traditionally high esteem associated with basic research, politicizing of science under the soviet system and a fragile industrial base unable to create sufficient demand for scientific results and innovation.

Since the 1990's scientists have gained the freedom to perform research according to their interests. What is more, in the name of full democracy they collectively became responsible for science policy and funding allocation. The commercial exploitation of scientific achievements was not a universal priority. Particularly, that science funding was inadequate and aiming rather at obsolete, abstract targets than the real needs. In response, the society turned out to be disillusioned with the usefulness of science, which lead to further reduction of science funding.

In this context participation in the European Framework Programmes, first as an associated country and then as a member with the full rights, was to certain extent an eye opener. While Polish teams from academia and research units have been able to engage in competition, albeit at low but acceptable level, the industry based teams are virtually nonexistent. This unfavourable situation continues to date and it is increasingly clear, to the scientists themselves and to the science policy makers that prolongation of such isolation from the real life problems is very detrimental and will result in eventual deterioration of both quality and capacity of the scientific research in Poland.

The science administration, particularly since Poland's accession to the EU, has undertaken a number of initiatives to reverse this isolationist trend. However, with persistently low funding from both public and private sources it became a task doomed to failure. For the modern industry requires modern science, capable of providing innovative solutions, developed in high-tech laboratories and using up to date infrastructure. Unfortunately these in the first place are lacking in Poland. The severity of such situation is aggravated by the fact that Poland intensified production of university graduates, creating on an unprecedented scale large numbers of well educated, dynamic young people. But the scientific career is not sufficiently attractive for them.

These developments therefore lead to recognition that if Poland wants to realize its capacity to be a useful and meaningful player on the European science scene, it needs a steep change in investment in science. The present government plan, still in early stages of implementation, to double the current science funding within four years and to gradually aim for the Barcelona target of 3% GDP, is clearly a step in the right direction, but in the present circumstances does not seem to be sufficient.

However, mentioned above additional financial resources should open new horizons in front of the Polish science. The bulk of these funds, under the National Programmes "Innovative Economy" and "Infrastructure and Environment" will be used to modernise existing and develop new research and academic infrastructure (1.3 + 0.6 billion euros). Interdisciplinary, integrated research centers will be created in the fields of materials sciences (Warsaw and Wroclaw), in the biomedical sciences (Warsaw), in the advanced technologies (Poznan), in the physical sciences (Krakow) and in the clean coal technologies (Katowice).

Second biggest component of the funds, under the National Programme "Innovative Economy", will be dedicated to development of new technologies (1.3 billion euros). Again, the relevant activities will be carried out in selected, leading research centres across the country in many diverse research domains. They will include fields such as high temperature reactor technology, nanotechnologies and new materials, medical diagnostics and therapies, body armour technologies, biodegradable materials and high energy transmission.

Finally, the strengthening of human capital (1.0 billion euros) will be undertaken under the National Programme "Human Capital". This activity will include various schemes and programmes of continuous and tertiary education as well as assistance in early stages of professional career. Selected, top universities will be given tasks to undertake specially designed professional education programmes. Also, an emphasis will be placed on raising the number of doctoral students. The most aspiring of these activities concerns a plan to establish 'elite' interdisciplinary PhD studies, targeting the brightest and ambitious to become future leaders in many aspects of the society life.

Important aspect of all these activities will be to enhance an innovation absorption capacity of enterprises, by system of sponsored projects, undertaken jointly with research units and academia, and grants enabling employment of scientists in non-research sectors. The other key issue will be to raise attractiveness of the research career, particularly amongst university and PhD graduates.

While such a perspective looks very promising, its realisation in reality will require a great effort of all stakeholders, namely the scientists and research institutions, the industrial enterprises and the administration. Absorption of additional funds and their wise and effective use constitutes considerable challenge. In order to make this a successful operation, modernisation and reform of science system is indispensable. Such reform has been already initiated, and its key element includes creation of two funding agencies. One concerned with the realisation of large, strategic research programmes and the other directed towards the frontier research. Further actions will also include streamlining of existing research institutes, both industrial and those belonging to the Polish Academy of Sciences. The underlining theme of this reform will be a separation of science policy making from research financing and from research performance. However, the above mentioned challenges cannot be met only by the administrative measures. The change of attitudes towards more entrepreneurial, more pro-innovative, more society oriented has to take place foremost in the minds of scientists. The science administration in Poland is working together with many scientific communities to achieve this transformation.

Summarising, it should be underlined that availability of structural funds for Polish science opens many new and exciting perspectives. It will change Polish science landscape during the coming decade. However, it also brings new challenges, which will require mobilisation of all stakeholders and resources available to them.

Prof. Michal Sewerynski

Minister of Science and Higher Education

Poland

The Baltic Sea needs to be politicized

by Eija-Riitta Korhola

Recent news about the state of the Baltic Sea has not been very good. Last summer, for instance, we saw an exceptionally large oxygen-depleted area and the state of the bottom sediment as at its worst since measuring started in 1999. Last summer was also exceptionally grim in regards to the bottom fauna. An abundant and multi species bottom fauna community was only found in four of all together 47 measuring spots.

In order for permanent improvements to be made there needs to be a significant reduction in phosphorus and nitrogen loads both in the Gulf of Finland as well as in all of the Baltic Sea's catchment area.

We human beings are almost solely responsible for the eutrophication of our coasts, archipelagos and inner seas. It is up to us to fix the situation. Special focus needs to put on the sporadic loading of agriculture. The agricultural industry is responsible for a little over half of the phosphorus load and little under half of the nitrogen load in the Baltic.

A broader examination shows that the main problem of the Baltic Sea and the Gulf of Finland are effluents and sewage waters deriving from Russia, Poland and the Baltic States. The aim of international cooperation should be the nutrient load reduction as well as the renovation and repair of efficient chemical-biological sewage facilities in these countries.

There is, how ever, also some good news. The results of the BIREME program of the Academy of Finland show that properly directed actions result in surprisingly fast improvements in the state of the Baltic Sea. This news is contrary to the reports from Sweden where some researchers have claimed the Baltic already to be in a state of lock that cannot be opened. Finnish studies are more promising. It has been shown that a decrease in external loads lead to a decrease in internal loads.

Calculations also show that a 25 % decrease in the nutrient effluents of Russia and Poland would result in a significant decrease in the amount of blue-green algae already in just five years. After 30 years the 25 % cut in effluents would reduce the biomass of blue-green algae by 60-70 % and the quantity of other harmful algae would also have been decreased significantly.

Simply by applying modern purification techniques used in the Finnish and Swedish sewage plants to all the countries surrounding the Baltic Sea, effluents can be reduced by 40 %.

Research is an important factor in recognizing all potential threats. We know now more about the origin of the species of the Baltic and the recognition of new alien species and their potential harmfulness is easier thanks to research.

The stress of fish farming can be decreased through precision feeding and better feed as well as by using bag pens instead of the now used net pens.

The Baltic Sea is an environmental problem of the European Union. The enlargement of 2004 made the Baltic an inner sea of the EU. This means that we now truly have the opportunity to save the Baltic Sea.

I would also propose we ask the question whether the Baltic Sea could save the EU. After 50 years of European unity our continents leaders are looking for a way forward. The popularity of the union amongst its citizens is at a record low. This would be a concrete example of what the EU can accomplish. Taking a firm stance on saving the Baltic would be a way to show that together we are stronger than alone.

For this reason I have suggested that we politicize the Baltic Sea. It should be marketed as a model example of what the EU can at its best achieve. The Baltic Sea should not only be seen as an environmental problem of some border states but a political priority high on the Union's agenda. According to an old saying a clever politician makes one's own interest into a common interest. With the Baltic Sea this should not be very difficult. We have to politicize to Baltic in order for us to get ample resources for research and protection.

Eija-Riitta Korhola

Member of the European Parliament

Branding the Baltic Sea Region: "Just do it"

by Uffe Ellemann-Jensen

Branding – everybody speaks about it and takes possession of the word as if it alone is a stamp of recognition and respect. If you are talking about branding you must be up to something big whether you are a local politician or the CEO of a huge corporation. The word has been used and abused so much and so often by politicians, businessmen and marketing hot shots that it is on the verge of becoming a cliché, defunct and useless.

Let me tell you that within Baltic Development Forum (BDF) branding is not just a fad or a fancy buzz word. We have been looking at branding the Baltic Sea Region ever since we first put in on the agenda of our St. Petersburg Summit in 2001. In the past few years it has gained a still higher priority as we have recognized the need to create more awareness and give the region a more distinct profile so it can stand out in an increasingly competitive global environment.

In the global competition, you have no choice – there is only the fast lane. That's why we, at BDF, have decided to focus on the region's strengths and not ignore our weaknesses in order to identify our comparative advantages and devise a strategy that will ensure that the region can remain a frontrunner and a magnet for capital, talent and innovative thinking.

What we may lack in natural resources we have, over the years, compensated for by developing infrastructure, bringing our education systems up to the highest levels, and creating friendly business environments. When we look around in the region and its 11 fabulous countries today, it is obvious that this strategy has paid off. What we see are the clusters of biotech companies in Medicon Valley, the global leaders in high tech, the prowess of the region's financial sector, and the power houses of innovation backed and funded by a combination of private and public resources. All this testifies to the fact that the region already has accomplished a lot and has a lot more going for it.

At a string of conferences, seminars and, of course, at several summit sessions, BDF has taken a stab at how we can present the Baltic Sea Region as a coherent region that is equally attractive to investment, business, research and tourism despite the obvious differences and obstacles in geography, history and culture. Whether we would call it branding or something else, the task and the challenge was to define the differences that divide the region and the similarities that tie it together in order to build identity and help it with positioning itself as a leader. The issues at stake are image, identity and perception.

The goal we set for ourselves was to promote the Baltic Sea Region in a way that in future rankings by the Economist or other respectable magazines and organizations, the region would come up on top of them all as the leading region preferred by companies and people from all over as their favourite place for business, investment, education, entertainment and leisure. This is setting the bar very high, but the point is that this is where you want to go when you start a branding campaign – you want to be on top and not running just as one of the numbers in the pack.

We have clearly chosen to be on top of Europe, and we have, indisputably, much working for us in that respect. One of our core advantages is the high level of education in the entire region – one of the absolute preconditions for achieving success in today's world. Research and development comes on top of that and several of the regional centres have over the years proved that they can be world leaders in their particular fields. But life in the fast lane of global competition does not let anyone rest on their laurels. In yesterday's world there was not such a thing as a free lunch. In today's world, there is not such a thing as a secure position when we talk about competition in a globalized market place.

I feel that history has given our region a unique chance not just by putting the conflicts and divisions of the past behind us, but also by bringing together societies that are quite diverse in economic development and creating a dynamic mix between mature economies and the transition economies which show growth rates that are very hard to achieve for others. There is no doubt in my mind that with the adequate policies, we will be able to exploit these differences and turn them to our advantages both in our own growing home market and in our position as a gateway to the EU.

The free movement of labour and the exchange of talent across the borders will become one of the region's lifelines and help building the foundations for its future success. One of the future challenges will not just be to keep attracting capital and investment, but to create an environment that will remain attractive to the best and brightest among the talents that our region will keep producing. In today's reality, there is no doubt that many of them will go to other parts of the world in search of opportunity. It is our task to create the conditions that will appeal to our home grown talents and make our region appear as the most attractive place for them to pursue their professional aspirations and fulfil their dreams.

To brand an entire region is an enormously ambitious task. It's much easier to talk about devising the right policies, cross border collaboration and coordination, and implementation of strategies. Whatever word we choose, whatever road we prefer, and whatever tool we select, it is clear to me that the Baltic Sea Region, after the years of post-cold war euphoria, now is in the process of taking ownership of the new opportunities and transforming some of the dreams into reality.

It certainly is more demanding than cheering and toasting with champagne. But we have already seen some of the results and despite hardship and some inevitable failures, the progress is encouraging. It will be the prerogative of the future generations to pass the final judgment on how successful this process has been whatever name or label they will put on it.

Uffe Ellemann-Jensen

Chairman of Baltic Development Forum

The Baltic Economic Area represents a major opportunity for Finnish industry

by Antti Herlin

The Baltic Economic Area offers great opportunities for Finnish industry, but this has not always been the case. Twenty years ago, Europe was still divided by the Iron Curtain, which placed major restrictions on the development of economic cooperation. Finland, for all practical purposes, was an island. To the East and South the Soviet Union, to the West, across the sea, a more knowledgeable but, for a little brother, difficult-to-approach Sweden.

Following the EU's expansion in 2004, the Baltic became almost an inland sea of the European Union. Of the nine countries bordering the Baltic Sea, eight are EU members. Approximately 80 million people live in the sea's catchment area, representing a third of the entire European Union's population, and member countries bordering the sea also produce a third of the European Union's total output.

Finland is rooted by religion and culture in the West. For a long time the sea served as the major means of communication, supporting the introduction and maintenance of western influences in our country. Across the long common land border with Russia, on the other hand, Slavic culture and Eastern Orthodox religion also found their way into Finland. In addition, Finland's position on the northern edge of Europe, largely surrounded by the sea, significantly influenced the national character of the Finnish people. Seafaring in arctic conditions helped build Finnish toughness and persistence while also teaching humility when confronted by the great powers of nature.

The Baltic Sea has given birth in Finland to a prominent shipbuilding industry, whose significance as a bearer of prosperity has been important. Today, shipbuilding has evolved into an even more widespread marine technology industry with a vast network of partners and suppliers. Marine technology industries are a significant source of livelihood along Finland's southwestern shore in the provinces of Satakunta, Southwest Finland and Uusimaa. The development of marine technology industries has contributed to Finnish industry's long-standing and ongoing dependence on marine transport. The majority of Finland's foreign trade is transported along "the Baltic seaway".

Modern economic globalization makes industry increasingly dependent on logistics. Increasingly expensive energy, and the desire to make environmental protection more effective, place heavy demands on the efficiency of the entire logistics chain. With the help of information technology, it is possible to make logistics chains increasingly efficient and as seamless as possible. The growth of the service sector and development of information technology, however, have done nothing to change the fact that transportation infrastructure continues to play a very important role in determining the location of industries.

During the past ten years the transport of goods on the Baltic Sea has increased significantly. Trade continues to grow in the Baltic Area, and so does the volume of goods being transported. The logistical goals of international companies are based on treating the entire Baltic Area as a domestic market without national boundaries.

The Baltic Area is currently one of Europe's most dynamic growth centers. The economies of Russia and the new EU member countries are growing briskly. The Baltic Sea has become a corridor connecting the West, North and East.

Many new "Baltic enterprises" have sprung up in the area. Finding it too challenging to reach for global markets, they consider the Baltic area a proper environment for expansion. This group includes not only many industries but, to an increasing extent, commercial and financial enterprises.

Smaller regional growth centers are emerging within the expanding European Union. For the Baltic Area to solidify its position as a true growth center, it must improve the efficiency of internal markets by removing the trade barriers that still remain and increasing the free movement of labor. It is also important for the new EU countries to adopt the Schengen Agreement and the use of the euro as soon as possible. Reducing the number of invoicing currencies creates a significant advantage for companies.

The economic area should undertake the rapid implementation of a "seafaring highway" strategy. This requires, above all, close cooperation among the various countries. The goal is to form transportation chains in which diverse forms of transport converge to form broad and functional wholes. The projects to be carried out in Finland are very important, especially the E 18 highway to Vaalimaa connecting East and West. Transportation investments to be implemented elsewhere in the Baltic Area must also be taking into account by Finnish planners and decision-makers. For example, projects to improve major traffic arteries in Russia, Poland and the Baltic states impact on transportation in the entire Baltic Area and, thereby, also in Finland.

The greatest opportunity for the Baltic Economic Region is represented by the potential for improved integration of Russia and EU markets. Serving as geographical points of contact are southwestern Russia and the Baltic Sea. Russia's economy is largely dependent on export revenues; consequently transportation connections are very important to Russia. Gulf of Finland ports should be developed into logistics growth centers, which can be of benefit Russia's western economic area, whose capital consists of St. Petersburg and its surrounding economic zone. In the expansion of economic cooperation between the EU and Russia, it is precisely the St. Petersburg area that is in a key position. Its industrial foundation, though still thin, is rapidly growing stronger.

So, excellent opportunities exist for strong development of the Baltic Economic Area. One great risk exists, however. The Baltic is one of the world's most polluted seas. It is a shallow and relatively young inland sea, which came into existence at the end of the Ice Age some 10,000 years ago. The runoff from melting glaciers filled the depressions they had left behind, and little by little a brackish basin was formed. Freed from under its icy burden, the land began to rise and formed one of the world's most extensive and beautiful archipelagos. Even though a lot has been done in recent decades to attenuate the amount of excess nutrients in the Baltic, eutrophication is sea's severest problem. Finnish and Nordic industries have largely taken care of their own share in cleaning up the sea. Eutrophication weakens the attractive power of the entire Baltic area, and cooperating to reverse it should therefore be a top priority for all countries surrounding the Baltic Sea.

Antti Herlin

Chairman of the Confederation of Finnish Industries

Elinkeinoelämän keskusliitto

The challenges of the EU's Baltic Sea strategy

by Teija Tiilikainen

The EG was once a central-European project. Its various enlargements have given cause to new policies focusing on the particular challenges of the new geographic dimensions. The enlargement to the UK and Denmark strengthened the EG's transatlantic policies and the whole Mediterranean policy programme, the so called Barcelona process, came into being along with the southern enlargement.

The need of a particular political strategy for the Baltic Sea region has been discussed for a couple of years now in the EU. When Finland and Sweden joined the EU a Northern Dimension programme was launched to raise the challenges of the Union's northern borders and border areas to the common agenda. A change of emphasis was, however, needed along with the enlargement of 2004. This enlargement implied essential changes in the Union's external borders in the north. The Baltic Sea became practically an inland sea in the EU. Of its current coastal states only Russia is not an EU member. When the European Parliament adopted in November 2006 a report on a Baltic Sea Strategy for the Nordic Dimension this was an important first step welcomed by many actors. The parliament focuses both on the positive and negative challenges of the Baltic Sea region, economic perspectives and ecological concerns among them. It also raises a variety of issues from the EU-Russia relations to the core of the Baltic Sea Strategy. The role of Kaliningrad, energy policy cooperation and external border cooperation belong to these.

The EU has often been criticised for a weak ability to formulate coherent policies. One reason for this inability has been found in the divergent national interests of the member states, which challenge their commitment to common policies. This challenge becomes accentuated in the EU's external relations, where many member states have their special interests linked many times with firm historical roots. Another reason for the Union's incoherence can be traced to the complex set up of policy instruments. If relations for instance with a neighbouring country are conducted in the form of a variety of political and economic instruments like agreements and forms of political dialogue, the contours of an overall EU policy remain easily fuzzy.

Even if a particular political strategy for the Baltic Sea region can be useful just in order to respond to the EU's incoherence in its policies linked with the Baltic Sea region as it clearly defines the Union's priorities, it is faced with the same challenges identified afore. A Baltic Sea policy meets first the divergent national interests of the Union's member states in many both general and more detailed issues linked with the policy. The first of them deals with itself the utility of such programmes with a regional focus. While some member states perceive them to be perfectly compatible with their all-European policies and interests, others see too much unnecessary regionalisation and creation of dividing lines in them. Due to these reasons neither the Mediterranean programme nor the Northern Dimension programme has received a completely positive reception.

The formulation of a coherent Baltic Sea policy will face many challenges also what comes to many of its key issues of content. It is well known that the major differences in the member states' policies concerning the EU's relations with Russia can be found among the Baltic Sea states. When Germany has traditionally represented a more constructive position and policy in relations with Russia and has also like most other big member states shown some inclination to a bilateral conduct of issues with it, Estonia, Latvia and Lithuania together with Poland belong to the most critical members. They belong also to the ardent supporters of a multilateral way of dealing with Russian policies. These policy differences are reflected in issues which form the core of the Baltic Sea policy like for instance energy policy cooperation, border control cooperation and problems linked with the role of Kaliningrad.

The utilisation of the economic potential of the Baltic Sea area undoubtedly gets the support of every EU member in the region. The region has been identified as one of the most promising economic sub-regions in the EU, linked with strong economic growth and growing flows of trade and investments among the states. The overall picture is, however, not that rosy as the region is also characterised by large economic and regional inequalities and by remarkable environmental challenges. It is the attitude towards these problems, the means of preventing economic inequalities as well as environmental risks, which easily forms another dividing line among the Baltic Sea states and forms another challenge to a coherent Baltic Sea policy. The new EU-members have this far focused more on the economic premises of their international competitiveness and have been less concerned about the social or environmental endurance of their policies. Germany and the Nordic countries again have aimed at more balanced policies in this respect.

The EU's Baltic Sea Strategy thus faces the challenge of divergent national interests of the member states which, of course, doesn't decrease its value. The complexity of policy instruments was identified as another major factor challenging the formulation of coherent policies in the EU. In order to become an efficient policy the EU's Baltic Sea policy should have a clear-cut position in this respect and should be supported by proper instruments of funding. The European Parliament proposes a Baltic Sea Strategy to be created as a continuation of the Northern Dimension (ND) and to become its priority area. This might be well-motivated as the geographical scope of the ND programme is very wide covering in addition to the Baltic Sea region also specific parts of the Arctic Sea area. It should, however, be deliberated how the recent change that has taken place in the ND's character affects this policy combination. The ND has recently been changed from an internal policy programme of the EU into a common undertaking of all of its parties comprising the EU as well as Norway, Iceland and Russia.

Anyway, one should try to avoid the risk that the Baltic Sea Policy becomes another ambiguous part of the Union's already manifold policy instruments used in relations with Russia. Its aims and profile should be kept clear from the beginning and its relations to other policy-instruments as well. Otherwise the well-motivated effort to sharpen that dimension of the Union's recent enlargements which undoubtedly might risk to remain in the shadow of the more Central-European dimensions will fade away.

Teija Tiilikainen

Director

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Nuclear energy in the Baltic-3: Dilemmas and determination

by Amelia Hadfield

Nuclear energy is back on the agenda[1]. Both the force majeure of environmental degradation from CO2 emissions and the political and economic dangers associated with rising import dependence have forced EU member states to re-evaluate their energy portfolio. The European Commission – a reliably tacit opponent of nuclear power – may also be reconsidering its position. This short exposé provides a snapshot of the nuclear profile of Latvia, Lithuania, Estonia and Finland within the context of recent European energy dynamics.

The Baltic Sea region is a critical area in a number of ways. Materially, the region is characterised by strong mutual dependence in both foreign investment and foreign trade, which has buoyed regional economies and contributed to the transport system. The Baltic Sea itself is becoming an increasingly important conduit for Russian oil and gas, whilst the territory of the three Baltic states promises potential for enhanced electricity transport frameworks. While only Lithuania and Finland are key nuclear producers, the region may in the future be capable of launching an indigenous nuclear industry.

Politically, the region is the site of much activity within the Northern Dimension, an EU-Russia project launched and led by Finland since 1997. Its 10 year anniversary should re-invigorate the programme with new regional priorities, such as enhanced foreign investment to fortify national and commercial energy industries, ecological measures to protect the increasingly busy Baltic Sea, and a more robust agreement with Russia in which both security of supply and demand are addressed. As the latter issue continues to defy the EU's ability to summon the necessary political will to act collectively vis-à-vis Russia, and as environmental degradation shows no sign of slowing, the 'nuclear option' now needs to be addressed.

The issue of security of supply is a tricky one for Baltic states. Whilst each country relies increasingly upon Russian oil and gas imports, the Nord Stream gas pipeline project (running under the Baltic Sea connecting Russian natural gas exports to Germany) is viewed by many in the region as a project that could actually strengthen the position of Baltic as a key EU transport route. While increasing the percentage of Russian gas imports (and arguably increasing European dependence), the pipeline could also be of serious benefit to the Balkan-3, making them something of a lynchpin in future EU-Russia cooperation.

The strategic importance of the Baltic region is undeniable. Yet import dependence is an equally potent concern, one which could easily see the Baltic states on the wrong side of the security of supply dilemma should relations with the national and commercial energy entities of Russia (or indeed any other major exporter) deteriorate. For these and other reasons, the idea of indigenous energy generation via nuclear power must therefore be considered.

Finland continues to act as regional patron of the Baltic. While the Northern Dimension has been accused of a somewhat lacklustre performance, Finnish nuclear energy has seen a renaissance in the past decade. Indeed, Finland has to be energy-saavy: it is second in the world (after Canada) for the highest per capita consumption of kilowatt hours of energy. Like Canada, Finland must contend with a harsh climate, long distances and energy-intensive industries, all of which contribute to increased energy intensity. 36% of Finnish electricity is currently generated by nuclear power thanks to four units, running in two separate stations. The two Loviisa units are of Russian design, nicknamed 'Easting-house' models (as opposed to Westinghouse), while the two units at Olkiluoto are Swedish in design.

Finland's nuclear profile will increase with the fifth unit currently being built by Franco-German vendor Areva, with audible industry agitation to begin a sixth unit (with E.On as a possible investor). As measure of the urgency of the project, former Prime Minister Lipponen, criticised the slow progress of Areva in building Olkiluto-3 in July 2006, arguing that the plant must commence operations for Finland to meet its Kyoto Protocol carbon emissions target. The nuclear industry however is not the speediest of animals. While the strict requirements by the Finnish nuclear regulatory authority (STUK) have acted as a brake on the speed of completion, Lipponen has had to argue that the agency's rigorous standards remain a calling card for Finnish nuclear credibility[2].

Latvia on the other hand has no nuclear generation, only a five megawatt Russian research reactor in Riga which is presently being de-commissioned, with the remnants of its fuel shipped to Russia. Remaining behind as part of the research reactor establishment are the 'hot cells', with plans to use these independently for radioisotope production in industrial radiography and medical research, enabling Latvian research and development to viably capitalise on this area. Lacking a discernable nuclear strategy, the benefits of upcoming Lithuanian nuclear plants may provide Latvia with a proxy nuclear policy.

The northern-most of the three, Estonia also has the farthest to travel in terms of becoming a nuclear energy player. Estonia possesses no nuclear plants and has had to deal with the nuclear leftovers of the Soviet presence, in the form of the naval training base at Paldiski which trained crews on two nuclear submarine reactors. Despite having been partly filled with concrete after the change of governments, the reactors were largely left intact and are only now being decommissioned. Estonia also possesses an ex-Soviet uranium extraction and fuel fabrication plant, and is currently making a name for itself in the supply of rare earths (rare and valuable minerals including hafnium and lanthanum, which being rare require large amounts of ore for their production). With no indigenous energy sources, Estonia too is heavily dependent upon imported Russian oil and gas.

Of the three Baltic states, Lithuania has the strongest nuclear profile. The two 1,500 megawatt RBMK units at the Ignalina plant have run well, but suffered from being the same design as Chernobyl. In a rather ignoble use of EU accession criteria, the first of these two units was forced to shut down at the end of 2004, and the second unit is to close by the end of 2009. Lithuania has invested much in constructing a facility to transfer partly-used fuel from Unit One to the still-functioning Unit Two, an operation that is expensive, difficult, and in the view of some, wholly unnecessary. This option however may be better than sourcing more fuel from Russia. Operating together, Ignalina's two units had granted Lithuania a pre-eminent place as Europe's highest nuclear-generating country at close to 80%. The first unit supplied the domestic market and the second generated power for export[3]. However, the closure of Ignalina has effectively eliminated Lithuania's ability to export power, transforming it from a net exporter to a net importer (buying around 20-25% of its energy needs from abroad). This rests uneasily with the EU's 2007 Energy Policy for Europe and its goal of reducing Europe's overall import dependence.

[1] Grateful thanks to off-record interviews with a relevant IAEA staff member, March 2007

[2] Ann MacLachlan, *Nucleonics Week*, Vol. 47, No. 27, July 6, 2006, p.5.

[3] Ariane Sains, *Nucleonics Week*, Vol. 47, No. 37, September 14, 2006, p. 3.

Market realities may be kicking in however. The current ambition to construct a replacement to Ignalina has aroused much interest among its neighbours. Latvia, Estonia, Sweden and a Polish-German consortium have all bought shares of the proposed new multi-unit complex with a target date of 2015. The possibility of converting Lithuania back into a major Baltic power export is keenly felt in the country and beyond, as the project should yield reliable profit margins and shift the balance of energy power back to the Baltic. With accompanying infrastructure a vital part of any such project, the news that new electric power lines are to be built between Poland and Sweden by 2013 is welcome in terms of expanded cross-border systemisation.

As ever, the impetus of national projects needs to be converted into political capital, preferably with a national energy strategy which makes clear its choice of power source. Lithuania appears close to publicising such a strategy, balancing government choices and heavy foreign investment. More encouragingly, the country appears to be leading a Baltic ‘regional strategy’ that can be reflected in each country’s national energy priorities. Lithuanian undersecretary Danius confirmed in September 2006 that this approach is ‘more reasonable compared to just a national strategy’.[4] Such views were reinforced the following month when a joint review of all three states confirmed the need for new nuclear capacity to replace the Ignalina closure, citing the triple goal of a diverse energy portfolio, Kyoto emission goals and security of supply thanks to the ready availability of nuclear fuel from a global, rather than monopolistic market.[5]

In order not to remain an ‘energy island’ - linked to the EU by overland transit through Poland or Baltic Sea cables and overly-dependent upon Russian exports - the Balkan-3 have no choice but to reform and work collectively. All share the same legacy and face the same challenge of profitably and safely making use of their ex-Soviet nuclear infrastructure. A necessary corollary of this ambition is mustering the political strength to make the hard decisions necessary to achieve increased energy efficiency, reduced imports and realistic carbon emission goals. Like the EU itself, a synchronised collective approach rather than a series of individual projects is preferable. Similar to the Balkan Energy Community Treaty, the Baltic-3 may have an opportunity to operate as a regional vanguard by visibly keeping the nuclear option on key agendas in the national capitals and at the EU level – representing the Europeanisation of energy.

Following the Balkan developments, the Baltic states have at least tentatively agreed to overhaul the existing interconnection of their Soviet-legacy power grids, unifying around a central control and guaranteeing maximum flexibility and responsiveness. Connecting the Baltic grid to western European grids is an obvious extension of such a project, and the size of any individual nuclear power plant unit would be a factor in such an endeavour.

What is evident in such grid projects - as well as the 2006 connection of the Estlink undersea transmission cable between Finland and Estonia to the Nordic transmission grid (Nordel) - is the growing sense of collective political will between the Baltic-3. Defying the electric isolation of the region, the three states now need to capitalise on the security of supply inherent in such infrastructure by generating indigenous power. A greater goal may therefore be the Poland-Lithuania inter-connector linking the Baltic States to continental grids. Until these projects come to fruition, the group remains a litmus test for the choices made by other newly-acceded buffer states.

In sum, the Baltic states appear to have three foreign energy policy choices: first, they can elect to continue bilateral relations with energy suppliers like Russia. Second, they may attempt a regional energy consortium. Third, they may support the ambitions of the European Union to construct an Energy Policy for Europe in which energy operates as an inter-sectoral policy area concomitant with trade, investment, security and foreign policy, demanding greater competence than previously seen.

Of these, the regional option seems the most likely. What is needed is a sense of a Baltic energy neighbourhood to accompany its initial attempts at regional integration – an energy acquis in which regional energy cooperation features heavily and the nuclear option kept open. Equally however, the EU needs to agree upon and disseminate far clearer messages on the role of nuclear in its burgeoning energy policy. The Commission has hedged its bets and this will prove unhelpful in the long run. Nuclear power currently remains a national option. However nuclear safety, security, non-proliferation and indeed the competitive nature of its very output are already cross-national issues, and an obvious area of future harmonisation. The 2007 Commission Communication, An Energy Policy for Europe, tacitly acknowledges that nuclear power can play a role in addressing the three-pillar goal of security of supply, competitiveness and sustainability. Clearer indications from Brussels are urgently needed in order to assist the burgeoning development of the Baltic region as it strives to integrate itself with the EU.

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[4] Ariane Sains, *Nucleonics Week*, Vol. 47, No. 37, September 14, 2006, p. 3

[5] Ariane Sains, Nucleonics Week, Vol. 47, No. 43, October 26, 2006, p.7.

TriCity - Kaliningrad - Baltic Europol?

by Tadeusz Palmowski

One of the rapidly developing forms of cooperation and new relations initiated by political transformations in the 1990s are the intensely developing transborder contacts. Transborder contacts provide grounds for overcoming social barriers and restrictions. This is also noticeable along marine borders.

On the opposite sides of the Gdańsk Gulf there are two settlements systems. On the western side, there is the TriCity metropolis, and the Kaliningrad agglomeration on the eastern side. The Gdańsk Gulf and connected Vistula Lagoon with neighbouring land are the borderline between Kaliningrad Oblast of the Russian Federation and the Republic of Poland. Both settlements developing around the Gdańsk Gulf for over fifty years, though distanced merely 160km from each other, did not maintain consequential relations.

European Union enlargement in May 2004 resulted in the Baltic becoming an internal EU Sea. Geographical proximity, coastal location, relatively good transport infrastructure, development of border crossings both inland and sea crossings indicate the special opportunities for developing transborder cooperation between north-east Voievodships of the Republic of Poland (RP) and the Kaliningrad Oblast (RF).

Two of the decisive factors for the development of TriCity metropolis are: the geographical factor resulting from its coastal location and the historical factor of relatively independent development of three big towns forming the nucleus of the metropolis Gdańsk; Gdynia and Sopot. This three member settlement structure forms the functional union called TriCity. In the last few years, the relations between the three towns lying on the coast of Gdańsk Gulf became very intense creating in fact the TriCity metropolis, which with economic development of the coastal area extended to cover neighbouring towns.

The position of Kaliningrad is unique in historical, economic and geopolitical terms. The disintegration of ZSRR meant that the region, which was a closed military base for decades and up to 1991 remained completely isolated from the West, came again into focus of European discussions. After Lithuania gained independence, the Oblast became a Baltic exclave. After EU and NATO enlargement eastwards, the Kaliningrad exclave became "the Russian window to the European Union".

The Kaliningrad agglomeration was also determined by geographical, historical and geopolitical factors, quite different, however, than in case of the TriCity. The most important city of the Oblast is Kaliningrad, which concentrates 46% of the population and 60% of the industrial potential. Kaliningrad is a historical city with more than four hundred thousand inhabitants lying on the Pregolya River, formerly the capital of Eastern Prussia, destroyed at the end off World War II, and assigned to the Soviet Union under the agreements of the Potsdam Conference. The entire agglomeration comprises 650 000 inhabitants.

The present changes taking place in the Pregolya River region give a lot of hope and to a minor degree some anxiety. The contemporary Kaliningrad, part of Russia, is subject to continual transformations in all spheres of life. Cut off from the world for decades it is now dynamically catching up economic and cultural neglect. The attempt to cut away from the past failed. We can see the trend of coming back to the roots, though these vary from the state and ethnic origin.

The new geopolitical situation created a good environment for the framework of the new metropolis around the Gdańsk Gulf. The main centres of this bi-centric metropolis would be: Kaliningrad and TriCity.

The first stage of infrastructural premises of bipolar development of the metropolitan region and development of its competitiveness is the connection linking both core transport and communication infrastructure.

Present TriCity and Kaliningrad relations

Cooperation between the Kaliningrad Oblast and Poland is taking place along two lines: as cooperation between Poland and the Russian Federation, and as transborder cooperation between Polish north east Voievodships and the Oblast. Cooperation going beyond solely official measures, since the first agreement was signed in 1991, spread wider to particular gminas and towns, companies and non governmental organisations. A General Consulate of the Russian Federation was opened in 1993.

An important area of cooperation for the Pomorskie Voievodship and the Kaliningrad Oblast is that of contacts between schools of higher education in both regions. For example an agreement was signed between the State University in Kaliningrad and the University of Gdańsk.

Gdańsk and Kaliningrad also cooperate on many initiatives and Baltic programmes such as Baltic Sea States Subregional Cooperation (BSSSC), Union of Baltic Cities, VASAB 2010, Baltic Port Organisation (BPO), Baltic Association of Regional Development Institutions (BARDI), and Baltic Euroregion.

Development perspectives of the bipolar TriCity - Kaliningrad framework

In 2007, an express road Gdańsk-Kaliningrad, part of Pan-European Corridor no I A Riga-Kaliningrad-Gdańsk, is to be commissioned for use.

Due to the intensive development of border traffic between the Kaliningrad Oblast and Poland, exceeding 3.8 million people in 2005, further development of both land and sea border crossings are planned.

Potential spheres of further actions connected with the concept of developing the bipolar system and enhancing the synergy effect can also involve such areas as: development of communication links, developing industrial links, company cooperation, cooperation in agriculture, development of business environment infrastructure, opening up to international specialist staff, power supply, scientific cooperation, protection and restoring of cultural heritage, protection and reasonable development of the national heritage, cooperation of self governments and non governmental organisation. The Polish side supports all measures taken towards eliminating economic and civilisation barriers between the Kaliningrad Oblast and countries of the region. A factor facilitating regional cooperation of the TriCity and Kaliningrad is the exclave nature of the Oblast and relatively fast pace of privatisation in Russia. Innovations and development incentives may be passed from the TriCity to Kaliningrad and further eastwards.

The bipolar framework TriCity - Kaliningrad may in future become a Baltic Europol. The development of this settlement system will contribute to a stable and sustainable development of the town network around the southern Baltic.

The development of a bipolar framework around the Gdańsk Gulf is possible provided good relations develop between the European Union and Russia. It also depends on whether Kalinigrad and TriCity are capable of taking advantage of the new more favourable geopolitical situation in Baltic Europe, the geographical opportunities - proximity of the neighbourhood, common Vistula Lagoon, Vistula Spit, and mutual relations of north east Voievodships. However, this is a complex and long term process.

The mission of the TriCity and Kaliningrad metropolis is of international nature with high European sustainability and safety connotations. The process of involving the Kaliningrad Oblast of the Russian Federation into the sphere of European cooperation may constitute an essential input of Poland in the development of the new European order.

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Challenges to the efficient EU border with Russia at the Kaliningrad enclave: A view from Lithuania

by Alvydas Medalinskas

Like other new EU countries, Lithuania is under process of the preparation for the Schengen membership. Full adaptation of Schengen acquis, implementation of the EU Integrated Border Management, creation of Integrated Border Security Security Model are very important tasks to achieve for Lithuania in order to have efficient external Schengen borders with non EU member countries.

Various EU documents describe integrated border concept, but a universal model for border management has been neither provided by the EU acquis, nor by its 'Schengen' standards. There is clear understanding that European borders have to be open and secure with neighboring countries in order to facilitate legal cross-border activities, without creating security problems. There is also an experience of various EU countries with practical implementation of integrated EU border concept.

The border between Finland and Russia is one of such examples, which is very helpful for Lithuania to follow making effective border with Russia at the Kaliningrad enclave. Part of this positive experience deals with the cooperation between various services at the border checkpoints on both sides of EU border. It is less degree of cooperation among all institutions working on the border in Lithuania than in Finland. Finnish-Russian co-operation on border issues is based on the agreement and has a long tradition. There is still no such agreement between the Border Guards of Lithuania and Russia and no tradition of cooperation during the last half century.

One of the main problems on the Lithuanian-Russian border is a smuggling of various commodities, such as vodka, cigarettes and petroleum. It is very difficult to tackle effectively this problem without efficient cooperation of various authorities across the border, including sharing the information not only between various agencies on the border checkpoints of each country, but also between similar agencies across the border. Different national border agencies in Russia are not keen to share information even with each other and much less with EU partners. No clear guidelines from the EU side set up on data exchange in relations with Russian partners.

Without solution of this problem it is impossible to talk also about setting up of joint checking points on the EU-Russian border, which Russia views as an important measure to reduce queues of the traffic at the border, while EU countries are more skeptical. Border checkpoints in Russia are less developed than in the neighboring EU countries. Russia is happy to modernize its border checkpoints, but mainly with the EU funds.

Green border security on Russian side is very efficient. This is partly a consequence of a different philosophy in the EU and Russia. While the EU tried to invest in the system of measures before the borders, Russia all efforts concentrated directly on the border. Green border surveillance on the border with Russia in Finland is more efficient than in Lithuania. Old technical border security system with barbed wire fences, observation towers, electronic alarms etc. are still in place on Russian-Finnish border from Cold War time, while Lithuania had to build it from the scratch. It is impossible to build up all new border checkpoints on Lithuanian-Russian border. Most of them have to be modernized. Under preparation for Schengen membership Lithuania had to make improvements in existing checkpoints, splitting the lines at the border checkpoints for traffic using the green lane and red lane and also splitting lanes for Schengen countries nationals and third country nationals.

However, because of lack of space in some earlier built checkpoints, such new lines might come up on Lithuanian side in place of existing green and red lanes. But there is even bigger problem on the Russian side: not everywhere Russia has green lanes. Unlike in Finland, queues at the Lithuanian-Russian border are not structured before the checkpoints. This has not been foreseen, when checkpoints were built up and now it might take additional investments to make such arrangements.

It is a great interest in Lithuania on the system of Green corridor, which has been implemented on Finnish-Russian border according to the agreement signed between the Swedish, Finnish and Russian Customs administrations. Companies participating in this project were allotted a separate lane to handle their customs matters and customs clearance for them could be done within a few hours, while others have to wait.

Lithuania implemented system, which, apart of the Finnish example, has other additional components. The system called Kaliningrad transit has been created by custom authorities from Russia and Lithuania and could serve to the interests of various companies, which have a guarantee from the transport company association in Lithuania and Russia and cross the territory of Lithuania from Kaliningrad district to the rest of Russia or vice versus. This system is based on the advanced electronic goods declaration system and goods application customs control.

Russian services on the border checkpoints lack sophisticated equipment, such as radiation detectors, X-ray devices, computer systems, etc. It might also explain why check up procedure for example of trucks on Lithuanian side takes less than on Russian side. Without sophisticated equipment it is very difficult to do quick, but effective check up of the traffic passing through the border crossing point.

Certainly, even implementation of such systems, as Green corridor or Kaliningrad transit, splitting traffic lines, modernization of checkpoints and new technological equipment would not help to reduce queues on the border with Russia, if the situation will remain unchanged with the practice and quality of work of various institutions in the Russian border checkpoints and legal basis for such activity.

Customs work in Russia is organized on selective control, where mainly the attitude or interest of custom officer matters and which is the main source for bribes and corruption. Checking on the Russian side might take about half an hour, while average checking procedure on the EU countries side takes only few minutes, because it is based on the risk analysis. If Russia would also start to do checking procedures based on the risk analysis, it would mean less formality and corruption, more effectiveness, shorter waiting time and reduced queues on the border.

No compatible legislation on both sides of the border, different rules and regulations constitute are one of the most serious problems for the co-operation at the external EU border with Russia. Harmonization of legislation in Russia according to the European border management principles would be a very important step to make the external EU border with Russia effective and efficient. In order to achieve efficient EU borders with Russia at the Kaliningrad district it is not enough that EU countries, such as Finland and Lithuania make right steps. It is also important that Russia would implement integrated border concept.

Integrated border concept could serve as a pilot project for further cross-border co-operation between the Russian Federation and the European Union to make border more open and secure. At least such border management strategy could be introduced by Russia on the border with EU at the Kaliningrad district, particularly, if Russia, as well as EU, still regards the Kaliningrad district as a pilot project.

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Maritime transports and their future prospects in the Baltic Sea Region

by Antti Saurama

In recent years, the Baltic Sea Region has developed rapidly in economic terms, BSR states recording outstanding GDP growth rates compared to Europe in general. Between 1995 and 2004, the region's aggregated GDP grew by 42 percent, totalling an average growth of approximately 4 percent (the region including Finland, Sweden, Denmark, Poland, Lithuania, Latvia, Estonia, the western regions of Russia, the northern regions of Germany, and Norway). The fastest growing economies during this period were Lithuania (367 percent), Estonia (309 percent) and Latvia (296 percent) while the overall Russian economy grew by around 90 percent. Despite the more modest growth of some other states, considerable differences between the absolute sizes of the BSR national economies and the volatility of growth in some states, this continuous aggregated growth has fostered international trade within the region. The result, albeit not solely due to economic growth, is ever greater demand for transport, which is forecast to grow considerably in the future.

Maritime transports play an especially important role in the BSR. Dominated by the Baltic Sea at its centre, this region and its industries and consumers need maritime connections for their international and intra-Baltic trade relations. Bulk commodities play a major role in the trade and transport of BSR countries, and these commodities are usually best transported by sea whenever possible. Indeed, the BSR's maritime transportation is dominated by bulk commodities. Liquid bulk commodities (mainly oil and oil products) have a share of around 45 percent of all maritime transport in the region, while dry bulk commodities total around 27 percent, making the share of bulk products more than 2/3 of total volumes in the BSR. When analysing maritime transports between BSR States, or intra-Baltic maritime transports, dry bulk commodities constitute the lion's share at 43 percent.

Extensive, annual analyses of maritime transport development covering the whole BSR are difficult to find, partly due to statistical difficulties. The few analyses performed are customarily produced for larger individual projects on an ad hoc basis. One such project, Baltic Maritime Outlook 2006, which involved the writer of this article and the Centre for Maritime Studies, was completed in 2006. This study provided a macro-scale view of transport development, especially maritime transport development in the BSR. The study reported a gross total of 909 million tons of maritime transports in the BSR during 2003. The net total, reflecting the volumes handled in ports, was reported as 730 million tons. It should be noted that these figures included the maritime transports of Norway, the German North Sea ports and Danish North Sea ports. To some extent, the gross figure for 2003 can be compared to the author's own rough estimation based on various statistical sources from the year 2005, indicating a gross volume of around 1100 million tons in the same region. These volumes are handled in approximately 400 ports around the region, ranging from minor local ports to European and global hubs. Taken together, the figures indicate that maritime transports play a significant role in the BSR and its development.

The BSR is currently witnessing the rapid growth of maritime transports as a whole, especially in some specific segments such as oil transports and container transports. What does the future hold in terms of maritime transports in the BSR?

The longer the forecast period, the more uncertain the answer. In Baltic Maritime Outlook 2006, an effort was made to estimate future maritime transport flows in the BSR. Results based on various economic and trade analyses as well as forecast transport infrastructure development and macro-simulation indicate that the BSR is the growth centre of maritime transports in Europe. Based on these analyses it is expected that from 2003 to 2020 cargo transported by sea within the region will increase by 470 million tons. This equals a 64 percent increase compared to 2003. Based on analyses of the expected growth, more detailed results show that out of the 470 million ton increase, around 150 million will move between BSR States (an increase of 83 percent), around 270 million will represent exports from the BSR to the outside world (an increase of 68 percent) and around 50 million tons will represent imports from the outside world to the BSR (an increase of 35 percent). The overall growth in maritime transports in BSR will exceed that of the whole of Europe: in terms of transport operations (ton kilometres per year) the indexed growth in the BSR, from a base of 100 in 2003, will reach 193 in 2020 whereas in the whole of Europe it will reach 166. Total transport operations measured in ton kilometres will double within 20 years.

Some interesting remarks can be made on the presented growth figures and trends. The greatest relative growth in maritime transports is expected in intra-Baltic transports. This is a reflection of expected trade development in the BSR as, in relative terms, more goods are traded between the BSR states. Hence, maritime transports are indicative of the increasing economic integration of BSR states which is likely to occur in the future. Also, the growth of national economies and trade is expected to be proportionately highest in the eastern parts of the BSR and the analysis indicates that, in this region, east-west cargo flows will grow much faster than north-south cargo flows. On the whole, maritime transports are expected to become the leading transportation mode in the BSR in the period up to 2020, leaving behind both rail and road transports. In other words, the BSR will witness a clear modal shift from rail and road to sea. As with all forecasts, the reference study includes many assumptions and uncertainties. However, the trend is clear: maritime transports will continue to grow substantially in the BSR.

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Kaliningrad and the benefits of gambling

by Kristian Nygaard

With the signing of the law on casino zones in December 2006, Kaliningrad has moved into the tourism spotlight and is now among the candidates for most promising European tourism destination. The law has meant that the region as of 2009 will have something to offer its visitors that only 3 other Russian regions (all of which are far away) can have as well.

As of today, the casino zone will most likely be located in or close to Yantarnyy. Here the tourist future of the Kaliningrad region might well be founded and the zone would probably very quickly surpass any other attraction in the region in regards to number of annual visitors.

The establishment of this zone would create possibilities in the following fields:

Casinos

These will see great possibilities in the area, both for the Russian and European markets.

Tourism

The Kaliningrad region would have an added attraction in gambling that together with existing ones such as the Kuronian Spit, Svetlogorsk and Zelenogradsk would make up the 'Kaliningrad Experience'.

Tax-free shopping

Since being outside the European Union, Kaliningrad have the possibilities of offering tax-free shopping for visitors coming from one of the European Union countries.

So potentially for the region it could create these benefits:

Greater Income

Casinos will mean more tax revenue which in turn can be used within the public economy of the region.

More jobs

These additional jobs will be created both within the casinos as well as within any sector that could be affected, such as restaurants, hotels, taxis, shops and many more.

Growth in other sectors

Not just the casinos themselves could benefit from the zone. In order to run casinos many suppliers are needed within sub-sectors such as food, beverages, handicrafts etc.

Improved image

It is no secret that Kaliningrad has suffered from a poor image. Mostly it has been undeserved and the majority of the factors that made the region receive this image in the 1990's have been dealt with as of today. However, the negative image of the region still lingers on. The introduction of gambling and the establishment of the casino zone could create headlines and subsequent positive news about the region. So instead of being known for AIDS, Soviet style architecture and prostitution, Kaliningrad could receive a whole different image. So when people in Europe would think of the region, what first would come to mind is that of a place to go to have fun and enjoy yourself. Much in the same way as one would think of other tourist destinations, i.e. London for shopping, Amsterdam for canals, Las Vegas for casinos and entertainment etc.

Improvements in infrastructure

With the advent of casinos and other gambling establishments tourists will come. They will arrive to the zone through ports of entry located within the Kaliningrad region and via air, railway, ship or road. The infrastructure improvements that are necessary along the way will also affect and benefit the general public. For instance, the construction of a connection road would benefit the tourists, the workers in the zone and any resident in the local area. Thus the citizens that live and the businesses that operate within the region will have better options for getting to and from Kaliningrad.

More entertainment offers

Casinos have been known to provide entertainment for their clients. This could include everything from shows to sports events etc. These entertainment offers are naturally also available to other tourists not playing at the casino as well as residents of the region itself.

So the establishment of a casino zone will provide the region with many benefits. However, one should not close the eyes for the possible problems that could arise from a strong casino presence.

For instance, one should mention the following:

Higher level of criminality

Especially the economic crime forms as well as the presence of groups that live of criminal activities and practice this in an organized form. Herein lies first and foremost a responsibility of the authorities to control all relevant economic transactions that take place within the casino. Also the casino management should put up an effective surveillance system that effectively should deter anyone fro committing any type of crime within the casino.

Prostitution

It is a well known fact that wherever there exist easy money, prostitution flourish. And casinos are naturally no exception to this rule. Prostitutes will flock to a place where money are being won and lost within seconds and where historically sex has been viewed as a commodity for the winners.

Gambling addiction

The strong presence of casinos will unfortunately not only attract the tourists that come for a couple of hours of fun. Also persons who are suffering from gambling addiction will be attracted to the gambling tables like flies to honey. In this case it is important that the casinos know of their responsibility in promoting responsible gambling. Often however, this is not enough. It will also be necessary for the authorities to support and maintain help for these unfortunate individuals who suffer from this illness. Funds for this could very well derive from the taxes that the state receives from the casinos.

In summary, Kaliningrad has excellent possibilities in terms of development of gambling tourism. Within 10 years, my estimate is that the casino zone could mean more than 1800 more jobs within the casinos and in businesses that supply the casinos. On a yearly basis approximate one million people would visit the casino zone for gambling, entertainment and shopping. These are divided into day-visitors and those who would stay for 1 night or more.

The zone would have 4-5 casinos, many restaurants and bars as well as a well-stocked area for shopping, mainly dedicated to visitors from the EU.

Most visitors would arrive through: a) Kaliningrad Airport, b) Port of Baltiysk, and c) Kaliningrad Main Railway Station. From a) and b) direct non-stop bus services would operate in connection with arrivals and departures. From c) a regular train service would run serving both locals and tourists, perhaps even with a side line sometime in the future for the casino zone. Also indicated in this is the projected railway to the Airport.

Thus in 10 years time many things that are now part of the tourist image of Kaliningrad would be drastically different due to the introduction of the casino zone. Gambling would mean that Kaliningrad could get an image that is more linked to fun and entertainment. And that this would in time mean more income and jobs for the region.

To conclude, the introduction of a casino zone in Kaliningrad will have a profound effect on tourism in the region. Potentially income and jobs will be created both within the casinos, the trade sector and any other sector that supply these. Also it could benefit the region and its population in other ways, such as infrastructure and image.

However, one should also note the potential negative effects such as prostitution and criminality. In 10 years time from now, Kaliningrad could be a very different region in a tourist perspective. The casino zone could contain several casinos, hotels, restaurants as well as a large section of shops targeted the visitors coming from the EU countries. The effects would be infrastructure improvements, more jobs, and greater income.

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Quiet Russia: St. Petersburg as a mirror of Putin's political stabilization

by Nikita Lomagin

Arguably, the most important event in the political life of Russia in the first quarter of 2007 have been elections for legislative assemblies in 14 of Russia's 86 regions, including the biggest metropolis of the Northwest Russia - St. Petersburg. The elections have also some international implications for both Russia's new image as a country steadily retreating from democracy and at the same time a country which can provide more security for foreign investors through building a sort of a monolith between executive and legislative branches of power not only on the federal level but also ob the regional one.

The St. Petersburg elections seen as a rehearsal for the State Duma elections in December were the first to be held since the removal of the minimum turnout limit, which was lifted by the Russian parliament in December 2006. In this situation the parties are not seeking new voters, not trying to get more people interested in elections but rather they all target one-and-the same group of people traditionally go to polling stations.

Another novelty of the local campaign was the introduction of a proportional electoral system – also known as the party lists system that requires candidates to run on a registered party list in contrast to a majoritarian system that allows independent candidates to stand. It seems that Vladimir Putin's political credo is very much the same as of the Russian Prime Minister Petr Stolypin who almost a century ago addressed the hostile State Duma with the following call,"Give us twenty years of peace both internally and externally – and you will recognise Russia". Internal stability by all means appears to be the highest priority of the Kremlin today. Quiet Russia is, in fact, what Putin is dreaming of today.

As for the campaign itself and the way how it was run, there are three features which distinguished it from all previous contests. First, political platforms of neither party paid any significant attention to foreign policy issues or any issue related to the Baltic Sea Rim. In this sense, they were local indeed. Second, among the frontrunners of all political parties there were prominent women on party lists. For instance, the rector of St. Petersburg State University Ludmila Verbitskaya was number three in the United Russia party while a very popular State Duma Deputy Oksana Dmitrieva was on top of Just Russia party list. Third, a number of well know sportsmen participated in the campaign not just advocating for this or that party but being on party lists. Among them were, for instance, Olympic champion Yevgenii Plushenko and the captain of the national soccer team Andrei Arshavin. The message to the voters was simple: St. Petersburg does not need any longer political battles with participation of 'strong men' be they generals (this was a common place from 1993 on) or so-called 'successful businessmen' who made their fortune during privatisation of 1990s. The really successful are those who achieved a lot by hard work, and long-term service in traditionally respectful in St. Petersburg areas such as science, education and sport. Another goal was to attract to elections besides traditional voters the youngsters who admire their sport's icons. Was this campaign a success for the Kremlin?

In terms of results, yes. Pro-Kremlin bloc United Russia received 37,37%, giving the party 23 out of 50 seats in the Assembly. Another pro-Kremlin party, Just Russia, came second with 21,9% translating to 13 seats. The only opposition party qualified for the Assembly - Communist Party - won 16,02%, equal to 9 seats, and the Liberal Democratic Party gathered 10,82% and 5 seats in the parliament. The other forces selling themselves as an opposition - Patriots of Russia and the Union of Right Forces failed to entitle them to seats in the assembly, having collected 5,8% and 5,2% of votes cast respectively.

But there was another result of election which is quite a negative for the Kremlin. It is the apathy of voters – nearly seventy percent of voters ignored elections to the St. Petersburg Legislative Assembly. A total of 37,501 ballots were declared invalid, according to the St. Petersburg Election Commission. The figure significantly exceeded that expected in normal election conditions of less that 1,5%, the statistical average of spoilt ballots. Liberal Party Yabloko - expelled from the elections on a contested technicality earlier – had asked its supporters to go to polling stations and write the words "protest", "Yabloko", or other words of discontent on the ballot.

Yabloko officials insist they were cut from out of the political process because they oppose construction of a Gazprom skyscraper near historical centre of St. Petersburg.

The Governor of St. Petersburg Valentina Matvienko who openly campaigned for United Russia – was satisfied with the results of the elections. And this is quite understandable. For the next four years she will be guaranteed from any opposition from the Legislative Assembly of St. Petersburg. It might be a good sign for strategic investors too who need stability and predictability. The Governor wants to leave little to chance of challenging a number of ongoing and planned projects which might bring to the shores of the Neva river billions of dollars.

It appears that voters in St. Petersburg as well as in other Russian regions put the so-called 'stability' promised by the United Russia far above traditional democratic values, civil rights and market economy. The results of the Levada Centre's opinion poll from December 2006 indicated that only 16% of those surveyed identified the 'Western model' of democracy as the ideal (this same figure was 25% in 1996) and 35% said that they "prefer the Soviet system before 1990s". Another 30% of those surveyed that Western democracy "wasn't suitable for Russia" and 12% said it has had a "devastating effect on Russia". Another alarming data indicates that 94% of those surveyed said they "don't have any influence on the current situation: in the country or that their influence was "relatively small" or even "too small" (13% and 18% respectively). Directly related to this is a very low sense of responsibility among respondents for what happens in the country (82%). In general, Russians appear to have reconciled themselves to the idea that all significant decisions in the country are made independently of their opinion.

The result is growing apathy, as 17% of those surveyed said they would not vote in State Duma elections this December, 11% that they yet to decide whether to vote and 23% said they were undecided for whom they would vote. The worsening of Russian attitudes towards Europe and its basic values is an alarming indicator, revealing the insufficient (if not completely absent) effort on the part of the elites looking for Russian integration into a European system of values.

The Governor Matvienko critics, however, do not agree with her optimism calling the election "a triumph of hypocrisy". "What we got was a cynical trade-off between two pro-Kremlin parties, equally loyal to the President", said Maria Matskevich, a senior analyst with the Institute of Sociology of the Russian Academy of Sciences. "It was an imitation of choice, and a step toward a fictitious two-party system, with the difference between two cloned parties being only their names. The only genuine and strong opposition part, Yabloko, had been shut out of elections. Nearing the State Duma elections in December, liberal parties were given a clear message".

United Russia and Just Russia were on the ballots in all 14 regions along with the Communist Party and the Liberal Democratic Party of Russia, whose leader Vladimir Zhirinovsky is seen as loyal to the Kremlin. SPS, Yabloko and several smaller parties (the Greens) were also seen on some of the ballots. In a sign of United Russia's strength, the Party won 13 out of 14 regional parliamentary elections.

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St. Petersburg: The most important foreign city for the Finnish economy

by Kari Liuhto

Recently, regional elections were held in St. Petersburg, and the results were in accordance with expectations. The winners were the two main pro-Kremlin parties – United Russia and Justice Russia. Together these two parties garnered a full 60% of the votes cast. The 16% of votes captured by the Communists was also pretty much as expected.

The results of the nationalists and the liberals, however, were followed with greater than those of the leading trio. The nationalist Zhirinovskyites gathered a large share of the vote in St. Petersburg (more than 10%), which indicates in a regrettably telling way a growing feeling of nationalism in Russia. In assessing the state of nationalism, it is worth remembering that St. Petersburg is Russia's stronghold of liberalism. Or, rather, it was. In the event, right-wing liberalism was suffocated or suppressed, as the Union of Right Forces received less than the 7% of the vote required to be entitled to seats in the city parliament, and the Yabloko party was expelled from the elections on a technicality.

The expulsion of Yabloko from the elections was a setback not only for liberalism in Russia, but also for nationwide democratic development as a whole. In the longer term, Russia will perhaps no longer prove to be as united and just as it currently seems. In the short term, the election results are indeed hardly reflected in St. Petersburg's economic policy, and the strong rebirth of the city continues.

The city has succeeded in tripling the size of its budget in three years; and not a single other one of Russia's 86 regions can trump that. The economy of St. Petersburg is growing at a faster rate than the Russian average. The gross regional product has increased at an annual rate of more than 10% for the past decade. The growth in Russia as a whole has not exceeded 7%.

In St. Petersburg a group of significant development projects is starting up, in such fields as environmental protection, logistics and changing the city's public image.

Of the environmental protection projects, one of the most significant is the St. Petersburg waste water treatment plant, which will contribute to a considerable reduction in the environmental load that the city places on the Gulf of Finland. In addition to waste water, St. Petersburg's other environmental problems must be tackled more strongly than before. The EU's Baltic Sea Strategy and Northern Dimension policy offer excellent means for this.

On the logistics side, interest is being stirred in the development of St. Petersburg and its surrounding ports, the construction of a gas pipeline from near Vyborg along the Baltic Sea bed to Germany, the considerable increase in sea shipments of oil in the Gulf of Finland, the completion of the St. Petersburg ring road, and the construction of a high-speed rail connection between St. Petersburg and Helsinki. In their own way, all the above-mentioned projects have an impact on the surrounding countries.

As far as the revamping of the city's public image is concerned, the most publicly discussed projects are the major Chinese investment to build a new district of St. Petersburg (the Baltic Pearl) and the Gazprom City project of Russia's major gas corporation. The Chinese project, with an investment in excess of one billion euros, is the manifestation of a new phenomenon in international business – Chinese business expansion beyond the China's borders. Correspondingly, Gazprom City reflects the dawning of the migration of the headquarters from Moscow to St. Petersburg. According to Sergey Fiveysky, the First-Deputy Chairman of the Committee for Economic Development, Industrial Policy and Trade of the St. Petersburg City, energy companies (Gazpromneft ja Transnefteprodukt), logistics companies (Sovkomflot ja Transaero) and banks (Vneshtorgbank) have moved or are moving their headquarters to St. Petersburg. Although it is too early to assume that economic decision-making power will move from Moscow to St. Petersburg, moving headquarters supports St. Petersburg's economic growth and foreign trade.

Foreign trade in the city of St. Petersburg has developed rapidly. During the past decade, the value of external trade has more than quadrupled. Finns have received a juicy slice of this growing cake, as Finnish companies account for one-tenth of the foreign trade in this city of some 4,5 million people. St. Petersburg's foreign trade is still less than that of Estonia with its total population of 1,3 million, which leads us to believe that the limits for St. Petersburg's growth will not be reached, at least in the near future.

Finnish companies are also active in setting up operations in St. Petersburg and the surrounding Leningrad region. This is shown by the fact that the Finnish investments in St. Petersburg made in the first half of last year constituted 6% of all foreign investments made in the city. The corresponding figure for the Leningrad region was over 20%.

Although the results of St. Petersburg's regional elections raised some dark clouds, the economy of the city seems to be improving at a healthy pace. I would even venture to claim that an economic boom has begun in St. Petersburg, and its compound effects will also be seen in the whole Baltic Sea region, sooner or later.

St. Petersburg will experience a similar kind of economic renaissance to Tallinn a decade ago. The most significant difference between these cities, however, is that St. Petersburg is ten times larger than Tallinn, so its compound effects on the nearby economies will be considerably more powerful than those that resulted from the economic boom in Estonia. St. Petersburg has become the most important foreign city for the Finnish economy, as Anders Blom, the coordinator of the Finnish Advisory Group for the St. Petersburg City Government, has aptly concluded.

St. Petersburg's future strengthening is an axiom, which automatically also leads to increases in the flows of goods, services, money and people in the direction of the Gulf of Finland. Some of these flows are a threat, particularly to the environment of the Baltic Sea, but others offer huge opportunities to the firms in the Baltic Sea region and beyond.

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