

# Baltic Rim Economies

Estonia – Latvia – Lithuania – Poland – Baltic Russia  
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## Estonia

### GDP growth slowed down in the first quarter

Estonia's economy expanded by 9.8% in the first quarter of this year, the slowest rate in two years. Economic growth is still fast but somewhat decelerated compared to the previous quarters. As in 2006, growth in the first quarter of 2007 was based on the strong domestic demand, which increased by 16% y-o-y, mainly due to the growth in both household final consumption and capital investments by 18%. In terms of economic activity, the GDP growth was mainly related to manufacturing, wholesale and retail trade, transport, storage and communications, and financial intermediation.

Exports of goods and services grew by a mere 5% in the first quarter compared to the corresponding period of the previous year, mainly supported by the growth in service exports, up by 21%. Imports increased by 11%. There was a rapid 21% y-o-y surge in service imports, primarily influenced by the growth in the areas of sea and land transport. Once again, quarterly imports outpaced exports, pointing to persistent discrepancies in the current-account deficit.

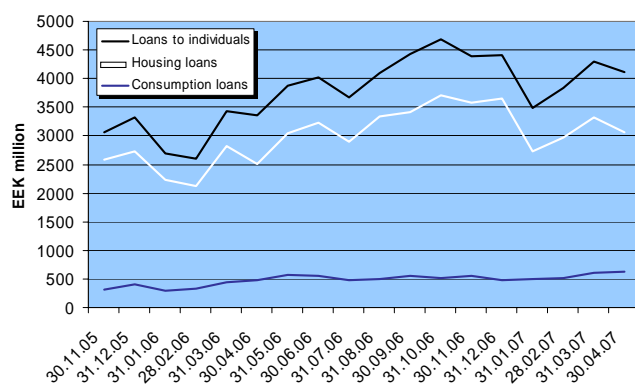
It seems that the economy is slowly entering a phase of more moderate growth. Rising interest rates are slowing consumption and property-market expansion, and will contribute to a further slowdown in the coming quarters.

### A 25% growth in the construction industry in Q1

According to Statistics Estonia, the total production of Estonian construction enterprises in the first quarter grew by 23% y-o-y, of which 22% was in the domestic market. The production value of construction enterprises amounted to EUR 447 million. The figures for building construction and civil engineering totalled EUR 358 million and EUR 89 million respectively, which is correspondingly 29% and 3% more than in the first quarter of the previous year.

According to the Bank of Estonia, the total value of outstanding loans to individuals at the end of April amounted to EUR 5.6 billion, an increase of 58% y-o-y. Approximately three-quarters of the new loans were for housing. Lending to companies grew by 52% during the year to EUR 5.9 billion, while loans to financing institutions fell by 17% to EUR 1.1 billion. The total value of outstanding loans issued by Estonian banks was EUR 13 billion at the end of April, compared with EUR 9 billion a year ago.

### Loans to households



Source: Bank of Estonia

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	9.8	1-3/2007
Industrial production (y-o-y %-growth)	14.6	8.9	8.2	11.0	8.0	9.7	7.0	10.5	4/2007
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	5/2007
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	596	660	Q1/2007
Unemployment (% end of period, LFS data)	13.9	11.9	11.3	9.3	8.5	7.9	5.9	5.3	Q1/2007
Exports (EUR million, current prices)	3 445	3 698	3 642	4 003	4 770	6 190	7 647	1 877	1-3/2007
Imports (EUR million, current prices)	4 615	4 798	5 079	5 715	6 704	8 213	10 576	2 624	1-3/2007
Current account (% of GDP)	-5.5	-5.6	-10.6	-11.6	-12.5	-10.5	-14.8	-10.4	1-3/2007

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

### Wages and labour costs up by a fifth in a year

According to Statistics Estonia, compared to the first quarter of 2006 the average monthly and hourly gross wages and salaries were up by 20% y-o-y. Average monthly wages were EUR 660 and the gross hourly rate was EUR 4 in the first quarter. Employers' average monthly labour costs per employee were EUR 886, and the average hourly labour costs were EUR 5.7. This was an increase of 19.9% and 21.1% respectively over the first quarter of 2006.

### No euro adoption before 2011

The Bank of Estonia has released a new report on the adoption of the euro, which has been delayed because of the relatively high inflation rate. According to the Governor, given the country's robust economic growth and price developments in the global commodity market, the current rise in consumer prices is inevitable. The level of inflation will not allow Estonia to introduce the euro before 2011. However, its adoption remains a priority and preparations continue.

### Parliament-approved tax amendments to decrease the tax burden

The new government approved a package of tax amendments on May 24th. According to the Ministry of Finance, Estonia's taxpayers will save some EUR 351 million over the next four years as a consequence of lower income tax, for example. The Minister of Finance emphasised that as a result of these measures the overall tax burden in the country would decrease from 31.1% of GDP in 2007 to 28.8% in 2011. However, the government will raise excise duties and taxes on tobacco, alcohol and petrol at the beginning of 2008, in compliance with EU requirements. The rise in excise duties may increase inflation to above 6%, perhaps to as high as 7%. Nevertheless, this is a good decision in terms of economic policy, and could ensure that Estonia will become a euro-zone member in 2011 or 2012.

### Some business highlights

- ELFA, the Sweden-based component distributor, has acquired the Estonia-based Tevalo group, a distributor of electronics products. Tevalo has been an ELFA reseller since 1998, and has subsidiaries in Latvia, Lithuania and Ukraine.
- Cargotec has agreed to buy Balti ES, an Estonia-based manufacturer of steel structures and components. The seller is AP Moller Maersk's Odense Steel Shipyard. Balti ES generated sales of EUR 14 million last year and has a workforce of about 600.
- Estonian casino operator the Olympic Entertainment Group (OEG) opened a new casino in the five-star Warsaw Hilton Hotel in May. The investment was worth EUR 7 million. OEG also plans to invest over EUR 30 million in the Polish market during the next two years.
- The BLRT Group, Estonia's largest ship repairer and builder, acquired Finnish ship-repair company Turku Repair Yard for an undisclosed sum. Turku Repair Yard handles up to 100 vessels a year.
- Nasdaq Stock Market Inc. took over OMX AB to create the world's largest global network of exchanges. The new group will be called The NASDAQ OMX Group.
- In the first five months of this year, Estonians purchased 37% more cars than a year ago. In five months 13,757 cars were sold, which is 3,700 more than in 2006. If the trend continues, one in every two Estonians will have a car in less than four years.

## Latvia

### GDP up 11.2% in Q1

Latvia's strong economic growth continued, as expected. The gross domestic product increased by 11.2% during the first quarter compared to the corresponding period in 2006. The steepest value-added increases were observed in trade (up by 16%), services (10%), manufacturing (2%), transport and communications (8%) and construction (17%). GDP growth was lower than in the previous quarter and the rate is expected to slow down to an annual level of 10%. However, the risk of overheating still exists.

The consumer price index maintained its exalted level in May, reaching 0.6% for the month and 8.2% y-o-y, the second highest inflation level in the EU. Although slightly down from April it is still four times as high as in the euro zone. According to the Central Statistical Office, the price rises in the transport sector had the greatest impact on consumer price changes in May. The food sector, which is strongly reflected in the inflation rate, showed only moderate growth at 0.6% m-o-m. The y-o-y prices of goods increased by 6.5%, and of services by 12.7%.

### The steepest growth in retail trade in the EU

The volume of retail trade grew by 24% in April y-o-y, which is the steepest increase in the EU and continues the trend of the four preceding months. According to Eurostat, the next steepest increase was recorded in Estonia, up by 14%, followed by Lithuania, up by 13%, and Poland, up by 10%. Latvia's Central Statistical Office data reveals that sales of motor vehicles, motorcycles and their parts, which went up by 41% in the first four months of 2007 compared to the same period last year, strongly contributed to this growth. The turnover of catering enterprises also increased y-o-y by 10%.

Latvia's trade deficit in the first four months of this year grew by 48% compared to the corresponding period of the previous year. Exports increased by 23% y-o-y in January-April (at current prices), and imports by 37%. Although the robust growth in exports was based on increases in all of the main product groups, the sharpest rise was observed in exports of base metals and related products (up by 51% y-o-y in Q1), machinery, and mechanical and electrical appliances and equipment (42%). The main export group, wood and wood products, still accounted for 24% of the total export value. On the import side, the steepest increase by product group concerned machinery, and mechanical and electrical appliances and equipment (56%). There was an eightfold increase in cigarette imports, and a threefold increase in the import of cement.

### Gross wages up by almost 33% in a year

According to the Central Statistical Office, average gross monthly wages and salaries in Q1 were EUR 508, while the monthly net wage reached EUR 368. The biggest increases were mainly in electricity, gas and water supply (up by 44% y-o-y), public, social and other services (41%), mining and quarrying (39%), construction (38%), and health and social work (37%). The y-o-y increases in the public sector reached 35%, and in the private sector 33%. The average hourly labour costs grew by 35% in the first quarter y-o-y, and increased from EUR 3 to EUR 4 during the first period.

The number of job vacancies in the country increased by 26% in Q1 compared with the same period in 2006. The increase was higher in the public sector, up by 30%, but it was also up by 22% in the private sector. At the end of Q1 in 2007

there were 21,600 vacant jobs in the country, 4,500 more than in the same period last year. Almost 70% of the vacancies were in Riga.

### Commodity prices in the Baltic countries

Average retail prices in April in euros	Estonia	Latvia	Lithuania
Electricity, kWh	0.08	0.07	0.10
Petrol 95, l	0.86	0.88	0.92
Vodka 40°, l	9.07	8.58	7.68
Milk, fat content 2.5%, l	0.43	0.61	0.52
Butter, kg	4.31	3.87	4.78
White bread, kg	1.13	1.11	1.08
Beef, kg	3.00	3.19	3.39
Chicken, kg	2.53	2.48	1.95
Potatoes, kg	0.55	0.51	0.54

Source: Statistics Estonia

According to a price survey carried out by the business dailies in all three Baltic States, the average monthly salary buys 568 sq. m in a newly renovated apartment in the Old Town of Riga, the highest price in the Baltic. The corresponding figure in Estonia is 1.115 sq. meters in the Old Town of Tallinn, and in Lithuania it is .960 sq. meters in a corresponding area. According to Mercer's survey, Riga was 72nd most expensive capital in the world. Compared to last year Riga has climbed 9 places in the ranking as in 2006 Riga was in the 81st place. Tallinn is the second costliest capital in the Baltic States, ranking in the 90th place in the world and climbing 6 places from the 96th place in 2006. Vilnius has changed 116th place in the ranking to 97th place climbing 19 places since last year.

### Some business highlights

- The government is preparing to invest tens of millions of euros in developing Liepaja airport. AirBaltic, in which Scandinavia's SAS has a 47% stake, flies from Liepaja to Riga, Copenhagen and Hamburg.
- Alta Capital, the rapidly expanding Estonian investment firm, has acquired an 80% stake in Rigas Piensaimnieks (Riga Dairy Farmer), the third largest dairy in Latvia.
- EBO International Ltd, a Norwegian-owned investment and property-development company, is planning to create a large-scale business park next to Riga Airport with an investment of EUR 400-500 million.
- According to the Latvian Authorized Autotrader's Association, 14,065 new cars were sold during the first five months of this year, up by 56% over the same period last year. Toyota was rated top, and Skoda was in second place.
- The Latvian government has given the green light to a proposal to sell off the Lattelecom electronic services provider to the company's executives and employees. Lattelecom management plans to buy the company for EUR 413million.
- Inchcape, one of the world's biggest car dealers, has agreed to purchase Baltic Motors and BM Auto for up to EUR 90 million from MVC Capital Inc., a publicly traded business-development company.
- At the end of May the line of lorries waiting to cross the border from Latvia into Russia reached 1,900, a new record, and all indicators show that lorry traffic on the Russian-Latvian border will only increase in the future.
- In line with the Government's inflation-curbing plan, from June 12<sup>th</sup> this year additional tax must be paid when registering cars with an engine capacity of over three litres.
- Sakret LT, a subsidiary of Latvian manufacturer of concrete mix Sakret, is planning to open a new factory in Lithuania with an investment of about EUR 8 million.

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	10.6	11.9	11.2	1-3/2007
Industrial production (y-o-y %-growth)	3.2	6.9	5.8	6.5	6.0	5.6	4.8	-0.9	4/2007
Inflation (CPI, end of period, y-o-y %-change)	1.8	3.2	1.4	3.6	7.3	7.0	6.8	8.2	5/2007
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	430	508	Q1/2007
Unemployment (% end of period, LFS data)	13.3	12.9	11.6	10.3	10.3	8.7	6.8	6.9	Q1/2007
Exports (EUR million, current prices)	2020	2 232	2 416	2 559	3 204	4 086	4 594	1 737	1-4/2007
Imports (EUR million, current prices)	3 453	3 910	4 284	4 634	5 671	6 879	8 828	3 397	1-4/2007
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

### First-quarter GDP up 8.3% in a year

GDP in Lithuania increased by 8.3% year-on-year in the first quarter. The revised result is 1.2% higher than the previous estimate (7.1%). The difference was brought to light in the quarterly information on construction volumes, which showed faster-than-expected growth at 43% y-o-y. The construction sector has experienced the fastest growth in value added for the sixth consecutive quarter. High growth rates have also been observed in trade, and in the hotel and restaurant and transport and communications sectors, both up by 12%; financial mediation, property and other business services increased by 11%. Due to the strong domestic consumption, y-o-y imports rose by 16% in the first four months of this year, while exports grew by 7%. The foreign trade deficit reached EUR 1.6 billion, up by 49% y-o-y.

The Minister of Finance estimates that Lithuanian GDP growth may exceed 8% this year: earlier projections suggested 7.2%. It is also expected that domestic consumption will continue to be driven by borrowing and strongly declining unemployment.

### Earnings up by a fifth in a year

According to Statistics Lithuania, average gross monthly earnings in the whole economy (individual enterprises excluded) in the first quarter of 2007 totalled EUR 504, up by 21% y-o-y - EUR 513, up by 18% y-o-y, in the public sector and EUR 498, up by 23%, in the private sector. The Average net monthly earnings in Q1 were EUR 379, up by 28% y-o-y. The steepest rises were in the construction sector, up by 33% y-o-y, and in the manufacture of basic metals and fabricated metal products, up by 25%.

The Cabinet decided to raise the minimum monthly wage from EUR 174 to EUR 205, and the minimum hourly rate to EUR 1.20, as of July 1<sup>st</sup>. According to Statistics Lithuania, 15% of the labour force are paid the minimum monthly wage or less, and 8.5% of all employed people receive the minimum monthly wage for full-time work.

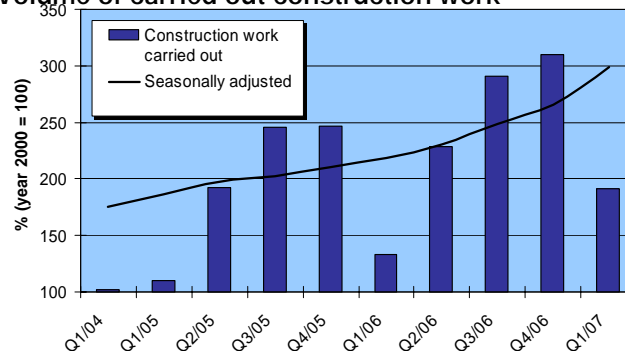
The number of unemployed in Q1 reached a five-year low and stood at 79,500. The rate fell to 5% during the period, down from 6.4% in Q1 of 2006. At the same time, the number of job vacancies has increased. According to the Statistics Department, there were 24,700 vacant jobs in Lithuania at the end of the first quarter, a 1.6-fold rise y-o-y. The highest numbers of vacancies were in the manufacturing, trade and education sectors, and the lowest numbers were in fisheries (0.2%), agriculture, hunting and forestry, and hotels and catering (1.4% of all vacancies).

### Housing prices up 33% in Q1

According to a report published by the Register Centre, housing prices increased by 33% in the first quarter of this year compared to the corresponding period of last year. Compared with Q4 of last year, however, the growth rate was up by around 10%. Housing prices in Vilnius rose by 28% y-o-y and by 1.7% quarter-on-quarter. This suggests that property prices have stabilised in the capital. Experts claim that inadequate supply of new housing has been the main driver. The main obstacles to property development in Lithuania continue to be the red tape surrounding the granting of construction permits, and land problems.

Statistics Lithuania reported that Lithuanian builders carried out construction work worth a total of EUR 480 million during the first quarter of 2007, a surge of 43% y-o-y. The total value of construction work undertaken by Lithuanian companies within the country increased very rapidly, by 99%, while the value of work carried out abroad edged up by 1%, to EUR 3.8 million. New construction was valued at EUR 285 million and accounted for almost 60% of the total volume of construction work carried out in the country in the period. According to preliminary estimations, total quarterly investments in the construction sector grew by 47% y-o-y, of which about 14% went to residential construction.

### Volume of carried out construction work



Source: Statistics Lithuania

### Some business highlights

- Arosa Vermoegensverwaltungsgesellschaft, a German investment firm, was given permission to buy 50% of Ozantis, a project involving the creation of a shopping and entertainment centre, Ozas, in Vilnius.
- The Polish company PKN Orlen, owner of Mazeikiu Nafta, intends to invest over USD 1.6 billion in the next six years to raise the value of the oil refinery. The refinery is expected to be operating at full capacity by the end of this year.
- Representatives of 502 Lithuanian companies have picked Verslo Zinios, Valstieciu Laikrastis and LTV as the most transparent media enterprises. This was the result of a survey carried out by the market-analysis and research group RAIT for the Lithuanian office of Transparency International in April and May 2007.
- Lithuania's shipyard Vakarų Laivų Statykla has signed a EUR 43 million agreement to build a special-purpose ship. The Klaipėda company will construct the ship for the German company BARD Engineering GmbH. The 102-meter-long and 36-meter-wide vessel will be completed in March 2009.
- U.S.-based media firm Alro Media has purchased a majority stake in the publisher of Panevezio Balsas, a regional daily paper.
- A pulp mill will be built in Alytus. The project was given the green light by the Alytus regional development board, even though it had been rejected in February. Project investments will be around EUR 1.2 billion and 700 new jobs will be created.
- Several leading timber companies and furniture makers have submitted a proposal to the government to build a EUR 200 million wood-processing plant in eastern Lithuania. The investors, who presented their proposal to the Prime Minister on June 7, would build the new plant in the eastern district of Svencionys.
- The first fish auction in the Baltic States has been set up in Klaipėda. It will serve wholesalers of fish caught in the Baltic Sea and will offer fish-sorting, refrigeration, packaging, cleaning and other services.
- Euler Hermes, the international credit insurer, estimates that insolvency and bankruptcy in Lithuania will increase this year, largely due to the global slowdown in economic development and the growing number of bad debts.
- According to Hansabanka's experts, funds of funds have become one of the fastest growing investment options in Lithuania.

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	6.9	10.3	7.3	7.6	7.5	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	3.7	4/2007
Inflation (CPI, end of period, y-o-y %-change)	1.4	2.0	-1.0	-1.3	2.9	3.0	3.8	4.8	5/2007
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	459	504	Q1/2007
Unemployment (% end of period, LFS data)	16.9	17.9	13.0	11.6	10.6	8.3	5.6	5.0	Q1/2007
Exports (EUR million, current prices)	3 841	4 778	5 526	6 158	7 478	9 502	11 250	3 774	1-4/2007
Imports (EUR million, current prices)	5 650	6 767	7 943	8 526	9 959	12 446	15 384	5 348	1-4/2007
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

### Largest GDP growth for ten years

The growth in GDP in the first quarter of 2007 equalled 7.4%, which is the highest level for ten years. Economic growth was also higher than expected. The rapid pace was caused by domestic demand: private consumption grew by 7% y-o-y, while gross fixed capital formation soared by 30%. As in the last two quarters of 2006, growth in domestic demand was higher than in GDP, and reached 8.6%. The negative effect of foreign trade on GDP growth was abated somewhat by strong exports. Poland exported goods worth more than EUR 26 billion in the first quarter, representing nominal growth of 14% y-o-y. Imported products, in turn, surpassed exports, totalling EUR 26.4 billion, up by 15% y-o-y. The strong domestic demand had only a small effect on the trade deficit. It was below EUR 3.1 billion, which represented approximately 4.5% of GDP in Q1.

The record performance in the first quarter raised expectations: second-quarter growth in GDP is expected to be about 6.5%. Forecasts for the whole of 2007 project an average level of 6%.

The strong growth has not increased inflation, and in May the consumer price index was 2.3% y-o-y. During the year the steepest rises were in the prices of food (4%), goods and services related to housing (4%), hotels and restaurants (3%), and fuel (3%). Clothing and footwear prices decreased by 7%.

Industrial output rose by 13% y-o-y in the first four months of this year, thus continuing the strong increase observed in the previous quarters.

### Property markets booming

Economic growth was also boosted by strong growth in the building sector. Robust investment has produced record results in the construction industry. Construction-assembly output rose by 37% y-o-y in April, being slightly lower than in the previous month. As a result, output in the first four months of this year was more than 50% higher than in the corresponding period last year.

Even though unemployment is very high, companies are finding it difficult to recruit staff. The Confederation of Polish Employers estimates that there is currently a shortage of about 200,000 specialists in the country. One in three building companies and one in nine manufacturing plants are looking for workers. The situation is getting worse in the building industry, and some companies are even withholding investments.

### Unemployment down to 13%

The Polish labour market is being transformed due to the strong economic development. According to the Labour Ministry, the unemployment rate fell to 13% in May, down from 13.7% in April. The drop was due to the need for seasonal workers in gardening, construction, road building and tourism. Another reason is emigration: hundreds of thousands of Poles work abroad, especially in Britain and Ireland. There is currently concern that too many young, skilled workers have left the country.

According to the latest estimates by the European Commission, the unemployment rate in Poland will go down to 9% by 2009. The rapid growth in demand for labour has constantly pushed the unemployment rate downwards and wages upwards. The average gross monthly wage in Q1 of

this year amounted to EUR 679, representing a 7.1% y-o-y increase, and in the corporate sector in April it was EUR 730, up by 8.4% y-o-y. Labour productivity in the first quarter rose to approximately 9% y-o-y.

### Foreign direct investments down y-o-y in Q1

Last year was record-breaking in terms of foreign direct investment channelled to Poland. According to the Bank of Poland's preliminary estimations, the first quarter of this year is lagging behind: FDIs were down by 28% compared to the corresponding period last year.

In May the Warsaw Voice gave awards to companies that had made the biggest greenfield investments in Poland. The winner in the largest investment category was the U.S. Dell Corporation, which plans to build a EUR 200 million computer factory in Lodz, creating 3,000 jobs.

### Biggest foreign investments in Poland in 2006

THE BIGGEST FOREIGN INVESTMENT IN POLAND IN 2006	
Investor	Investment value
1. Dell Poland Sp. z.o.o.	EUR 200 million
2. Bridgestone Standard Sp.z.o.o.	EUR 200 million
3. Green Source Poland Sp. z.o.o	EUR 150 million
3. Sharp Manufacturing Poland Sp. z.o.o	EUR 150 million
5. Indesit Company Polska Sp. z.o.o.	EUR 80 million
THE BIGGEST FOREIGN INVESTMENT IN TERMS OF NUMBER OF JOBS IN THE PRODUCTION SECTOR IN POLAND IN 2006	
Investor	Jobs
1. Sharp Manufacturing Poland Sp. z.o.o.	3000
1. Dell Poland Sp. z.o.o.	3000
3. Indesit Company Polska Sp. z.o.o	1313
4. Shell Polska Sp. z.o.o	800

Source: The Warsaw Voice no. 21/2007

### Some business highlights

- The LG Technology Park, grouping together nine factories of the LG Electronics concern, was opened in May, in Biskupice Podgórne near Wrocław. The South Koreans are investing EUR 800 million over the next four years in a manufacturing plant that will mainly produce LCD modules and domestic appliances. It will offer work to almost 12,000 people.
- Amcor, an Australian packaging company, plans to build its third factory in the Lodz Special Economic Zone (SEZ). The investment is worth EUR 20m and will employ 70 people at the outset.
- The German company MTU Aero Engines will invest EUR 50 million in a new factory in the city of Rzeszów. Initially, the factory will employ about 100 people.
- The American firm Summit Packaging will build its first Polish factory in Tarnów, for manufacturing aerosol valves. The plant will be operational by September of this year. The value of the investment is estimated to be EUR 4 million, and it will offer work to about 60 people.
- Marcegaglia, an Italian steel-processing company, plans to open a tube plant in Kluczbork at a location controlled by the Walbrzych SEZ. The planned investment will be worth EUR 250 million and will create 1,000 new jobs.
- The American company 3M has started to build an industrial adhesive tape factory in Wrocław. The investment is worth EUR 16 million, and once completed the factory will offer work to 75 people.
- TPV Technology, a Taiwanese-Chinese electronic concern, plans to build an LCD monitor and television factory in the Kostrzyn-Slubice SEZ. The EUR 41 million investment will create approximately 1,200 new jobs.
- The net profit of the Polish banking sector increased by 22.3% y-o-y in the first quarter of 2007.
- ABN Amro is planning to recruit 1,000 employees at its competence centre in Warsaw by the beginning of 2009. Currently the Warsaw office employs 150 people.
- Indesit is investing EUR 80m in the construction of a new washing-machine and dishwasher factory in the Lodz SEZ. The new plant will employ approximately 1,500 people.

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	7.4	1-3/2007
Industrial production (y-o-y %-growth)	6.7	0.6	1.1	8.3	12.6	4.1	5.7	8.1	5/2007
Inflation (CPI, end of period, y-o-y %-change)	8.5	3.6	0.8	1.7	4.4	0.7	1.4	2.3	5/2007
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	720	Q1/2007
Unemployment (% , last survey in the year, LFS data)	16.0	18.5	19.7	19.3	18.0	16.7	12.2	11.3	Q1/2007
Exports (EUR billion, current prices)	34.4	40.4	43.4	47.5	59.7	71.4	87.5	23.4	1-3/2007
Imports (EUR billion, current prices)	53.1	56.2	58.3	60.4	71.4	80.6	100.0	26.4	1-3/2007
Current account (% of GDP)	-6.0	-2.9	-2.6	-2.1	-3.5	-1.7	-2.3	-4.5	1-3/2007

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

## St. Petersburg

### Industry grows, but more slowly than services

March-April 2007 saw significant increases in all sectors of the St. Petersburg economy. Some sectors experienced not only continuing but also accelerated growth. Industrial production is a shining example: it expanded in January-April 2007 by 11.4% compared to the corresponding period in 2006, although it was more modest in January-February 2007 (10.5%): during the first four months of 2006 industrial output rose by only 5.4% y-o-y.

### Regional economic developments

	Jan-Apr	
	2006	2007
Industrial production, y-o-y, %	-7.0	11.4
Manufacturing	-8.7	12.2
Energy, gas and water production*	8.3	10.7
Construction, y-o-y	35.6	15.3
Transport, y-o-y, %	20.9	14.2
Communication, y-o-y, %	38.3	25.8

Source: Petrostat, 2007

\*- also includes energy, gas and water distribution

As far as industrial growth was concerned the main contributors were large and medium-sized enterprises: this group alone (excluding small businesses) showed a 14.8% rise in output during the four first months of 2007. To a certain extent this resulted from the activities of large companies that had recently entered the market. *Gazpromneft*, for example, increased its output of mineral products four-fold. Metal production and metalworking expanded by 22.0% y-o-y in January-April 2007. Petrochemical companies increased output by almost 50% y-o-y following the fuel and lubricants price rise in 2005-2006.

Nevertheless, significant increases were reported in sectors focused on regional consumption, namely the textile industry and in the production of shoes and leather goods: the first four months of 2007 saw growth of 19.1% and 28.3% respectively.

In general, the service sector developed at a higher rate than industrial production, proving the diminishing importance of the latter for the regional economy. Particularly rapid development characterised the communication and retail-trade sectors, although some smaller service sectors and sub-sectors experienced similar growth - 20% y-o-y in catering in January-April 2007.

### Infrastructure boom on the agenda

The growth in the St. Petersburg economy and the positive investment performance of the region require improvements in the infrastructure. According to Governor V. Matvienko, its poor state has become the basic obstacle to further development. The priority projects aimed at solving this problem include the building of new electricity-generating facilities and networks, and the development of the regional transport system.

The City Administration and Russia's energy monopoly RAO UES signed a long-term development programme covering the period up to 2010, the planned investment totalling nearly EUR 8.7 billion. *Lenenergo*, the regional subsidiary of RAO UES, allowed the city to become a company co-owner with a share of 25.1%. This will give the city the opportunity to co-ordinate its plans with the local supplier of electric energy, and to invest money from the regional budget in the renovation of the municipal energy network. The Western High-Speed Road and the Orlovski Neva Tunnel could be mentioned among the large-scale projects in the transport sector being financed by the regional government.

### Foreign investment and trade increase rapidly

The "external" sector of the regional economy continued to grow in the first quarter of 2007, following the previous trend. Foreign investments more than doubled compared to the same period in 2006. The main engines of the continuing investment boom were FDI, which rose by 280% y-o-y, and portfolio investment with a 53.8-fold increase y-o-y. This changed the whole structure of foreign investment in the region. The share of FDI in the total FI volume grew from 20.8% in the first quarter of 2006 to 36.4% in the same period of 2007. Portfolio investment increased much more impressively: from 0.4% in January-March 2007 up to 8.9% of the total in the period. Other investment prevails in the structure, but the proportion decreased from almost 80% to a little more than a half of all foreign investment in the St. Petersburg economy: there was just a 50% increase in the reviewed period. Steep growth in the city's foreign trade has resulted in the doubling of exports and a 70% increase in imports in January-March 2007, y-o-y.

### Some business highlights

- The forthcoming St Petersburg Economic Forum to be held on June 8-10 is expected to be a more prestigious event than previously. At least this time it will be attended by Russia's vice-premier Sergey Ivanov, the "father" of liberal reforms Yegor Gaidar, President Vladimir Putin, and top managers from the largest multinationals (Royal Dutch Shell, BP, Citibank, Fortum, Gaz de France, TeliaSonera, PepsiCo, Deutsche Bank, BHP Billiton and Scania, for example).
- The regional budget continued to grow in the first quarter of 2007; revenues increased by 17% y-o-y. The current surplus reached 30% of budget revenues.
- The owners of the St. Petersburg Big Seaport agreed on a long-term (up to 2015) development programme with a planned investment of EUR 550 million. The aim is to create two new terminals for container and automobile cargoes, and to improve transport access to the port.
- General Motors re-scheduled its investment programme for an automobile plant to be constructed near the city. Its projected annual output was raised from 25 to 70 thousand vehicles, and the investment increased from the previous EUR 90 million to the new figure of EUR 230 million.
- British engineering company Acertec Holdings Ltd. entered the new regional automobile cluster, planning to invest around EUR 58 million in building a plant for automobile components near St Petersburg by 2009.
- Finnish catering company Fazer Amica, a member of the Fazer Group, entered the rapidly growing St Petersburg catering sector. The company has thus started to diversify its business in the region (previously it focused on bread production).
- The Scandinavian CRAMO group will start its expansion on the St Petersburg market for construction equipment leasing with a planned investment of EUR 7 million in 2007; the whole target market is estimated to reach EUR 72 million quite soon.

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	11.4	1-12/2006
Industrial production (y-o-y %-growth)	26.2	0.2	31.4	5.8	14.1	4.2	-7.0	11.4	1-4/2007
Gross average wage (monthly, EUR)	n/a	n/a	217	209	285	344	407	451	3/2007
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	1 224	1-3/2007
Imports (EUR million, current prices)	2 693	4 423	5 158	5 123	5 560	8 081	10 299	2797.4	1-3/2007
FDI inflow (EUR million, current prices)	158.4	126.8	88.9	62.1	90.0	200.5	512.4	185.1	1-3/2007

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

### Unexpected stagnation in basic sectors

Despite comparatively good performance in the first two months of 2007, the core sector of the local economy, namely industrial production, showed almost zero growth in March-April. This was the result of a sharp 28.5% y-o-y decline in the biggest branch, food production, which alone accounted for 26.9% of the region's manufacturing output. Outstanding results from other industries, including rubber and plastics production with y-on-y growth of 34.2% during the first four months of 2007, could not compensate for this fall due to their much lower share of the total output. The basic reason for the decline was the strengthening of the Russian rouble and the rapid increase in imported foodstuffs, which accounted for 33.9% of total imports in the first quarter of the year.

### Regional economic developments

	Jan-Apr	
	2006	2007
Industrial production, y-o-y, %	5.9	0.5
Construction, y-o-y, %	7.9	-3.2
Transport, y-o-y, %	20.1	49.3
Agriculture, y-o-y, %	8.2	0.2
Communication, y-o-y, %	15.7	12.8
Retail trade, y-o-y, %	22.0	9.0

Source: Petrostat

The construction sector expanded by 16.6% y-o-y during the first quarter of 2007, but in April faced a fall of 34% on the previous month. This could have been the result of market stagnation at a currently high price level. Future development in the sector depends very much on prices, which should decrease and make property more affordable, thereby enticing purchasers to return to the market.

The leading regional pipeline company *Baltnefteprovod* increased the internal transport tariffs for oil exporters, which became the main reason for the growth in the sector. Nevertheless, physical volumes of cargo processed by the regional transporters rose by 12.2% y-o-y. The basic contribution was made by the stevedore companies of the Vyborg, Primorsk, Vysotsk and Ust-Luga seaports, which processed a 23% higher volume of cargo in January-April 2007 than they did a year ago.

Agriculture, the region's traditional sector, stagnated further. However, some structural changes are taking place. The total area of sown ground as of May 1, 2007 was 2.4 times larger than a year ago, which might lead to bigger grain crops in the autumn. On the other hand, the root-vegetable crop yield was 30% lower than in 2006. Hog livestock had increased 40% y-o-y by May 1, 2007, while there were 20% fewer sheep y-o-y. This reflects a shift to more technological and efficient arable and livestock production.

### Wage growth accelerates

Real wages continue to grow in the region, and the growth rate is accelerating: at the end of 2006 it was 14.4%, while

at the end of the first quarter of 2007 it was already 18.6% y-o-y. Increases in wages vary widely depending on the sector of economic activity. The highest growth in the average wage was reported by the construction sector (41.9%), trade (38.2%) and the hotel business (35.3%), while growth in other sectors was more moderate. Real incomes also continued to expand in January-March 2007, 13.6% y-o-y. Wage growth in Leningrad province was higher than in the neighbouring St Petersburg. City wages increased by 17.4% y-o-y, and real monetary incomes rose by just 7.1% in the first quarter of 2007. This could be explained partly by the prevalent large gap between wages and incomes, which is now becoming narrower.

### Rapid increase in FDI and foreign trade

The 60% growth of foreign investment in the Leningrad region in the first quarter of 2007 was less impressive than in St Petersburg, but also prominent. FDI made the main contribution to this result, and the share of direct investment reached 63.4% of the total foreign capital inflow. Of all foreign investment 70.9% came to the manufacturing sector and, surprisingly, 16.3% to real-estate operations. In terms of geographical structure, Finland dominated in January-March 2007 was, with a 27.9% share of the total, leaving the traditional offshore investor Cyprus far behind (second with 16.5%).

Foreign trade continued to increase in the region. However, imports rose by 35.1% y-o-y in the first quarter of 2007, faster than exports with a 23.7% growth. The proportion of mineral products in regional exports reached 81.7%; 89% of this commodity group comprised oil and oil products. Almost all oil exports went to fuel-trading companies registered in Switzerland and Great Britain, which turned out to be the leading export partners (accounting for 38.4% and 32.2% of total exports, respectively).

### Some business highlights

- In May 2007, the regional energy supplier Baltenergo and the Swedish companies Svenska Kraftnat and Basel agreed on building an underwater cable link across the Baltic Sea between the town of Sosnovy Bor and a region south of Stockholm. The planned construction investment amounts to EUR 300 million, and the total volume of energy supplies from the Leningrad region to Sweden over 15 years may exceed EUR 4 billion.
- The regional energy-generating company TGK-1 put out a tender for the reconstruction of two hydropower stations on the Vuoksi river in the Leningrad region. The tender was won by the large St Petersburg company Silovye Machinery; the planned investment totalling EUR 160 million. This marks the start of a large regional power-station reconstruction project with a budget of EUR 3.8 billion.
- The Russian government agreed to become a co-investor in a new vehicle terminal, Jug-2, in the Ust-Luga seaport with an annual capacity of 360 thousand automobiles, and to invest EUR 60.7 million in this project from the budget. The total volume of investment the project has attracted is EUR 240 million.
- The Russian construction company ROSSTRO invested EUR 10 million in building its second construction-materials plant in Kingisepp.
- The market for countryside cottages in the region doubled in volume in 2006. This led the Russian and Finnish construction companies Olimp 2000, M-industria, the Seti Group and Rossa Rakenne SPb to enter the market with huge development plans.

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	0.5	1-4/2007
Regional inflation (CPI, y-o-y %-change)	23.5	19.6	14.8	13.0	14.9	12.0	9.9	4.0	4/2007
Gross average wage (monthly, EUR)	105	141	152	173	190	259	324	349	3/2007
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	1 323	1-3/2007
Imports (EUR million, current prices)	328	810	939	1 061	1 372	2 562	2 858	696	1-3/2007
FDI inflow (EUR million, current prices)	222.5	266.0	121.9	104.5	106.6	178.7	288	50.7	1-3/2007

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

## Kaliningrad region

### Manufacturing continues to expand rapidly

Industrial-output growth remained strong in the first four months of 2007 – increasing by 60% over the same period in 2006. It was heavily concentrated in the manufacturing sector, which showed a 2.6-fold increase y-o-y. The main engine of the manufacturing growth was an upsurge in the production of cars and TVs assembled from imported parts: production in April 2007 was 5.2 and 2.8 times higher, respectively, than a year previously. Although these figures were somewhat inflated by the weak performance of manufacturing in the first half of 2006, growth in process manufacturing is likely to remain strong for the rest of the year given the flow of news about new contracts concluded by Kaliningrad companies for the production of TVs and transport vehicles.

### Growth rates by sector, y-o-y, %

	2006	2007
		Jan-Apr
Industrial production	68.2	59.9
Mining	17	1.8
Manufacturing	40.6	155.5
Utilities	370.0	21.7
Construction	-8.9	65.4
Retail trade	16.1	16.2

Source: Kaliningradstat

### Construction boom

The boom in residential construction that started in 2006 does not show any signs of a slowdown: in the first four months of 2007 construction companies built the same volume of residential properties (197,000 sq. meters) as in the first six months of 2006, which itself was a record year. Consumer demand for new housing is buoyed up by rapidly rising incomes and the greater availability of long-term financing. The stock of residential mortgage loans grew by 32% in Q1 alone (although from a low base: on April 1<sup>st</sup> the total stock was just EUR 58.3 million). Despite a large increase in the supply of residential property, prices continued to climb rapidly – prices of new apartments soared by 43.5% in Q1.

### Investment paradox

Investments in fixed assets increased by 26.9% in January-April of 2007, y-o-y. However, the fastest-growing sectors in manufacturing are not investing much. For example, investments by companies engaged in the production of transport vehicles and electronic equipment (including TVs and other home appliances) comprised only 0.7% of total fixed investments in manufacturing in Q1, 2007. At the same time, although output in food processing declined by 3.8% in the first four months of 2007, company investments in this sub-sector comprised 74% of the total investments in manufacturing. One quarter is too short a period to enable any conclusions to be drawn, but it was not very unusual: current manufacturing growth in Kaliningrad is not based on significant investment. Many officials hope that the new law on the Special Economic Zone (SEZ) that came into force in April 2006 will change this situation.

Another interesting fact is the significant shift in the sources of investment financing. The proportion of companies' own funds decreased to 36.3% in Q1 compared with 70.3% in 2006. At the same time, the proportion of bank loans increased from 5.8% to 30.8%.

### Foreign investment: a temporary peak?

The first months of 2007 have also seen a significant increase in foreign inward investment in Kaliningrad. The total foreign-investment inflow in Q1 was EUR 33.1 million, which included EUR 10.0 million of foreign direct investment (FDI). FDI grew by a factor of 5.6 y-o-y. Of this, 76% came from just one country – Cyprus. Since this is a country that is often used by Russian residents as an offshore haven for their money, some of these funds are likely to include repatriated Russian money.

### Consumer inflation slows down

After a peak in consumer prices in February due to the traditional annual increase in housing tariffs, consumer-price inflation started to decrease, and closely followed the 2006 pattern. CPI increased by 0.8% in March and 0.7% in April.

### Labour costs increase rapidly

The rapid growth in business activity has kept demand for labour very strong, and this has fuelled wage growth. Many indicators and anecdotal evidence show that the situation on the labour market is strained. The number of registered unemployed dropped to 6,900 in April 2007 from 8,500 a year previously. Although the size of the labour force is increasing due to immigration and an increased participation rate, it has not slowed down growth in wages. Gross monthly salaries reached EUR 344 in March, and increased in real terms by 19.3% y-o-y. Such rapid growth will undermine the competitiveness of Kaliningrad's companies if productivity growth does not keep pace.

### Some business highlights

- At the end of May the total number of registered investors in the Kaliningrad SEZ reached 39 and the total volume of committed investments was RUR 21.3 billion (EUR 610 million).
- The Minister for Economic Development and Trade, G. Gref, announced that the Federal Target Programme for the Kaliningrad Oblast will be extended for five additional years until 2014. It will potentially bring additional investment from the federal budget in Kaliningrad's infrastructure.
- RAO UES delayed construction of the second unit of the new Kaliningrad power plant because Gazprom refused to commit to supplying it with natural gas. Electricity consumption in the region is growing rapidly, and according to the regional government there may be a power deficit in two years.
- Kaliningrad TV manufacturer Baltmixt signed an agreement with Matsushita Electric to produce about 300,000 Panasonic LCD TVs p.a. for the Russian market. Earlier Baltmixt had signed a similar contract with Sony.
- The Kaliningrad-based airline KD-Avia is planning to start flights to 12 cities in Europe and 11 in Russia in June. The airline doubled its number of passengers to 584,000 in 2006.
- U.S. design company IdeAttack presented its "Amber Coast" proposal for the Kaliningrad gaming zone, which will require investment of up to US\$ 20 billion.
- At the same time, opponents of the gaming zone decided to create the NGO "People against the gaming zone", and have been collecting signatures to initiate a referendum against such a zone being sited in the Kaliningrad region.

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	59.9	1-4/2007
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	4/2007
Gross wage (period average, EUR)	67	99	125	137	155	193	275	325	Q1/2007
Unemployment (% end of period, LFS data)	15.6	10.6	7.1	7.5	6.4	5.9	5.9	4.5	Q4/2006
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	10.0	1-3/2007

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



## Patience is a virtue in EU-Russia relations

by Olli Rehn

Since the 2004 enlargement, the Baltic Sea cooperation is developed more and more in the context of the EU-Russia relations. This provides good basis for further development and deepening of the cooperation. But at the same token, these relations are also burdened by the overall situation in the EU-Russia relations.

The European Union is ready for closer partnership with Russia, once Russia is also ready for that. This would be for our mutual benefit. There is a positive interdependence between the EU and Russia. What is now needed is a willingness to solve common problems in a business-like manner without politicising them unnecessarily.

In its internal dealings the EU bases itself on the principle of the rule of law and in its external relations on the principle that "might is not always right". This is why the EU endeavours to resolve conflicts on the basis of facts and in line with the international law.

At the EU-Russia relations, the EU has shown strong solidarity with its individual Member States. EU's solidarity is demonstrated, for example, in the case of Finland, where the EU defends Finland's legitimate interests in the dispute over export duties on roundwood; and for Estonia in the case of removal of the war monument. Solidarity between the 27 member states is not an empty word but one of the basic values of the EU.

### Reasonable and realistic cooperation

The relationship between the EU and Russia is marked by strong interdependence. Since 2000, EU exports to Russia have tripled and over the same period EU imports from Russia have doubled. This positive development has benefited in particular the states and businesses around the Baltic Sea. It has made this region a centre of economic growth, trade and investments. There is a great potential in the Baltic Sea area which can be materialised even further.

The interdependence is seen in the energy relations. Europe will remain dependent on Russian fossil energy for many years, even though it is trying to improve its self-sufficiency and create new import routes through South-East Europe. Russia needs EU's energy demand and market. Russia is also dependent on EU technology and business, without which it will not be able to reform its economy.

The interdependence between the EU and Russian can create the basis for reasonable and realistic cooperation, and we should build on this.

An EU – Russia cooperation agreement based on shared interests is in the long term just as important for the EU as it is for Russia. The EU is trying to achieve a comprehensive and legally binding agreement with Russia that builds on the previous arrangements and extends to issues like energy.

The same drive towards common rules applies also to Russia's membership of the World Trade Organisation. The EU supports this objective. Efforts are under way to conclude the negotiations still this year. The opening-up that the WTO membership will bring supports the competitiveness and diversification of Russia's economy. It would be in EU's and Russia's interest to adopt the rules of the game and improve predictability in our trade relations.

Even if the EU – Russia relations have hit a sticky patch, it has been important to keep the EU-Russia dialogue alive and channels of communication open.

There have been some positive steps in 2007. People-to-people contacts between EU and Russian citizens became easier as the visa facilitation agreement entered into force at the beginning of June. This benefits most the people and business contacts in border regions and facilitates further also the Baltic Sea cooperation.

There have also been positive developments in the policy of the Northern Dimension which has offered a good and solid framework for the EU-Russia cooperation in the Baltic Sea region. In the EU-Russia Summit in 2006, during the Finnish Presidency, the Northern Dimension entered a new phase when it became a common policy between the EU, Russia, Norway and Island. Russia and President Putin committed to develop common policy for North-West Russia. President Putin, coming from St Petersburg, understood the possibilities offered by closer political cooperation and economic development in the Baltic Sea.

In the future, we need to develop the economic potential and tackle ecological concerns in the Baltic Sea region. The strategic importance of the Baltic Sea will increase as it is becoming an important hub for energy transports.

### New challenges ahead

Russia is going through a phase of political transformation. As regards domestic politics, the elections to the Duma will take place in December and the presidential elections next spring. There is speculation regarding Putin's role after his presidential term and who will be his successor. The uncertainty in domestic politics is manifesting itself in a hardened foreign policy. One example of this is Russia's position on the future status of Kosovo which is discussed in the UN Security Council.

### Stand firm, stand united

The EU's relationship with Russia is at times something of an acid test for the EU (and sometimes a bit of a headache too), but it is also a great opportunity.

I do not believe that trading insults or cutting off dialogue would produce any results. Megaphone diplomacy rarely bears any fruit. At the same time, I do not believe that an over-flexible policy of appeasement would produce anything positive either.

What is needed is for the EU to speak with one voice, also about difficult issues, and commit itself to long-term co-operation with Russia. This should be based on a realistic assessment of the situation. There will be times when our patience will be tried, but those are precisely the times when it is most needed. Now is not the time to lose our patience.

*Olli Rehn*

*Member of the European Commission*



## The future of Estonian economy and economic policy

by Juhan Parts

When I took the office of Minister for Economic Affairs and Communications in April this year, some people were joking that they envy me, because our economy is doing well and my task would be fairly easy, as the main challenge would be finding a comfortable chair to sit in and marvel the growth curve. On one hand, of course there are reasons for complacency – economic growth of 11,4% in 2006 and average growth of 9% during 2001-2006 or unemployment falling to 5,9% by the end of 2006 which is lowest in many years – are all nice numbers. But on the other hand, such a starting point puts high pressure on new government to find and implement policies to keep this “Baltic tiger” running and avoid overheating.

The success of Estonia has been built upon hard work, smart policies and good neighbours. One of my priorities will be keeping and developing our open, simple and transparent business environment. Estonian liberal economic policy has resulted, and for good reasons I think, in high rankings in various indices – 12th in economic freedom ranking, 17th in “Doing business” report to name but few. Openness in terms of trade and investment has brought along the highest level of FDI inflow per capita (7985 EUR as of end of 2005) in Central and Eastern Europe. Rapid capital inflow has been accompanied by considerable technology and skills transfer. Importantly, FDI has also contributed to strong integration into Nordic and Baltic value-chains, as more than 80% of all FDI has come from this region.

Openness alone is not enough; attractive business environment must also be simple. That is why Estonian Government is committed to continue with 0% tax rate on reinvested profits, which has clearly helped companies in developing and expanding their businesses. In the face of labour shortage, that we are now experiencing, we are planning to bring more flexibility into employment contracts act. I believe that in rapidly developing economy like Estonia, it is needed to make hiring easier, encourage more efficient use of part-time working, but also make it easier to fire or lay off people in sectors or companies that cannot keep up with fast changes.

Simplicity is not only about legal framework, but also having supportive e-solutions. Estonia's e-tax board (86% of income taxes for 2006 were declared online), e-voting (1st parliamentary e-elections in the world in March 2007) are rather well-known by now. Since late 2006, it is also possible to found and register a company online in only 2 hours. We have realised that economic policy is increasingly also becoming IT policy – that is why we also push ahead with new for e-invoicing and e-procurement solutions that will cut administrative cost for both public and private sector.

Another area where Estonia needs to simplify legal environment, is saving and investment of private actors. Rapid rise of salaries (real wage growth 10,9% in 2006) and favorable credit situation have led to strong growth of domestic demand (real growth 15,1%), which gave impetus to rising inflation (4,4%) and also contributed to worsening of current account deficit (-14% of GDP by end of 2006). That is why we need to give better incentives and legal opportunities for private persons to invest, instead of fuelling already buoyant domestic demand.

The third pillar of business environment – transparency – needs also attention. Despite positioning as the least corrupt Central Eastern European country (24th in Transparency International ranking), we are still lagging behind our Nordic neighbors who all are in top ten of least corrupt countries. Therefore Estonia needs to renew its anti-corruption strategy. Transparency means also stronger competition and functioning of internal market. We are currently working on wider usage of leniency program, to give incentives for co-operation with our competition authorities.

Most of the policy measures that I have described so far clearly support entrepreneurship and investment. But in order to stimulate the emergence and growth of smart and dynamic companies who could compete on global markets and to help transforming Estonian economy into a knowledge-based one, we need sophisticated micro not macro policies. Government program sets a target to increase R&D investments to 2% of GDP by 2011 and 3% by 2015. One of the major new initiatives is Estonian Development Fund that starts to invest into pre-seed and seed phase of innovative technology-based start-ups to have more the likes of Skype. We will also invest more into our Competence Centers which are linking our best people from university and industry in key areas. We will also introduce a new measure to support the mobility of highly skilled international innovation specialists to bring in extra competence. All these and other micro level policies that we have in place will help to change old business models, create new co-operation and market opportunities and very importantly also attract more knowledge-intensive FDI.

In terms of cooperation in the Baltic Sea region, I am confident that Nordic countries and Estonia will continue to have intense economic cooperation. The challenge is to climb up the value-added ladder so that in the future we have partnership in more sophisticated areas, bringing thus higher returns to all.

*Juhan Parts*

*Minister of Economic Affairs and Communications,  
Estonia*

## The role of Belarus in the Baltic Sea Region

by Andrei Yeudachenka

The region of the Baltic Sea in a broader meaning can be defined as the territory of its water basin area – thus including a significant part of Belarus with major rivers the Nioman (Niamunas) and the Zahodniaja Dzvinia (Daugava). A specific character of the Belarusian geographical relation to the Baltic Sea region is that the country's compact territory is located on the watershed of the Baltic Sea and the Black Sea making it in a natural way possible to link the two huge areas.

With regard to this transit location Belarus is responsible for a significant part of goods, service, information and migration flows both in east-west and north-south directions. This is relevant for mutual relations of Belarus with the other Baltic Sea nations as well as in a wider perspective considering various cooperation possibilities between different European regions like, for instance, the EU and the CIS or the Council of the Baltic Sea States and the Black Sea Economic Cooperation.

Geographical proximity of Belarus to the Baltic Sea as well as the well-developed transport infrastructure and trade advantages of the region increase the role of the Baltic Sea for Belarusian large-scale exports – as well as imports, which, in its turn, benefits to the development of the sea-ports of Lithuania and Latvia. This is also the case concerning the transit role of Belarus for Ukrainian and Russian exports/imports in the northwest direction.

Particular attention should be paid to energy flows and concerns in the region. Belarus hosts important transit pipeline routes both for oil and natural gas thereby supplying the energy resources to the other states of the Baltic Sea region. Moreover, there is evident interdependence between Belarus and the neighbouring Baltic Sea states as far as energy shipments, production, exports and consumption are concerned when it comes to the available energy infrastructure in the countries in question. As most of the Baltic Sea states – including Belarus - are net importers of energy resources it is essential to jointly ensure secure energy deliveries in the region. This issue becomes especially important in relation to the diversification of delivery routes for energy resources in this part of Europe and construction of new ones like, for instance, the North-European Gas Pipeline Nord Stream, which decreases the role and possibilities of the Baltic Sea region transit states as well as may have an impact on the regional environment.

The EU-enlargement of 2004 shaped a new political reality in the region, making the Belarusian border in the west and northwest the common EU-border. This has increased the significance of promoting cooperation vs. creating new dividing lines in Europe. In this regard an important instrument is the

European Neighbourhood Policy that includes all the adjacent states. In turn, Belarus has declared the importance of good neighbourly relations with the bordering countries contributing to mutual cooperation, confidence and security in the region.

Migration issues are closely related to cross-border cooperation. In coordination with the other countries of the Baltic Sea region Belarus has consistently worked on fighting illegal migration, trafficking and organized crime favouring the development of the regional stability and security.

Environmental security is a common concern of the Baltic Sea states and is characterized by mutual dependence. Belarus as well as other countries in the region bears the responsibility of environmental protection, as its watercourses can be a source of influence. All exchange of information and experience in the field of environment is welcomed, not least regarding energy transportation and production. Having suffered from the Chernobyl disaster Belarus is anxious about safety of nuclear energy production and waste storage both within the country and in its neighbourhood.

Belarus pays much attention to the development of cross-border cooperation with the other Baltic Sea states, in particular by creation of cross-border regions of cooperation such as "The Region of Baltic States" Neighbourhood Programme of the European Commission. These entities play an important role in resolving a wide range of problems of mutual interest as well as in promotion of cooperation between the Baltic Sea countries and sub-regions.

It is worth underlining that as a part of the Baltic Sea region Belarus serves the purpose of being a transit link to and from the region in relation to other parts of Europe. For development of both the country and the region it is important to make use of the existing potential that not only comes from Belarus' geographical location, but also from historical experience and opportunities offered by the available infrastructure. Political implications should also be taken into account when it comes to creating the basis for cooperation with mutual benefit as well as for resolving problems of common interest, such as, for instance, environment protection or migration where joint actions are needed.

*Andrei Yeudachenka*

*Deputy Minister of Foreign Affairs  
of the Republic of Belarus*



## Russian-Finnish neighbouring area cooperation

by Alexander Rumyantsev

In January 2007, fifteen years had passed since Russia and Finland concluded the intergovernmental agreement on cooperation in the neighbouring areas. During that time, the unique mechanism of direct collaboration between Finland and the four subjects of the Russian Federation that are adjacent to the Russian-Finnish state border - the City of St. Petersburg, the Republic of Karelia, the Leningrad Region and the Murmansk Region - has convincingly proved its indisputable significance in strengthening neighbourly relations between our states. Contacts between neighbouring areas form a harmonious part of the many-sided complex of Russian-Finnish partnership, covering practically all spheres of life in the neighbouring areas – environmental protection, the sector of transport and communications, customs cooperation, improvement of border infrastructure, development of the social sphere and health care, agriculture and forestry, power industry, promotion of the development of business activity, combating cross-border crime, strengthening democratic institutions. The results of this collaboration are weighty and visible on both sides of our more than 1200 kilometre-long border: hundreds of successfully implemented projects, thousands of jobs created thanks to contacts between neighbouring areas, tens of thousands of partnership contacts forged between Russian and Finnish private persons, companies, power structures, and non-governmental organisations.

During the last fifteen years, implementation of the bilateral Russian-Finnish agreement has not only promoted favourable socio-economic development of our states and improved the quality of life of our citizens living in neighbouring areas. One of its merits is also that collaboration with Finnish partners within the framework of the mechanisms established by the Agreement – the Intergovernmental Group on Neighbouring Area Cooperation, coordinated by the Russian and Finnish ministries for foreign affairs, and its territorial subgroups – has paved the way for the North-West Russian regions' closer ties to international economic cooperation, and on the whole promoted increasing positive interdependence and strengthening stability throughout the North of Europe. Today, neighbouring area cooperation between Russia and Finland has long ago expanded beyond the boundaries of the bilateral format and, combined with wide-ranging collaboration within such regional forums as the Barents Euro-Arctic Council and the Council of the Baltic Sea States, is becoming an integral part of the network of transnational contacts in the North of Europe.

It is quite natural that the evolution of the Russian-Finnish neighbouring area cooperation cannot be considered detached from the intensification of strategic partnership between Russia and the European Union. Moreover, the inter-regional and the transnational factor play today an active role

in forming the four Common Spaces of Russia and the EU. In this context, the fifteen-year experience of Russian-Finnish neighbouring area cooperation has proved to be very useful in the construction of the neighbouring-area component in the Russia-EU relations. Based on this experience were jointly compiled and approved within the framework of the European neighbourhood and partnership instrument the new transnational programmes, the implementation of which is expected to start in 2008.

By the Russian-Finnish border, three European transnational programmes will be in effect: "Kolarctic" (in which Sweden and Norway also take part), "Euregio Karelia" and "South-East Finland – Russia". It is gratifying that they have managed to "absorb" all that is positive in the accomplishments of the Russian-Finnish neighbouring area cooperation. The new programmes reflect the aspiration of the regions involved in neighbouring area cooperation to perform this work on the basis of the principle of equal partnership.

Founded on the same principle is also the policy of Northern Dimension, to which a new impulse was given by the leaders of Russia, the European Union, Iceland and Norway in Helsinki in November 2006. The philosophy of the partners' equal participation in making and implementing decisions, as well as of equal financing of the coordinated projects was unanimously supported by the participants of the Northern Dimension, which is in fact becoming regional implementation of the "roadmaps" for the Common Spaces of Russia and the European Union.

Today, 15 years since the day when the Russian-Finnish agreement on neighbouring area cooperation was signed, neighbouring area collaboration between our two countries is in a responsible, challenging and busy stage of adaptation to the new forms of regional cooperation in the North of Europe. But its essence remains unchanged – to promote complex economic and social development of the border areas of our states, to improve the quality of life of people on both sides of the common border. Our common task is to construct a comprehensive and correct model for further collaboration, in order to avoid competition between different formats and to take maximum advantage of the synergetic effect of their mutual supplementation. This will obviously be the key theme in the following, twelfth in succession, session of the Intergovernmental Group on Neighbouring Area Co-operation, which is scheduled for this year in Helsinki.

*Alexander Rumyantsev*

*Ambassador of Russia to Finland*

## 4 times Chernobyl on the shorelines of the Baltic Sea

by Satu Hassi

### 4 copies of the Chernobyl reactors in Sosnovy Bor

“An elephant in the living room” is a problem, which everyone in the family knows and is stressed by, but which is rarely mentioned, e.g. the alcoholism of one of the parents. The elephant in the living room of people around the Baltic Sea is the nuclear power station in a small town called Sosnovy Bor. It is the biggest security risk for people living in that region, especially in St Petersburg, Southern Finland and Estonia.

In Soviet time Sosnovy Bor was a closed city, because it was built only for nuclear installations. You still need a special permit to enter the city. It is located on the southern shore of Gulf of Finland, 70 km west of St Petersburg, 200 km of both Tallinn and Helsinki. What makes Sosnovy Bor nuclear power plant very special, is the fact that the 4 reactors there with 1000 MW capacity each, are of the same basic design as the reactors in the infamous Chernobyl nuclear power plant.

The RBMK reactor design was originally created for military purposes. For several reasons it is especially dangerous. First, there is graphite inside of the reactor. Graphite is used as moderator, to slow down the speed of the neutrons. Second, the fission process is more unstable than in the more common water-moderated reactors. What happened in Chernobyl was that the nuclear chain reaction went unstable; it started to speed up itself, leading to very rapid heating of the reactor. This led to an explosion, which broke the pressure vessel. Thereafter the hot graphite was contacted by air, and started to burn. The fire was extinguished only when there was no more graphite in the reactor.

Because there was no containment, which was the norm in Soviet Union, the smoke of this huge fire spread around, contaminating vast areas. More than half of the radioactive fallout went outside that time Soviet Union, mainly in Europe. But radioactive isotopes from Chernobyl can be traced as far as in Japan.

There are also no containments around the reactors in Sosnovy Bor.

In the early 1990ies international co-operation was started in order to improve the safety of the reactors in Sosnovy Bor. The instrumentation of the plant was modernized with money from west, the staff was re-educated and fire preparedness was improved. Finland is still every year funding projects to improve the safety of the reactors. The Finnish radiation and nuclear safety authority, STUK, visit Sosnovy Bor regularly.

### All RBMK reactors should be closed

But the basic problem, the fact that there is graphite inside of the RBMK-type reactors, cannot be changed afterwards. Therefore, all reactors of this type should be closed urgently. For example a precondition of the EU membership of Lithuania was the closing of the RBMK-type nuclear power station in Ignalina. The EU Commission has several times stated that also the RBMK type reactors in Sosnovy Bor should be closed.

The original 30 years operating permit of the oldest reactor block expired in 2003. The Russian nuclear authority extended the permit by 15 years. The same process is going on with the block nr 2. The permits of the reactor blocks 3 and 4 will expire in next decade.

I was the Finnish minister for environment in 1999-2003. During that time I discussed a couple of times the situation of Sosnovy Bor with representatives of the Russian atomic energy ministry. They simply stated that the reactors meet

Western safety standards, after the internationally financed improvements. This is simply not true. According to Bellona, a Norwegian environmental organization, and Zeleny Mir (Green World), a Russian environmental NGO, the renovation which was done in the reactor block nr 1 before the life-time extension, only upgraded the reactor to present Russian standards. This means that the other reactors do not even meet present day Russian nuclear safety norms.

### What instead?

If the reactors in Sosnovy Bor would be closed, how to find alternative sources of electricity? Personally I think that the best alternative is “negawatts”, energy savings, or energy efficiency. In early 2000ies the statistics of Russia and EU showed that to produce a GDP of 1 million Euros, Russia consumed more than 10 times the energy needed by EU-15 countries to produce an output of the same economic value. This can be traced back to Soviet time, when the price of energy in domestic market was almost nonexistent. Still, the price of energy is artificially low in the Russian domestic market. In the 1990ies the German Öko-Institute estimated that the energy efficiency potential in Northwestern Russia is so huge that all Soviet type nuclear reactors in that region could be closed without any economic loss. Much has changed since that, but I am convinced that there is still a huge potential of very cost efficient energy savings, given the fact that the world market price of energy has gone up in recent years.

The Russians are planning to gradually replace the reactors in Sosnovy Bor by four water moderated VVER-1000 reactors. The problem of this plan is that the opinion of neighbors has not been asked. This reactor does so far exist only on the drawing board.

In all countries constructing nuclear power stations or planning to do so, the people involved assure that in our country this is safe. But almost all nuclear power stations are very close to the borderlines. The Espoo Convention on international environment impact assessment came into force in 1997. It lays down a general obligation of countries to notify and consult each others on all major projects under consideration that are likely to have significant environmental impact across the borders. Russia has not consulted Finland and Estonia on the plan to build new reactors close to the capitals of both countries. Russia has not ratified the Espoo Convention and says that therefore it is not obliged to do this. But Russians themselves have demanded an international environmental impact assessment on some projects planned on the Finnish side of the Finnish-Russian border. I think that they should follow the same procedure with the projects on their side.

Estonia joined EU in 2004. The Finnish-Russian and Estonian-Russian borderlines are now also borders between EU and Russia. To improve the safety of the whole Baltic Sea region Finland and Estonia, together with the EU Commissions, should intensify efforts to first close down the Chernobyl type reactors in Sosnovy Bor, and secondly to create funding for alternative, non-nuclear investments, which would save the same amount of energy, and/or replace it with less dangerous energy forms.

Satu Hassi

Member of the European Parliament



## Metropolitan centres of the Baltic Region

by Kurt Bodewig

The Baltic Region is an exciting, interesting region in which we can observe the rapid development of a number of metropolitan regions. These metropolitan regions can look forward to a very promising future as far as their economic and social development is concerned. Researchers are already reporting a new trend for populations to move back into urban areas. The density of settlement in a city has many advantages – the trips people make tend to be shorter, amenities can be reached more easily and, above all, facilities are close at hand. These advantages are also driving the formation of larger metropolitan regions.

The fastest growing metropolitan region in Europe is Helsinki. In fact, hardly any other city has such a high proportion of graduates in its population as Helsinki. Central to this is the capital's university, which includes the famous Otaniemi Campus – Northern Europe's biggest high-tech centre. When the Helsinki region was picked out as one of the most innovative in Europe, the European Union justified this accolade by pointing to the many innovative new high-tech firms that have been set up there, particularly on the Otaniemi Science Park.

It is very clear that Helsinki is putting its faith in education and high-tech industries, and is building this sector up as one in which the region specialises. This specialisation is also "spilling over" to Estonia – Tallinn has the biggest university of technology in the country with more than 10,000 students and 1,000 employees working in research and development. One third of the country's gross domestic product is generated in Tallinn, and it is where most Estonian and foreign companies have established themselves. A good example in the neighbourhood encourages others to follow its lead. In the mean time, people are talking of a single region called "Talsinki". Admittedly, the two capitals are connected by several daily ferry services and there is close cooperation between the cities' universities and administrations. But the differences are evident – Tallinn still needs time to reach the same level as Helsinki, while the absence of a land link, the lack of a common labour market and the fact that they use different currencies make it more difficult for them to grow together. As a prospect for the future, triangular cooperative arrangements with St. Petersburg could well be of interest.

The twinned cities of St. Petersburg and Hamburg are both ports with favourable geographical situations. St. Petersburg's proximity to Western Europe's transport systems – it is about 200 km from Finland and the EU's external border –, its port on the Baltic Sea and its relatively convenient rail, road and waterway connections to Russia's industrial centres, are important locational factors that make the city a transport node of national importance. At the other end of the Baltic Sea, Hamburg has always been a meeting point for worldwide trade flows and transport routes. Furthermore, in recent times the Port of Hamburg has expanded into one of the biggest transshipment centres for the Baltic Region.

The trading metropolis of Hamburg lies at the intersection of significant trans-European transport axes, which link Scandinavia with Western and Southern Europe. They create close links between this metropolitan region and Berlin as well as Central and Eastern Europe. Through targeted incentives for the aviation industry and companies specialising in environmental technology, Hamburg has built up a distinctive skills base and come to occupy an outstanding position among the Baltic metropolitan centres.

As a metropolitan region with 4.5 million inhabitants, St. Petersburg is truly flourishing at the moment. Events like the city's 300th anniversary (2003) and the G8 summit last year (2006) have brought a breath of fresh new air to the city itself

– a great deal of renovation work has been done and St. Petersburg now has a special atmosphere that makes it quite unique – people who know the place intimately call it the "Petersburg metaphysics". By 2012, a business quarter with total floorspace of 150,000 square metres is to be created at the heart of St. Petersburg – just one example that illustrates how dynamically the city is developing. Further major investment projects are being planned or realised at the port – including a coal loading facility and two oil terminals.

Another metropolitan region on the Baltic Sea has grown up along the Øresund, with its centres at Copenhagen and Malmö. Overall, 20% of Denmark and Sweden's gross domestic product is generated in this area. The boom was made possible by the construction of the Øresund Bridge and its opening in 2000. Universities and their close ties to the economy are playing a fundamental role in Øresund, where the emphasis is on biotechnology. In total, about 330 biotech companies are based in the region, and the sector's annual growth rate is estimated at between ten and twenty percent.

Nor should we overlook the concentrations of activity at Riga, Stockholm and the Polish Tri-City conurbation of Gdansk, Sopot and Gdynia, which have smaller populations, but are just as economically, culturally and politically vigorous.

Specialisation and innovation have now become essential to the success of any metropolitan centre. Progress in these respects can be achieved through creative approaches to the development of new technologies and knowledge transfers. It is true that people tend to describe an administrative unit of between 500,000 and 1 million inhabitants or more as a metropolitan region, but any area that wants to establish itself as a player in our globalised world needs to grow a little more or concentrate on specific activities – which is exactly what the cross-border metropolitan regions of Copenhagen/Malmö and Helsinki/Tallinn have done. Smaller metropolitan centres also have to pursue the correct marketing strategy if they are to make a name for themselves and attract investors. And they need the right infrastructure: it is therefore not just economic strength that is important to the development of a metropolitan region. A metropolitan region must exert a strong appeal and send out signals that make people far away sit up and think. Cities have to offer their citizens a stimulating environment and also draw European and international attention with events, trade fairs and congresses.

The formation of large metropolitan regions is a trend not completely without its dangers. When a region specialises and concentrates on a single sector, this always involves a certain risk of failure. There is also the threat of rural regions becoming impoverished in terms of "know-how" and resources. Metropolitan regions are the key to economic success and should be strengthened accordingly, but at the same time rural areas should be protected from decline and unmanaged out-migration.

The Baltic Sea has been and remains a permanent uniting factor in the relations between the neighbours along its coasts. Water does not divide people, but brings them together. It is a great enrichment for all concerned to learn from one another, cooperate, study positive experiences and absorb the lessons of each other's mistakes. Only if we work together, both in regional and national contexts, will we be able to make the most of the chances we get and so hold our own in global competition. The "Metropolitan Areas" project has seen several metropolitan centres in the Baltic Region join forces to exchange information and discuss their experiences of the development of polycentric structures in metro-

politan regions, put in place a framework for decentralised concentration, open up opportunities to drive this process forward and draw up strategies for sustainable development. The members of this project include the following metropolitan centres, along with the areas that surround them: St. Petersburg (Russia), Stockholm (Sweden), Oslo (Norway), Vilnius (Lithuania), Warsaw (Poland) and Berlin (Germany).

Our metropolitan centres are having to cope with a continual process of transformation. Yet, despite their many similarities, these cities have retained their individuality. If you were to look down on Europe from outer space at night, you

would see these metropolitan centres standing out as big glowing points that form a chain of lights around the Baltic Sea. All of them glow brightly, but each city has its own individual attraction and beauty.

*Kurt Bodewig*

*Member of the German Bundestag,*

*Chairman of the Baltic Sea Forum*



## Helsinki and regional challenges in the Baltic Sea Region

by Jussi Pajunen

The Baltic Sea region is an area of cooperation of special importance for Helsinki, and in the future perhaps the most important field of activity. Even now, a significant proportion of the activity and turnover of Helsinki businesses comes from the region – the economic and labour growth is increasingly based upon free movement across borders. One can say that Helsinki is returning to its roots. Indeed, the city itself was founded specifically for Baltic Sea region trade. Using modern day terms, when establishing Helsinki, King Gustav Vasa utilized urban policy as a tool for strengthening the State of Sweden and for spreading its sphere of influence.

Today's governments should also consider this. Why are national urban policy, EU urban policy and international regional policy in their own, separate operational fields? In particular, maintaining a strict separation in regional cooperation for the Baltic region at state, regional and city level, and also the separation of foreign and domestic policy at each level in organizations and discussions, is increasingly becoming a barrier to cooperation. The real integration of the Baltic Sea region can only progress when these border fences are surmounted.

Swedish Foreign Minister Carl Bildt has proposed that the CBSS (the Council of the Baltic Sea States), one of the most important forums for cooperation between the Baltic Sea states, should develop as a forum for dialogue and cooperation between the EU countries and Russia, and that it should concentrate on issues that directly affect the citizens. He also emphasized the importance of the regional dimension for solving common problems. The proposal is excellent, but it requires governments to undertake activity that is more purposeful and flexible than at present in order to involve actors at local and regional level.

In this matter, the existing networks for cooperation between the cities, Baltic Metropolises (BaltMet) and the Union of Baltic Cities could be part of the solution as to how cooperation between the countries and between the cities could, within the framework of the CBSS, direct and develop cooperation expressly for concrete issues that directly affect people. Such partnerships are already being developed through the Baltic Development Forum, which promotes the competitiveness and profile of business in the region, and in the BaltMet network of large cities.

The Baltic Sea is often referred to as the EU's inland sea. However, this does not indicate that the region is also of critical importance to Russia, most of whose foreign trade is transported via the Baltic. Moreover, the fastest growing centre of this so-called inland sea is Russia's second capital, St Petersburg. The Baltic Sea must therefore be seen above all as a sea shared by the EU and Russia.

Referring to it as an EU inland sea may even be misleading. The coherence of the Baltic Sea economic area, if one can still even talk of such a thing, should be approached from this perspective. Indeed, the whole spectrum of organizations that can be found in Europe (EU, EEA, NATO, CIS, EMU, Schengen) are represented in the Baltic Sea region.

There are also major domestic issues in the regional development of the region, which are of vital importance to Helsinki. In terms of the current challenges where cooperation is needed, three matters stand out above all others: logistics, population decrease, and the state of the Baltic Sea environment.

In spite of all the globalisation and the development of the information society, logistics and transport connections continue to be of vital importance for the cities. Within the framework of the BaltMet cooperation, we are involved with other cities in organizing discussions and forming a common viewpoint on the development of a transport infrastructure for the Baltic region.

The EU's TEN-T project, Rail Baltica, a railway connection from Tallinn to Warsaw, is a key project supported by all the capital cities as well as St Petersburg. The cities believe that the extension of this railway northwards to St Petersburg, and westwards to Berlin, might also improve the profitability of this project. Research into the feasibility of a tunnel under the Gulf of Finland has also been put forward. The present Rail Baltica traffic predictions do not include the flow of goods from Finnish foreign trade.

In thirteen years' time Finland will have the second oldest population in Europe after Italy. The change in the population structure of Finland will be a major challenge for us far into the future. The need for services will increase, and the number of workers that can produce these will decrease. The situation is almost equally challenging in the other cities in the Baltic Sea region. We can find a solution to this problem by making the production of these services more efficient and by attracting labour from abroad.

Although there is beginning to be a shortage of labour almost everywhere, it is in our common interest to increase the mobility of labour in the Baltic Sea region by removing barriers, both legislative barriers and structural barriers in the labour market. A remodelled CBSS could be a forum where the different parties together seek a solution. Within the framework of the BaltMet cooperation, the cooperation on innovation policy for the region, which is already on a sound footing, should be extended to seek new innovations for boosting the efficiency of the production of services.

The Helsinki and Turku initiative, and the campaign that we have recently made to challenge other cities and actors, has headlined the saving of the Baltic Sea. Initially, Helsinki and Turku carried out a thorough study on how they could contribute to improving the state of the Baltic Sea through their own actions. The idea is to challenge all actors to find efficient and feasible measures within their own activities, and then commit themselves to implementing these measures. For our own part, we are strongly committed to cooperative work. And we propose the same to the others. We have started to gather together cooperating groups in Finland, but without the involvement of all areas, cities, businesses, farmers, yachters and boaters, and, of course, all the responsible authorities in the Baltic Sea region, we will not have the prerequisites for success. The saving of the Baltic Sea is an urgent matter.

*Jussi Pajunen*

*Lord Mayor of Helsinki*





## The Leningrad region – is an investment magnet

by Valery Serdyukov

I appreciate this opportunity to introduce the Leningrad region to you. Today our region is one of the most dynamically developing, economically successful, industrialized regions of Russia. Starting from 1999 average annual growth rates as regards industrial production volumes in the region were about 17%. How was it possible to reach such a high economical result? First of all owing to the establishment of favorable investment climate in the region, mild tax legislation, development of specialized market infrastructure. Because of its great location, natural resource wealth and informational openness, our region has become a formidable magnet for investors.

There may exist various options when it comes to attracting investments into a regional economy. Some administrations use demonstrative tactics, others prefer personal lobbying efforts. The Government of Leningrad Region bet on the powerful companies, which could integrate into the world economy and succeeded. Over the last ten years over two hundred companies arrived to stay in Leningrad Region, the Russian gateway to Europe and Europe's gateway to Asia, looking to implement their business strategies.

The Leningrad region holds third place in Russia in the volume of investments per head of population. Ahead of it are only the oil regions. The Leningrad region has brought together on its territory true "investment stars" IKEA, Swedwood Tikhvin, Philip Morris, Caterpillar, Ford, Kraft Foods, Rockwool, Metsä Botnia and Nokian Tyres. Every region would be glad about the coming of such companies.

The investment policy implemented by Leningrad Region Government is based on using the advantages of geopolitical location, natural resources capacity and economic, scientific and technological potential of the Region. Favorable taxation regime contributes to increase of investment appeal of the Region and forming of the wide range of market infrastructure institutions and civil society.

Those investors that are currently implementing the projects on the territory of Leningrad Region work within conditions created for successful business. The Leningrad Region Government ensures favorable environment for investors including tax incentives, a transparent information environment for business, and commitment of the government to upholding rights and contractual obligations regarding business and investments.

The investment climate of Leningrad Region is predicated by the following factors:

- Unique geopolitical location of the Region;
- Strong innovation and industrial capacity and human resources potential;
- Established system of legislation aimed at stimulation of investment activities;
- System of tax concessions and measures of state support of investors;
- Informational transparency;
- Certain level of political, social and economic stability.

Advantages of geopolitical location:

- Advantageous maritime location, several operating ports and ports under construction;
- Developed transport hub, located within the 9th European transport corridor;
- Intersection of sea, river, railway, motorway, air, pipeline and telecommunication routes;
- Boundary location (bordering with European Union).

The proactive investment policy conducted by Leningrad Region Government is aimed at effective usage of accumulated economic potential of the Region. This policy attracts over USD 3 billion of investments annually and supports establishment of dozens of new enterprises and provide for continuous growth of volume of tax income to the budget. The main result of this activity has become the creation of sustainable basis for economic development of the Region that includes the establishment of new industrial enterprises, new technologies and, not less important, actual absence of employment.

In 2004 the volume of direct investments made up about USD 2.5 billion and in 2005 - about USD 3.3 billion. In 2006 the volume of direct investments made up USD 4.5 billion. National companies prevail within the investment structure of the Region. The greatest unit weight in total amount of investments belongs to the sector of development of industrial production and transport.

In 2006 the regional economy received USD 540.4 million of international investments (1.5 times more than in previous year), of which USD 361.6 million (i.e. 67%) are direct international investments. The main investors are: USA - USD 115.7 million (21.4% of total amount of investments); Finland - USD 83.2 million (15.4%); Spain - USD 76.3 million (14.1%); Denmark - USD 60.9 million (11.3%); Netherlands - USD 60.8 million (11.2%).

As long ago as 1997 the statute on investment activities in Leningrad region was adopted. And still this statute is unique having no analogues in Russian Federation. It specifies a complete set of activities including state support and protection of the investors carrying out activities at the territory of Leningrad region in such spheres as industry, construction, communication, transportation agriculture. This document ensures equal rights to both Russian and foreign investors including both large-scale and small-scale investors. It determines a number of privileges and additional guarantees.

The preferential treatment providing for significant assets and profits tax benefits is given to investors for the entire investment payback period plus two years after the completion of the investment project. When the constituent entities of the Russian Federation were prohibited by Federal law from granting profit tax exemptions, Leningrad Region made an unprecedented move by passing in 2003 a new version of the Law "On Governmental Support of Investment Activities" entitling investors to regional government subsidies through corporate profits tax relief.

Investment environment in our region, surely, depends on work of the authorities: represented by people with their approaches and attitudes... We do not thrust our opinions of preferable sectors on companies, considering the investment potential of the sector to be defined by the market itself. What is advantageous for investors is advantageous for us. Our main goal is to create favorable business environment for investors.

We are ready to cooperation. Welcome to Leningrad region as investors, tourists and visitors. We wish all our business partners success!

*Valery Serdyukov*

*Governor of the Leningrad Region*



## Progress in logistics cooperation between the European Union and Russia

by Juhani Korpela

Finland's presidency of the European Union elevated transport logistics into the centre of Europe's transport policy.

Finland's initiative took aim at improving the competitive capability of Europe's logistics. Basic knowledge of the cost dimensions of logistics alone is fragmented in Europe. In the United States, the development of logistics has already been given attention for quite some time.

The policy decisions formulated during Finland's presidency provide new guidelines for EU operations. The next EU presidency country, Germany, has taken the matter forward with the goal of an operational plan embracing the European Union as a whole.

Russia has also been interested in the development of transport logistics. Russia is also endeavouring to gain more advantage from its position as a transit nation.

The foundation for cooperation between the European Union and Russia is the Partnership and Cooperation Agreement, undersigned in 1997. With this, Russia approved, among other things, the goal to harmonize transport and customs legislation in accordance with the EU model. Both have undergone advancement in the field, though plenty of work still remains to be done. The cooperative framework operations connected with the cooperation agreement have remained sporadic with respect to transport.

A new type of cooperation arrangement was born a couple of years ago when, at Russia's initiative, a transport dialogue based on five work groups was launched. The work group deals with general transport strategies, infrastructure, transport safety and special transport format-related questions. All work groups have already convened several times.

During Finland's presidency period, an additional sixth ad-hoc work group was established to clarify the logistics problems between the EU and Russia. The lorry queues extending dozens of kilometres and waiting periods lasting days on end could be found in the background. Combined recommendations to ease the problems of crossing the frontier from the work group are expected by the end of June 2007.

Frontier-crossing problems have also been clarified in the past. Finland, Germany and Russia established the joint TEDIM programme in 1995 to promote the utilization of telematic resources in Baltic region transport and logistics. Within the context of the programme, telematic solutions serving international transport and logistics have been developed and their initialization has been promoted. Estonia, Latvia, Lithuania and Poland joined the programme later. Denmark and Sweden have also monitored the project.

Within the limits of TEDIM, it has been noted that switching to electronic documents as well as incorporating the beneficial use of information technology are pivotal instruments to accelerate frontier crossings. Moreover, with electronic data transfer it is possible to reduce the so-called 'double billing' connected with customs clearance, by which the Russian market is resultantly distorted and considerable customs income remains unpaid to the State. However, the ready-developed 'green line' has not been taken into wide-scale use.

Another problem of the Russian frontier is the number of officials. When the number of officials on the EU side is only two—for freight transport customs and for passenger transport frontier guards—there may be 7–8 officials on the Russian side. This causes delays, multiple labour and unnecessary billing. A solution to the problem looks promised by Russia's Duma having approved new legislation designed to cut down this unnecessary bureaucracy.

On May 15th and 16th, 2007, an international TEDIM seminar was arranged in Helsinki with participants from 14 countries. Those at the seminar heard, for instance, about the plans on the part of Russia's Customs in initializing electronic customs clearance and reorganizing the operations of officials.

Up to this time, the utilization of electronic data transfer has progressed the farthest in the rail transport going on between Finland and Russia. It is natural that similar progress is also expected with respect to lorry transport.

Russia's advancement in electronic customs clearance requires, of course, that corresponding readiness exists in the European Union. The Finnish Customs has functioned actively both under the auspices of the EU and in the international customs organization on behalf of accelerating the commissioning of electronic customs clearance.

In the Baltic, over 300 million tonnes of hazardous substances are transported each year. The possibilities to avert, sooner or later, a major catastrophe from occurring on the open sea are minimal, due to the lack of the required vessel-carried oil destruction equipment. However, GOFREP—a marine transport supervisory and control project based on the collaboration of three nations, substantially reducing the risk of accident—has been implemented in the Gulf of Finland. A project has also been launched under the auspices of TEDIM by which there is an ongoing attempt to improve collaboration between officials and businesses to increase the safety of the transport of hazardous substances.

Finland's Ministry of Transport and Communications has functioned actively on behalf of the development of logistics and the information technology connected with the same. This has necessitated investment in the research and development operations thereby required. The research grants have nevertheless been eliminated from the Ministry in the State's budget for 2007. The field of activity of the Ministry has been divided between two ministers, so that cargo transport is the responsibility of the one and the development of information technology that of the other. Hopefully these solutions will not weaken Finland's possibilities to remain, in the future as well, a skilled partner with considerable initiative in the advancement of logistics and the information technology serving the same.

*Juhani Korpela*

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## Updating St. Petersburg economy: new heights, old problems

by Nina Oding

The economy of St. Petersburg has been showing growth during the last nine years just as the rest of Russia, though its growth rates have always exceeded the Russian average. In recent years, the GRP growth has been propelled by a surge in telecommunication services, in the retail trade turnover, and by a sustainable growth in transportation services. Judging by the main economic indices, 2006 was one of the most successful years for St. Petersburg, especially in terms of investment flows.

However, the positive dynamics of economic indices in the last years was not based on a profound modernization of all industries, which, among other things, is evident from the manufacturing output rates. In 2006 the manufacturing output index fell to 93.0% of 2005. Above all, these fluctuations were determined by the specific character of shipyard and electric-power machine production processes involving large orders with long-term delivery deadlines. In recent years, these problems were further exacerbated by outdated management techniques, lukewarm innovation/equipment-replacement activities, low labor culture, and low professional skills.

In the first two months of 2007, investments in the city grew 44% reflecting its increasing investment potential and a new investor-friendly environment. One can safely speak of stable economic growth conditions created in the city, while the quality of this growth and the possibility for sustainable development are still open to question.

The City Administration sets its sights on luring large investors and on providing individual support for investment projects. Such well-known international companies as Toyota, Nissan, General Motors, Bosch and Siemens, Knauf, and Elcoteq have moved their operations in St. Petersburg as the result of these policies. Besides this made it possible to launch such large infrastructure projects as the West High-Speed Diameter, Orlovsky Tunnel, and Pulkovo Airport Renovation under private-state partnership arrangements.

A driving force behind the city's modernization plans is mobilization of all budget revenue sources, including the registration of new corporate taxpayers, federal budget transfers, and tax administration improvement.

The main resource to support the achievement of these goals is the city budget, the revenues of which have almost tripled by early 2007 from 2003. The 2006 city budget revenues amounted to R215 219.9 million, which was R74 942.4 million (40%) over 2005. Despite a fairly high revenue budget for 2007 (a revenue of R229.8 billion against an expenditure of R261.7 billion), the first quarter results show that the initial revenue forecast will have to be revised upwards.

These revenues received in excess of the plan became possible not only due to the improved financial and economic activities of enterprises and higher population incomes, but also because some Russian flagship companies operating in other regions have chosen to register as taxpayers in St. Petersburg.

The huge budget revenue size and growth rates seem to make the City Administration forget its ultimate goal, i.e. public goods production. The St. Petersburg Master Plan and the Social and Economic Development Program for 2005-2008, approved by relevant city laws, aim at a sustainable improvement of living standards in the city up to the existing European levels. The economic growth has sparked off real-income growth in the city. However, instead of reducing the socio-economic stratification of the population, these measures contributed to its growth. The average wage in the city grew from R12 900 in 2006 to 14 400 in January-February

2007<sup>1</sup>. On the other hand, real wages in the new economic sectors (especially in services with a large share of "shadow" wages) are significantly higher than the official figures, which is evident from the registered upsurge in goods and services consumption in St. Petersburg.

The unemployment levels in St. Petersburg has been traditionally low during the last decade and amounted to 0.5% of the economically active population at the end of March 2007. Unfortunately, high employment rates do not automatically entail higher wages. Poverty in St. Petersburg is common not only among pensioners but also among those employed, including young working families with children. Even Governor V. Matviyenko recognizes that the last three years' economic achievements have not made a commensurate positive impact on the living standards in the city. 329 000 families live in shared apartments, most city buildings and structures are in an inadequate status, the number of available recreation and greenery areas is insufficient, garbage dumps surrounding the city and dusty streets adversely affect the environment and human health. The increasing motorization of the city resulting from higher population incomes has created enormous traffic and environmental problems, while the City's decisions are aimed at expanding the road network to accommodate the constantly increasing private car flows to the detriment of the public transport systems. This creates numerous conflicts which cannot be resolved due to the absence of a clear legal mechanism to handle them, low involvement of residents in the decision-making processes and the absence of efficient local self-government. At moment the most active player, initiator, and executive of all ideas, projects, and decisions in St. Petersburg are the City Administration.

The Governor's Address to the City Assembly of May 23, 2007 announced a goal to enhance the city's competitive power by updating all its key economy, infrastructure, municipal service, and social service sectors through mobilizing all budget revenue sources, creating conditions to lure investments, developing innovation activities, and utilizing the city's competitive advantages.

In order to close the development level gap between St. Petersburg and cities in leading EC countries, St. Petersburg has to ensure cardinal changes in its economy by significantly improving its efficiency based on innovations and expansive use of post-industrial technologies.

So far, neither innovation activities, nor the use of the city's competitive advantages have produced any palpable results in the tourism, transit cargo shipment, or science-intensive industry sectors. In fact, the city's transport industry development is impossible without new logistic solutions that would make it possible to generate substantial added value, including development of new port areas, port access routes, as well as warehousing and terminal/logistics zones.

The City's efforts to provide for a transition to an innovation economy include the creation of IT-parks and a special engineering-implementation zone, the establishment of a venture foundation and a business incubator for small programming, instrument-making, and bio-technology businesses. However, one cannot expect immediate results from these efforts, especially when the issue of providing incentives for new technology development remains unresolved. Meanwhile, the competitive power of St. Petersburg enterprises mostly relies on their comparatively low resource costs.

However, the city has yet to go a long way to resolve its long-standing problems such as the poor state of its housing stock, inadequate street-cleaning and garbage collection arrangements, poor potable water quality, and decrepit water-supply and engineering infrastructure facilities. <sup>1</sup>1 EURO=35R

These are exacerbated by new accelerated-development problems such as the deterioration of the urban environment, transport bottlenecks, and a downturn in ecological indices. Especially painful is the problem of the so-called "in-fill" housing developments (allowed under the pretext of an alleged lack of plots for new construction) which ruin the appearance of the historic city center accounting for only 6% of the total city area.

We believe that the scope of the problems facing the City has expanded considerably, and in the medium-term they can be dealt with only through feedback arrangements such as a dialogue with residents and public organizations and a broad participation of city residents in the preservation and development of St. Petersburg.

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## The Turku region is a junction point for Scandinavian and Baltic transport – a bridgehead between east and west

by Tuomas Mikkola

The Turku region has a favourable international location along the East-West transport corridor (especially the E18) which links Russia and Scandinavia. Its location is also central on the North-South marine route, linking Finland and Central Europe. Road, railway, marine and air transport all intervene effectively in the Turku region to support a competitive business environment.

By the year 2010, the EU intend to complete its trans-European Transport Network (TEN), designed to combine all modes of transportation. In the Turku region, this network will contribute especially to the development of the ports of Turku and Naantali, Turku international airport, and as far as road and railroad systems go, the motorway E18 and the railway link between Turku and Helsinki.

One part of the TEN project is so called Nordic Triangle, which is the transport corridor linking Denmark, Norway, Sweden and Finland. In Finland, the West-East corridor of the Nordic Triangle begins in Turku, extending all the way to the Eastern boarder of the country.

The Nordic Triangle has many connections to the so-called "Motorway of the Baltic Sea. Together, these two form a fixed transport system in the Baltic Sea Region. The Motorway of the Baltic Sea is one the four "motorways of the sea" established by the EU. A "motorway of the sea" is the concept of developing logistics chains with the aim of increasing maritime transport.

### **A direct route from Turku to China**

As Russia has opened up, ports in Finland together with the E18 and the railway connection to Russia and China have become increasingly important as part of the pan-European transport system.

Turku is gaining as a bridgehead for goods transport to China, with cargo pouring in from the other Nordic countries. Cargo travels the other way, too, from China to Turku, continuing by the sea to the other Nordic countries and Baltic ports.

Turku's asset, considering transit traffic in Finland, is that it hosts the only train-ferry port in Finland. The whole of Finland in fact has a competitive edge, owing to the fact that Finland has the same track gauge as in Russia.

### **LogiCity brings added value**

Road, railway, marine and air transport all intervene effectively in the Turku region to support a competitive business environment. Pilot Turku Ltd is public-private-partnership company specialising in marketing and logistics process for companies that are either offering or seeking logistics services in the Turku region. Pilot Turku is charge of the new business area in the surrounding of Turku International Airport, LogiCity. It will be a new type of business area based on effective logistics. LogiCity's unique strength is its location at a hub where all modes of transport meet. The city plan for LogiCity currently allows the construction of some 400 000 square metres of floor space. Once the land-use plan for the northern side of the airport has been completed, more than one million square metres of floor space will be open for construction.

Companies providing or using logistics services will gain the largest synergy benefits from establishing themselves at LogiCity. Sectors represented in the area include transport and value added logistics, distribution centres, warehousing and wholesale operations, and logistic functions for hi-tech industries, for which LogiCity offers an operating environment that generates genuine added value.

### **Trump cards in the Baltic Sea Region**

The aim of Pilot Turku Ltd is also to promote the status of the region and to develop a better operating environment for logistics-related businesses. Pilot Turku is building a logistics cluster in the Turku region. With the gateway position between East and West, and the efficiency in running logistics operations, the Turku region, Turku and LogiCity hold the trump cards in the Baltic Sea Region.

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# Climate change and the futures of Baltic Sea

by Juha Kaskinen

## Introduction

In futures work we talk about alternative futures. When we think about climate change discussion there seems to be a wide spread view on only one alternative; climate is warming. (It does not matter if the change is caused because of human activities or if it caused by other more 'natural' reasons.) But there are many views on what are the effects of global warming. No one knows for sure, what it means for the world or Europe or Baltic Sea region. So it is worth to think about possible, plausible and preferable futures of Baltic Sea. And how should we be prepared for different futures.

## Threats

Baltic Sea is quite vulnerable from natural environment point of view. We know that oxygen lost, eutrication and blooming of algae for example already are severe problems of Baltic Sea ecosystem. The sea suffers from poisonous substances. Climate change in next 100 years might increase the temperature of water 2-4 degrees of Celsius and temperature of air 3-5 degrees. Ice coverage decreases, increasing rain fall will especially during winter time wash more nutrients for forests and fields to lakes, rivers and Baltic Sea. Increasing number of high winds and storms has negative effect on sea safety. Level of sea water is expected to rise. New southern species will spread to the Baltic Sea. All these threats will have mostly negative effects on the Baltic Sea ecosystem. ([www.fimr.fi/fi/tutkimus/uutiset](http://www.fimr.fi/fi/tutkimus/uutiset))

Increasing oil and other shipment creates risks for big oil damage. The amount of oil transported in the Gulf of Finland increased over 150 % between 200 and 2005 (Finland's Natural Resources and the Environment 2005).

But some of the scholars have proposed that climate change will stop the Gulf Stream which would mean new ice age to the Baltic Sea region. This scenario is even worse than the warming scenario. If it would become reality, almost all living conditions of the region would disappear.

But not only nature will suffer from the changes. Effects on human life are also apparent. Even if humans are perhaps one of the most adaptive species in the globe there will be many kind of human suffering. Economical consequences could be quite severe. We already know that insurance companies have paid more compensations because of natural disasters than ever before during the last few years.

Baltic Sea has been popular recreation area. Fishing, yachting and tourism overall are very important for several Baltic Sea countries. The price of summer cottages and land on seaside has been going up so far. If the natural environment deterioration continues tourism industry is in danger. Not to mention fishing industry.

Social and cultural effects can be severe too. Changing ecosystems can parish traditional ways of life. A counter argument to it is that cultures and habits have been changing as long as humans have been on this planet.

## Possibilities?

Is there any good news related to climate change and the Baltic Sea? One thing is for sure: the effects will vary from regions to region. Already for example Finnish Gulf is suffering more nowadays than Gulf of Bothnia. The growing season will be longer and summers will dry and warm. It could benefit e.g. agriculture and in some cases tourism. It is quite hard to imagine many positive features. In Finland it has been stated that environmental technology could be one of the new areas of business. One can expect that better environmental technologies could help us in solving some of the environmental problems Baltic Sea suffers.

## What we can do?

Climate change forces us to change our way of living. It is of course possible to wait and see what happens and try to adapt to the new circumstances. But if we want to postpone climate change, radical actions have to take place. Some experts state that we have already lots the game. Our energy production and consumption patterns need rethinking because greenhouse gases emissions should be cut down rapidly. Traffic and transport is in the same situation as long as we use carbon based fuels as a main source of energy.

Countries around the Baltic Sea have been active on the level of speeches but perhaps a bit slow on taking action. First joint action Helsinki Convention took place in 1974. Now when all the other countries except Russia are members of EU the role of EU's policy is more crucial than before. It also means that EU and Russia must have a constant dialogue going on also on matters of Baltic Sea.

In futures work ethic and values are always present. Because climate change is a global phenomenon global actions are needed. This is what makes decision making hard. Different ethical and value codes exist all around. Additional problem is that we define the problems and their seriousness quite differently.

It is up to us and our decision making to decide what type of world we leave to the next generations. Even if we do not know what will happen for sure, it is possible to take positive actions on the basis of information we have gathered so far. We should be prepared for different possible futures not only to most plausible. And we should have a joint vision, mission and action plan for living and healthy Baltic Sea. Obviously, more research, data and information is required, but I would argue that basically the willingness to act is more important.

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## Towards a Baltic mining cluster

by Magnus Ericsson

The global mining industry is experiencing a boom longer and stronger than any for many decades. Commodity prices are shooting up and exploration for new deposits is being intensified. These two industries exploration and mining, and it is important to note that exploration is indeed a sector in its own rights, were only a few years ago considered to be dying and mainly associated in both the public discourse and on the political area with environmental problems and backward thinking in general. However the quick growth of demand for metals and minerals in emerging economies, not only China and India but also - for example - the CIS countries linked to a more metal intensive economic phase in the industrialised countries than expected by most observers, has rapidly led to a situation where security of supply has become a political focal point.

This new situation opens up opportunities for countries which are well endowed with mineral resources such as Sweden and Finland. Indeed the entire Baltic region could become *the mineral powerhouse of Europe*, including the copper and coal resources of Poland, the rare earths of Estonia and industrial minerals abundant throughout the region. The region has all the necessary prerequisites for the birth of a *Baltic mining cluster*, when also the downstream and upstream industries, such as highly specialised steel industries and the global leaders of mining equipment and mineral processing are included in the analysis. Recycling technologies should also be included in the cluster.

Most of these growth opportunities will be picked up by the private sector, both local mining companies, international mining TNCs and international exploration companies, so called juniors. Most experts seem to be convinced that metal prices will fall again but there is also a wide spread belief that the cycle will be prolonged and that prices will stabilise on a higher level than that prevailing before the boom started. The challenge for governments in the area will be to create a climate in which these private companies will be interested in choosing the Baltic region for their investments among all the opportunities available globally and to make sure that their efforts are benefiting not only their shareholders but the host countries as well.

There are several areas in which a joint approach would make the Baltic region more competitive and which would also ensure that public interests are met. Firstly coordination of mineral legislation and regulations. Steps in this direction would remove barriers to explore in the countries without having to follow national borders but only geological boundaries. In Finland and Norway new mining legislations are underway and consultations could probably facilitate their introduction and become the first steps in a harmonisation process even if it is premature to expect one joint law at this stage already. Secondly the coordination of geological information necessary for exploration would facilitate the exploration process. A joint Baltic Geological Survey would be a natural way of pooling resources and breaking down the artificial divisions set up when the present geological surveys were established in the nationalistic era of the mid 1800s. Thirdly environmental research and regulation of the sector would benefit from a joint approach both in terms of removing barriers between countries and avoiding unhealthy competition because of lower environmental demands in certain countries but also by making research into how to avoid emissions and how to make wastes harmless or at least less harmful more effective. A fourth area of cooperation within the cluster is training of mining engineers and exploration geologists. The lack of skilled people is today seriously hampering the development of mineral resources globally. R&D in mining and exploration technology is a fifth area, where Baltic cooperation could prove fruitful given the centres of excellence that already available in both Sweden/Finland and Poland. These could flourish even faster with proper coordination and additional resources.

*Magnus Ericsson*  
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# How to improve the EU's economic and trade strategies towards Russia?

by Christer Pursiainen

As the current Partnership and Cooperation Agreement (PCA) between the EU and Russia will formally expire in December 2007, a new PCA, perhaps to be called a Strategic Partnership Agreement (SPA), will be sooner or later negotiated. It will form the new legal basis for the implementation of the so-called Four Common Spaces between the EU and Russia, including the Common Economic Space (CES).

This provides a possibility to rethink the strategies for the EU, its Member States and enterprises when dealing with Russia in economic and trade issues. It is proposed to distinguish between three levels of strategies, which all are currently simultaneously present in the EU-Russian relations. Each of the strategies could however be considerably intensified.

## Integration strategy

The current CES approach cannot provide any tangible framework solutions for EU-Russian economic relations. The CES with its Road Map, being actually a "list of priorities" rather than any road map, is lacking two things in particular: a clear-cut goal and a schedule.

The first stage should be to detail the CES so that a clear goal of a free trade area (FTA), followed by a single market would be articulated. A realistic goal for the FTA could be to reach it by 2015 and for the single market by 2020. While Russia joining the World Trade Organization (WTO) should be regarded as a natural starting point for preparatory discussions on the preconditions of a FTA, the goals of a FTA and a single market should also be included into the new PCA (or the SPA).

During the preparatory phase, Russia's voluntary approximation of relevant legislation closer to that of the EU would be necessary in order to create a minimal regulatory basis for the FTA. Moreover, to be realistic, the FTA should be rather flexible with sectoral transitional periods safeguarding both the EU and Russian short-term interests.

Similarly, the single market negotiations could be started with preparatory discussions on the necessary preconditions, in particular defining the necessary level of legal approximation.

The legal approximation question would basically define the nature of the EU-Russian single market regime, namely whether it would resemble some existing bilateral (Switzerland) or multilateral (EEA) solution; or whether a new model should be created, perhaps including a system where the EU consults Russia in the preparatory phases of the legislative processes concerning single market legislation, giving Russia the ability to make comments and proposals. Consensus agreements so achieved would be automatically and voluntarily proposed or included in the relevant Russian legislation.

In any case, the goal should be an EU-Russian single market regime (with sectoral transitional periods), which would enable Russia to participate in most fields of the EU Common Market by 2020. More difficult questions, such as the degree of labour market or service market integration/liberalisation could however be solved after this deadline.

## Problem-solving strategy

Current EU-Russian relations are characterised by several trade-related problems, be the issue the import sanctions against Polish meat, Russian round wood export customs (which the EU regards as a violation of the 2004 agreement on Russia's WTO membership between the EU and Russia), transport-related problems, unfair treatment of EU-based companies in Russia and so on. From the EU's perspective, the issue is Russian protectionism, discrimination or the violation of commonly agreed upon norms and rules.

The current problem solving is not functioning very well from the EU's point of view. The nine Sub-Committees, mentioned in the PCA, do not resolve or even deal with any real problems, and often there are long periods when they do not meet at all. The specific "dialogues", be they in the field of energy or transport, do not in practice moreover even attempt to resolve any of the major problems between the EU and Russia. The different working groups around the CES do not do any better.

This has led to a situation where two possibilities exist. The first is that the Member States are left alone to sort out their problems with Russia. Bilateral negotiations with Russia are, however, difficult, because any Member State, at least the smaller ones, rarely have enough tools to pressure Russia.

The second possibility is that the EU defines the problem as not bilateral but as 'European'. This usually takes place only after a considerable and prolonged bilateral conflict. In this case however the only level where the EU can more or less effectively deal with the problems, often initiated by some Russian middle-level bureaucracies, is the highest Commissioner (EU)/ministerial (RF) level discussions. By the time they reach this level, they have already been politicized and a lot of face saving is necessary.

The lesson here is surely that the EU's problem-solving approach does not work with Russia to the benefit of the Member States.

Yet an effective solution could have been to impose, without delay, symmetrical joint EU trade sanctions on Russia, making perhaps illogical linkages between issue areas in the same way as Russia does.

Thus, while the integration strategy must be based on a patient search for the best possible long-term solution, the problem-solving strategy should be based on backing the negotiations with the potentiality of sanctions. If this would be done automatically at the middle-level of European Commission bureaucracy, the issues would not necessarily become so politicized. This automatic solidarity and reactive practice would also, after a while, also have the likely effect of preventing Russian bureaucracies from taking arbitrary decisions and violating previously agreed upon rules, because such decisions would become too costly.

## Adaptation strategy

The adaptation strategy is best suited to the sectoral and company level, although individual companies may also benefit from the actions taken by the EU and/or Member States. Given the problems with regard to Russia, such as protectionist legislation, companies might decide to avoid or withdraw from Russian markets while waiting for Russia to become more closely integrated into Europe. Instead, the best alternative might be just to study the current Russian circumstances as carefully as possible and then to try to better adapt to these circumstances.

This might include, for instance, competing with Russian enterprises with efficiency, flexibility, specialist knowledge or equipment; creating affiliated offices, registered in Russia, in order to avoid protectionism and discrimination; moving production to Russia. In the latter case, it might often be rational to try to control the whole cycle of the respective field of economic activity, thus avoiding vulnerabilities by not opting for the externalisation of parts of important elements of economic activity. The necessary agreements for investment protection should be worked out at the EU-Russian level (integration strategy).

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## Beware: dragons out of cage

by Valtteri Kaartemo

According to UNCTAD, China's FDI outflows reached US\$ 11 billion in 2005. The figure is about one fourth of its outward FDI stock, which indicates a remarkable change in the pace of the outward expansion of Chinese companies. Although the official (not necessarily realistic) outward FDI stock remains only a half of that of Finland, there are already more than 10,000 Chinese firms operating overseas. The phenomenon – competitive companies originating from emerging markets – is considered being one of the most important trends shaping the global economy in the future.

It is expected that there will be new booms for FDI from China in the near future. Especially with the yuan's expected appreciation, it is likely that Chinese companies enhance their international acquisition portfolio, when foreign assets become less expensive for them. In line with these expectations, China's Ministry of Commerce has estimated that China's outward FDI is to total over US\$ 60 billion between 2005 and 2010. In turn, estimates by Straszheim Global Advisors show that Chinese companies will invest some US\$ 80 billion already during 2006–2007.

High share of Chinese imports in the countries of the Baltic Sea region indicates that China has already increased her economic role within the region. Finland and Russia show even greater dependence on Chinese goods. Generally, exports to China are of less importance, although Russia and Germany are among China's ten most important trading partners.

According to International Trade Center (ITC), the greatest potential in the Baltic Sea region's trade with China is in the Baltic States and Poland, which partly indicates poor performance of these countries in their exporting activities in China.

Regardless of soaring imports (average annual growth about 30 %) and huge trade potential, FDI outflows from China to the Baltic Sea region have remained low. In Germany, the year 2006 showed a remarkable increase in FDI outflow relative to the FDI stock, nevertheless the Chinese FDI stock remains just a fraction of a percent of the overall figure. However, as Chinese foreign investments are expected to grow and Chinese companies are found to be market-seeking by nature, the soaring export levels may lead to a growing number of Chinese companies to invest in the region.

Currently, the most widely-known Chinese investments in the Baltic Sea region are perhaps the huge Baltic Pearl project in St. Petersburg, factory investments in Kaliningrad by television manufacturer TCL and automaker Chery, and R&D investments by telecommunication giants Huawei and ZTE in Kista, Sweden.

Table 1 Baltic Sea region's trade with China

Country	Value of exports in 2005 in US\$ million	Share of country's exports	Value of imports in 2005 in US\$ million	Share of country's imports
Denmark	1,190	1.4 %	2,789	3.7 %
Estonia	58	0.7 %	311	3.1 %
Finland	2,628	4.0 %	3,626	6.2 %
Germany	30,723	3.1 %	32,527	4.2 %
Latvia	9	0.2 %	282	3.2 %
Lithuania	11	0.1 %	361	2.8 %
Norway	1,144	1.4 %	1,322	2.9 %
Poland	557	0.6 %	2,595	2.6 %
Russia	15,890	6.6 %	13,211	13.4 %
Sweden	3,122	2.4 %	2,574	2.3 %

Source: ITC calculations based on COMTRADE statistics, author's calculations

A recent research on the motives of Chinese foreign investments in the Baltic Sea region indicates that Chinese companies are not only interested in securing markets for their low cost products but are willing to become a part of the value adding network of the region. This may sound concerning, as the region's countries have just started recovering from China's impact on the global movement of manufacturing jobs. However, the entry of Chinese firms may also provide business opportunities for the local companies in the Baltic Rim, as Chinese companies are willing to have new partners. In addition, Chinese companies are becoming increasingly important sources of knowledge, which makes them interesting partners together with their linkages to the Chinese market.

Thus, companies in the Baltic Sea region should be prepared in advance for the emergence of Chinese companies in the world economy. This means following up their maneuvers in given industries, and acting accordingly in order to prevent losing market shares and deteriorating competitiveness and, most of all, in order to exploit the new business opportunities which Chinese companies provide in the local market and globally.

The new role of Chinese companies needs also actions from policymakers and most of all measures to attract Chinese investments to the Baltic Sea region. One idea is to establish a common investment promotion agency, which would combine the resources of the countries surrounding the Baltic Sea. This would provide not only more financial resources and economies of scale but also a larger pool of enterprises which could be marketed for Chinese companies interested in the company networks of the region. Through networks of companies, the benefits of the investments could also be dispersed among those countries who shared the costs – regardless of the final target country.

In order to help the region's companies and policymakers, funding should also be found for the academia to develop an economic monitoring system which would track Chinese investments in different sectors and regions, providing thorough analysis for decision makers both in private and public sector.



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# Baltic Rim Economies

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