Baltic Rim Economies

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Estonia

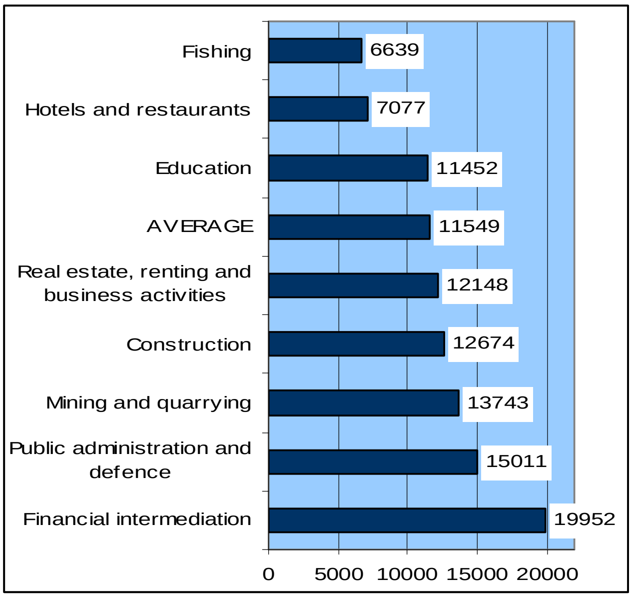
GDP development

In the second quarter of 2007, the Estonian economy grew by 7.6% compared to the corresponding period in 2006 according to Statistics Estonia. The growth rate for the second quarter turned out to be slightly higher than previously expected. When compared to the first quarter of 2007, the economy expanded by 8.7% in the second quarter. The year 2006 was a year of strong growth in Estonia, since throughout 2006 Estonia recorded growth rates of over 11%. The robust economic performance of last year was mainly driven by strong domestic demand. The slowdown in growth in 2007 is mainly explained by a slowdown in domestic demand. Also the growth in exports and imports has been decelerating, which partly explains the more modest growth than last year. The growth in exports started to decelerate already last year, and this year the exports of goods grew only by 0.5% in the second quarter of 2007 compared to the same period in 2006.

Growth in GDP was mainly driven by the increase of value added in the following economic activities: manufacturing, financial intermediation, the wholesale and retail trade, transport, storage and communication.

The Estonian economy has shown some signs of overheating, so news about growth slowing down might be good news. The Estonian central bank even announced that it has lowered its forecast for economic growth in 2008. According to original estimates in April, the Estonian economy was expected to grow by 6.5% next year. Now the Central bank announced that the growth forecast is more moderate 4.3%.

Rapid growth of wage level continues



Source: Statistics Estonia

The average gross monthly wages of full-time and part-time employees were EEK 11,549 or EUR 738 in the 2nd quarter of 2007. There was a 21.2% y-o-y increase in the average monthly wages compared to the corresponding period in the previous year. The highest average monthly salaries are in financial intermediation, namely EEK 19,952 or EUR 1275. The wages in this sector increased by 27.5% in the 2nd quarter of 2007 y-o-y. The fast development of the wage level has been caused by the accession to the EU, since more attractive labour markets in the EU have increased the pressure to raise the salary level in Estonia. According to Eurostat, the wage level in Estonia is still among the lowest in the EU27.

Housing sector accelerates inflation

According to Eurostat calculations, one of the highest levels of inflation in the EU countries was recorded in Estonia in September 2007. Statistics Estonia reported that the annual inflation in September was 7.2%, whereas average inflation for the EU27 area was 2.2%. Compared to August, consumer prices rose by 1.1% in September, which again is one of the highest rises in the EU. Higher annual inflation was recorded only in Latvia and Bulgaria.

The most significant contributor to this rapid increase in prices was the housing sector. The prices in this sector grew by 16.6% between August 2006 and August 2007 according to Statistics Estonia. There were also sectors where prices fell. Consumer prices for transport and communications fell modestly, by -1.0% and -0.4% respectively during the same twelve month period.

Some business highlights

- State owned rail freight carrier Estonian Railways will be split in three parts that will manage rail infrastructure, carry freight and act as the parent company of the first two. Estonian Railways also plans to buy new faster trains to facilitate passenger traffic between Tallinn-St. Petersburg and Tallinn-Riga.
- Next year, Estonia will have the highest alcohol excise duty in Europe. The government has decided to raise the alcohol excise duty first by 10% and later next year by an additional 20%.
- Tallinn airport has decided to lower landing fees, hoping to attract more airlines to Tallinn. New fees will take effect next year and apply to all airlines. For example Ryanair has shown interest to start flying to Tallinn.
- Atria, Finland's largest meat processor in terms of turnover, will reorganise its operations in the Baltic countries from 1 November 2007. Atria's Baltic operations will concentrate on Estonia. AS Valga Lihatööstus is one of the biggest production companies within the Atria Group.
- Aggregate profits of commercial banks in Estonia were 2.4 times higher in the first eight months of 2007 than in the corresponding period for the previous year. Assets of commercial banks went up by 44.1% y-o-y.
- According to a study of countries' business climate by World Bank, Estonia ranked as number 17, Singapore holding the top rank. In the study of 178 countries, Latvia was ranked as number 22 and Lithuania as number 28.
- Estonia may be applying for partnership in the Finnish Olkiluoto nuclear power plant project. It is not yet clear, how big Estonia's share would be in the project. Eesti Energia plans to add a second submerged power cable between Estonia and Finland by 2013.

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	8,0	7,2	8,3	10,2	11,2	7,6	Q2/2007
Industrial production (y-o-y %-growth)	14,6	8,9	8,2	11,0	10,5	11,0	7,3	2,0	8/2007
Inflation (CPI, end of period, y-o-y %-change)	5,0	4,2	3,6	1,3	3,0	4,1	4,4	7,2	9/2007
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	738	Q2/2007
Unemployment (% end of period, LFS data)	13,9	11,9	11,3	9,3	8,5	7,9	5,9	5,0	Q2/2007
Exports (EUR million, current prices)	3 445	3 698	3 642	4 003	4 770	6 190	7 647	3 967	1-6/2007
Imports (EUR million, current prices)	4 615	4 798	5 079	5 715	6 704	8 213	10 576	5 507	1-6/2007
Current account (% of GDP)	-5,5	-5,6	-10,6	-11,6	-12,5	-10,5	-14,8	-17,7	Q1/2007

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

Latvia

National economy

The Latvian economy has been showing signs of overheating after several quarters of economic growth over 11%. Their inflation rate has also been soaring, which has given reason to doubt that the Latvian economy is not on a stable basis. Some analysts fear that the Latvian economy will face a hard landing if the potential crisis actually occurs. Strong growth in nine consecutive quarters has been driven by strong growth in private domestic demand and fuelled by rapid credit growth funded by Latvian banks borrowing from abroad.

However, at least some light can be seen in the Latvian economy. Real estate markets have shown signs of cooling, which would lead to a damping of private consumption. Due to high interest rates in the euro-zone, the rapid credit growth has slackened, which is also a positive sign. The Latvian Central Bank estimates that a sustainable level of long-term growth would be 6 to 8%.

Fiscal tightening required

The Latvian economy needs to tighten their fiscal policies, if a soft landing is preferred, so as to prevent it from a crisis. Since the Latvian currency lat is tied to the euro in the ERM2 mechanism, monetary policy is fairly powerless to control the overheating. Instead, the government should use its fiscal policy to adjust the economy. At the moment, the government is aiming at a 0.4% surplus of the GDP in the 2007 budget. Next year, the target is to have a surplus of up to 1.5%. According to the Central Bank of Latvia, the budget surplus could even reach 2% next year.

Inflation continues to soar high

The inflation rate in Latvia is still the highest in the EU. It is also a lot higher than in the two other Baltic States, where inflation has been also relatively rapid.

In September 2007, the prices grew by 11.5% y-o-y. The price level rose by 1.9% compared to August 2007, which is high for a monthly rate. The average prices for goods rose by 1.6% and the prices for services increased by 2.5% according to the Central Statistical Bureau of Latvia. According to IMF estimates, the inflation rate will be slightly smaller next year but still remains on a relatively high level.

The overall level of producer prices remained constant in September 2007 compared to August. The y-o-y increase in producer prices, on the other hand, was 15.7%. The largest price increase was in the manufacture of wood and products of wood except furniture, which grew by 4.6% y-o-y. The producer prices in the manufacture of food and beverages increased by 3.3% and electricity, gas, steam and hot water supply increased by 2.6 percentage points y-o-y.

According to the Central Statistical Bureau of Latvia, construction costs increased by 23.8% y-o-y in the 3rd quarter of 2007. The steepest increase was in worker's salaries, which rose by 40.4%. Also the prices of construction materials and the maintenance of machinery and equipment went up, 10.1 and 34.4 percentage points respectively.

Foreign trade

The value of exports increased by 2.3% in August 2007 compared to July. The y-o-y increase in the value of exports was 15.6% according to the Central Statistical Bureau of Latvia. The value of imports, on the other hand decreased by 10.6% compared to July. However, imports grew by 12.9% y-o-y in August 2007. The total foreign trade turnover was 13.8% higher than in August 2006, reaching a total value of EUR 1.4 bln.

Latvia's main trade partners in 8/2007 as % of total

EXPORTS		IMPORTS	
EU27	75.6	EU27	77.8
CIS	15.7	CIS	13.2
Lithuania	15.1	Lithuania	16.3
Estonia	14.8	Germany	13.8
Russia	11.2	Estonia	8.8
Germany	8.7	Russia	8.0

Source: Central Statistical Bureau of Latvia

The EU27 area is the most important trading area for Latvia. The value of exports to and imports from the EU27 both exceed 75% of their total trade. Of individual countries, Lithuania continues to be the single most important trade partner for Latvia, both in the value of exports and imports. The value of exports to Lithuania increased 15.8% in the first eight months of 2007 y-o-y. The imports to Lithuania increased by 25% in the same period y-o-y.

Some business highlights

- RBS SKALS is planning to build a new office complex in Riga. The total cost of the construction process is estimated to be EUR 150 mln. The plan is that there will be offices, shops and apartments in the new complex.
- The number of retail stores has dropped by significant 34% in the last five years in Latvia. High rental fees, lack of labour force and fierce competition are the main reasons for this.
- Latvian ports were first in terms of cargo turnover in the eight first months of 2007 in the Baltic countries. Latvian ports handled 42.4 mln tons of cargo, when the respective figures for Estonia and Lithuania were 33.5 mln tons and 21.6 mln tons.
- It is estimated that the development of the railway line, Rail Baltica, in Latvia would cost EUR 142 mln. EUR 35 mln of this would be allocated by the EU. Rail Baltica will link Warsaw, Kaunas, Tallinn and Helsinki.
- According to participants of the Realty Baltics 2007 exhibition, the Latvian real estate market will face stagnation and a slight decline in prices. However, Capitolia Group disagrees with this opinion saying that housing prices are not going to fall in Latvia. Capitolia Group plans to invest in Riga and Jurmala worth EUR 183 mln in its projects.
- In the annual report by LaSalle Investment Management, Riga was ranked 41st. European Regional Economic Growth Index identifies European cities expected to be of most interest to investors and developers. Tallinn ranked 51st and Vilnius 55th in the index.
- Construction of high capacity biodiesel factory SIA Bio-Venta has been finished. The factory, located in the territory of Ventspils port, is planned to be launched in 2008, when the factory starts producing biodiesel, mainly using canola seeds purchased from local producers.

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	11,3	4-6/2007
Industrial production (y-o-y %-growth)	3,2	6,9	5,8	6,5	6,0	5,6	4,8	3,3	8/2007
Inflation (CPI, end of period, y-o-y %-change)	1,8	3,2	1,4	3,6	7,3	7,0	6,8	11,4	9/2007
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	659	Q2/2007
Unemployment (% end of period, LFS data)	13,3	12,9	11,6	10,3	10,3	8,7	6,8	6,9	8/2007
Exports (EUR million, current prices)	2020	2 232	2 416	2 559	3 204	4 086	4 594	3 662	1-8/2007
Imports (EUR million, current prices)	3 453	3 910	4 284	4 634	5 671	6 879	8 828	7 214	1-8/2008
Current account (% of GDP)	-4,8	-7,6	-6,6	-8,1	-12,9	-12,3	-21,1	-25,7	1-9/2007

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

Lithuania

Lithuanian economy

In the 2nd quarter of 2007, the growth of gross domestic product accelerated somewhat; and GDP grew by 10.8% compared to the first quarter of 2007. The y-o-y growth in the second quarter was 8.0% according to revised estimates by Statistics Lithuania. The overall growth in 2007 seems to be somewhat higher than in 2006, when the growth rate was 7.7%. According to the Bank of Lithuania, the deceleration of economic growth in 2006 was only temporary and caused by specific factors, not by business cycle fluctuations. The main drivers behind strong growth are domestic demand supported by credit, close to zero real interest rates and the lack of fiscal tightening by the government. The real GDP is expected to grow by 8.5% this year and by 7.4% in 2008.

The Bank of Lithuania expects an increase in the current account deficit, due to strong final consumption and investment growth. Despite rising production costs, the prospects for exports are favourable, and the deterioration of the trade balance does not affect the external competitiveness of the Lithuanian economy.

Annual inflation still high

In September 2007, the annual inflation in the Lithuanian economy was 7.1%. According to estimates by the Bank of Lithuania, the inflation is expected to continue on a fairly high level also next year, mainly due to increases in energy prices. Lithuanian Finance Minister Rimantas Sadzius hopes that the Law on Fiscal Discipline could help to fight inflation. The law envisages a reduction in national expenditure and stipulates that the general government deficit should not exceed 0.5% of GDP next year.

The largest increase was in the prices for food products and non-alcoholic beverages, which grew by 12.7% compared to September 2006. Food prices increased mainly due to increases in the price of agricultural products and increasing labour costs. There were also other commodity groups where prices went up, such as housing, water, electricity, gas and other fuels, as well as transport services. In some commodity groups prices fell, e.g. the prices for communication goods and services fell by 7.2% y-o-y and clothing and footwear by 4.8%. Overall, the prices for consumer services grew faster than the prices for consumer goods, 8.2% and 6.7% respectively.

Changes in prices (%) for selected commodity groups	in 9/2007 as compared to	
	8/2007	9/2006
Total CPI	1.4	7.1
Food products and non-alcoholic beverages	2.2	12.7
Housing, water, electricity, gas and other fuels	1.3	12.5
Transport	1.4	7.5
Communication	-0.3	-7.2
Clothing and footwear	3.8	-4.8

Source: Statistics Lithuania

Also the monthly inflation rate was relatively high. Consumer prices were 1.4% higher in September 2007 compared to August.

Price development has been quite rapid in producer prices as well. In September 2007, producer prices were 8.1% higher than a year before. The monthly increase in the producer prices was 1.1%. According to preliminary figures by Statistics Lithuania, the increase in producer prices was 5.4% in the 3rd quarter of 2007 compared to the corresponding period in 2006. The prices for mining and quarrying grew by 5.8%, manufacturing by 4.3% and electricity, gas and water supply by 11.7% y-o-y.

Amount of foreign direct investments keeps on increasing

The total stock of foreign direct investment in Lithuania in 2007 is approximately 21% higher than in 2006. The major investor is Poland, whose share of total FDI in Lithuania is 21.3%. Other important investor countries are Denmark, Sweden and Germany, 12.5%, 10.9% and 8.9% respectively.

The largest share of FDI goes into manufacturing, almost 40%. The main sectors within manufacturing are the manufacture of refined petroleum and chemical products, and the manufacture of food products, beverages and tobacco. Also the wholesale and retail trade, electricity, gas and water supply, as well as financial intermediation have attracted foreign direct investments to Lithuania, whose share of the total stock are 10.6%, 10.5% and 15.9% respectively.

Some business highlights

- Aggregate assets of Lithuanian commercial banks and foreign bank branches grew by 20.6% in the first eight months of 2007. SEB Vilniaus Bankas has the leading position in the market with assets of EUR 6.5 bln, followed by Hansabankas (EUR 4.8 bln), DnB Nord (EUR 2.8 bln), Sampo (EUR 1.5 bln) and Snoras (EUR 1.4 bln).
- The net profit of SEB Vilniaus Bankas went up by 56.1% in the first nine months of 2007 y-o-y. Its net profit amounted to EUR 93.6mln by September 2007.
- The Lithuanian Prime Minister Kirkilas has set up a task force to consider the possibility of building a liquefied gas import terminal in Lithuania.
- Lithuania has undertaken to decommission the nuclear power plant in Ignalina by 2009. The plan is to build a new NPP by 2015, which would leave a gap of six years in energy production, leading Lithuania into an energy crunch. It is estimated that energy prices would go up by 40% and their dependence on Russia's natural gas would increase to 75%. Lithuania has appealed to Brussels, hoping to get an extension to Ingalina, but so far there seems to be no continuation for Ingalina NPP.
- Aggregate profits of Lithuanian companies grew by 42.1%, reaching EUR 1.9 bln in the H1 of 2007. The average profitability of all companies increased by 1.2% to 7.8%. Total sales and service revenues rose by 21.2% y-o-y.
- The 9-month-profit of the TEO group increased by 23.4% y-o-y. TEO LT is a group of companies, and the group has made strategic plans to develop in new areas, such as IT, which will help the company to earn higher profits in the future.
- Lithuania's insurance market grew by 37% in the first nine months of 2007. The total value of insurance claims totalled EUR 133 mln in September.
- From January 1st, companies will have to pay higher real estate taxes. Increases in taxes vary between 0.3 to 1% of property value, depending on the municipalities. However, big cities and popular resorts are not likely to change real estate rates.

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	7,9	7,7	8,0	Q2/2007
Industrial production(y-o-y %-growth)	2,2	16,0	3,1	16,1	10,8	7,3	8,9	13,7	9/2007
Inflation (CPI, end of period, y-o-y %-change)	1,4	2,0	-1,0	-1,3	2,9	3,0	3,8	7,1	9/2007
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	529	Q2/2007
Unemployment (% end of period, LFS data)	16,9	17,9	13,0	11,6	10,6	8,3	5,6	4,1	Q2/2007
Exports (EUR million, current prices)	3 841	4 778	5 526	6 158	7 478	9 502	11 250	7 090	1-7/2007
Imports (EUR million, current prices)	5 650	6 767	7 943	8 526	9 959	12 446	15 384	9 957	1-7/2007
Current account (% of GDP)	-5,9	-4,7	-5,1	-6,8	-7,7	-7,2	-10,8	-13,2	1Q/2007

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

Poland

Steady growth continues throughout 2007

Economic growth in 2007 is expected to continue on the stable path of 2006, when the annual growth was 6.1%. The Polish economy grew strongly in the first quarter of 2007, their growth rate being above 7%, but the second quarter has proved that the total growth for 2007 is not going to continue that fast. However, growth is the second quarter was 6.7%, slightly higher than initial estimates. According to the Eurostat forecast, the annual growth for 2007 will be the same as last year, 6.1%. This indicates that the Polish economy is on a stable basis, and no risk of overheating is present, as does in the Baltic countries.

Price development still moderate

Price development has been much more modest in Poland than in the Baltic States. According to the Central Statistical Office of Poland, the annual inflation rate in Poland was 2.1% in September 2007, y-o-y. However, growing labour costs and excessive budget expenditure have caused fears that inflation may accelerate next year. The target is to keep inflation at around 2.5%, when inflationary pressure may result in higher interest rates. So far the inflation rate is within the limits set by the ERM2 mechanism, which is one of the main criteria for applying to the Economic and Monetary Union. However, Poland is not yet a member in the ERM2, so the adoption of euro is not about to happen in the near future.

On the consumer side, Central Statistical Office of Poland reports that the largest increases were in the prices for food products and beverages, which grew by 3.8% in the first nine months of 2007 compared to the corresponding period last year. Also dwelling expenses got more expensive, especially the prices for housing, water, electricity, gas and other fuels, which grew by 4.0% y-o-y. While the consumer prices went up in all other commodity groups, the prices for clothing and footwear decreased by 7.5% in September 2007.

Price indices of consumer goods in 1-9/2007 (%) y-o-y	
TOTAL	2.1
Food, beverages, tobacco	3.8
Clothing and footwera	-7.5
Dwelling	3.4
Restaurants and hotels	3.2
Communication	0.9
Transport	0.7

Source: Central Statistical Office

Unemployment rate keeps on decreasing

The unemployment rate has been constantly decreasing in Poland. In January 2007, the registered unemployment rate was 15.1%, whereas in September 2007, the rate was 11.6%. Throughout the year 2007, the rate has been slightly decreasing month by month, according to the Central Statistical Office of Poland.

However, the positive development of the unemployment rate has not been caused solely by improving labour market conditions, but the decrease has been largely contributed to by the EU's open labour market, which has attracted a significant amount of Poles to look for better jobs abroad. Now the Polish government has woken up to the labour shortage, since despite the relatively high unemployment rate, many employers find it hard to find qualified staff. According to an estimate by the Ministry of Labour and Social Policy, there are 1.2 mln Poles working abroad, whose average age is 26. These people are doing jobs for which they are overqualified, and Poland should find a way to attract these people back home.

Another worrying thing about the labour markets in Poland is the fast rising salary level. Average gross wages and salaries grew by 8.9% in the first nine months of 2007 y-o-y according to the Central Statistical Office of Poland. This fast development is not sustainable and is also one of the main contributors to rising inflation.

Foreign trade

The total amount of Polish exports grew by 14.8% in the first nine months of 2007 compared to the corresponding period in 2006, thus reaching a total value of EUR 64,260 mln. Imports to Poland, on the other hand, grew by 16.8% in the same period, totalling EUR 74,420 mln in September 2007. The EU area continues to be the most significant trade partner for Poland; approximately 79% of exports go to the EU and 65% of imports originate from the EU area respectively.

Some business highlights

- Plaza Centers, a Dutch-registered property developer plans to debut on the Warsaw Stock Exchange in the near future. This would make it the first company listed on the main market of the London Stock Exchange to also list on the Warsaw Stock Exchange.
- Eltel Networks has become the largest Finnish employer in Poland. Eltel networks builds and maintains telecommunications and power networks, and has acquired several Polish companies. Now Eltel provides fixed-line and mobile phone networks for most of Poland.
- McDonald's plans to double the number of its fast food restaurants in Poland next year. The fast food giant also plans to modernise 200 of its Polish restaurants. The construction costs are estimated to be around EUR 50-80 mln.
- Kostrzyn-Slubice Special Economic Zone has issued 142 permits over ten years, and attracted investment totalling almost EUR 500 mln. Kostrzyn-Slubice SEZ made a profit of EUR 1.4 mln in 2006, and today it employs 13,000 people. According to the KPMG consulting company, it was ranked in joint first place when assessed by investors.
- After four years of entering into Polish markets, Slovak fuel company Slovnaft has become one of the largest liquid fuel distributors in Poland. Slovnaft Polska, company's Polish subsidiary, is rapidly expanding its network of gas stations. At the end of 2006, Slovnaft's revenues were almost EUR 500 mln.
- Ryanair, the low-cost Irish airline, has announced that it will launch two new scheduled flights to and from Poland. From October 28th Ryanair flies twice a week from Szczecin to Dublin, and from November 1st it flies three times a week from Katowice to Dublin.
- Colliers' Property Management Department has been chosen to manage Poland Central logistics & business park in Wola Bykowska. The center has been designed to become a European distribution hub serving regional cities in Poland as well as Central & Eastern Europe.

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	6,7	Q2/2007
Industrial production (y-o-y %-growth)	6,7	0,6	1,1	8,3	12,6	4,1	5,7	5,2	9/2007
Inflation (CPI, end of period, y-o-y %-change)	8,5	3,6	0,8	1,7	4,4	0,7	1,4	2,1	1-9/2007
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	770	9/2007
Unemployment (%, last survey in the year, LFS data)	16,0	18,5	19,7	19,3	18,0	16,7	12,2	11,6	9/2007
Exports (EUR billion, current prices)	34,4	40,4	43,4	47,5	59,7	71,4	87,5	64,3	1-9/2007
Imports (EUR billion, current prices)	53,1	56,2	58,3	60,4	71,4	80,6	100,0	74,4	1-9/2007
Current account (% of GDP)	-6,0	-2,9	-2,6	-2,1	-3,5	-1,7	-2,3	-4,5	1-3/2007

Sources: Central Statistical Office, National Bank of Poland, Eurostat, author's calculations

St. Petersburg

Industrial cycle ending

In July and August 2007 the regional economy experienced a new deceleration of industrial production growth. It contrasted with the continuing rapid growth of service sectors, but was in line with the sudden worsening of national short-term economic results. In August industrial production in Russia grew by only 3.8%, which was significantly lower than a month before (+7.8%). Some experts interpret these results not as an accidental decline, but as a start of a medium-term stagnation or even recession for industrial production. The reason might be both global financial uncertainty leading to higher interest rates, and a domestic economic cycle reaching its end. Indeed, the big 10-year economic cycle in the Russian economy (it started right after the crisis of 1998 and exploited the strong rouble devaluation effect) is coming to its end. In 2007 Russia's GDP would eventually overcome the Soviet-era maximum of 1989 for the republic. That would open a way for the new cycle which would be driven either by a service sector favoured by booming domestic demand, or by a more competitive and innovative industrial sector.

Dynamics of regional economic development, St. Petersburg

		2006	Jan-August 2007
Industrial production, y-o-y,%		-7.0	7.9
	Manufacturing	-8.7	8.2
	Energy, gas and water production*	8.3	7.1
Construction, y-o-y, %		35.6	21.2
Transport, y-o-y, %		20.9	18.4
Communication, y-o-y, %		38.3	23.2
Retail trade, y-o-y, %		14.5	18.0
Investment in real assets, y-o-y, %		4.5	3.4

Source: Petrostat

*- also includes distribution of energy, gas and water

Another important indicator is the decreasing investment activity in the region. It also reflects negative or rather moderate expectations by investors at the moment. Nevertheless, some industrial branches in January-August still experienced impressive growth, e.g. metallurgy (+16.8%) and chemical production (+15.3%). It should be mentioned, however, that these branches have a longer production cycle than other industries in general.

Construction maintains their pace

Despite the abovementioned difficulties, construction kept growing at the same rate than two months before, July and August 2007. The cooling of industry and investment is, to some extent, linked with infrastructural limitations that became a real obstacle for growth. The construction sector is a key for expanding the space for the regional economy through the renovation of the existing infrastructure and the creation of new production facilities. In January-August 2007 the absolute volume of construction services supplied by regional construction companies reached EUR 1.64 bln, which by 21% exceeded the result of the same period of 2006. Impressive growth was observed in residential construction: the number of flats constructed in January-August 2007 grew by 40.5% y-o-y, and the total residential space of apartments finalised increased by 28.0% y-o-y. The development of construction influenced the automobile transportation sector; the cargo turnover of regional automobile transport companies grew in January-August by 36.7% y-o-y, whilst the entire transport sector experienced a more modest increase of 18.4%, y-o-y.

Foreign investment on its peak

In the first half of 2007 foreign investment to the St. Petersburg economy increased by 30.9% y-o-y, totalling EUR 1.55 bln. The structure of foreign investment was changing towards FDI and portfolio investment. The share of FDI grew from 15.4% of the total inflow in January-June 2006 to 18.5% in the first half of 2007; this reflecting a 50% y-o-y increase of FDI inflow to the region. Portfolio investment experienced an even larger increase: its share rose from 2.0% in the first half of 2006 up to 23.9% in the corresponding period for 2007. Thus, portfolio investment became larger than FDI for the first time in the region's history. This 1480% increase was induced by so-called "hot money" from global markets which came to St. Petersburg corporate sector. Other investment, consisting mostly of various foreign credits, decreased its share from 82.6% in January-June 2006 down to 57.6% of the total in 2007, y-o-y. The leading investor in the regional economy in the first half of 2007 was USA with 20.6% of the total, followed by offshore Cyprus (16.6%) and next Great Britain (8.8%). Regional exports and imports continued to grow in the first half of 2007 and both increased almost equally by 60% y-o-y.

Some business highlights

- American paper producer International Paper (IP) purchased 50% of Ilim Holding S.A., a structure created by St. Petersburg-based leading forest industry holding Ilim Pulp, for EUR 490 mln. The new alliance of IP and Ilim Pulp plans to implement a large EUR 1.1 bln targeted investment programme plus the modernisation and development of paper producing plants of Ilim Pulp.
- Russian holding OPK invests EUR 414 mln in total restructuring of Severnaja Verf shipyards and Baltijski Zavod factory. Reconstruction and removal of industrial facilities should release a large territory in the city centre which could be used for new residential and office buildings.
- Finnish concern Fortum decided to sell its 33.5% package of regional power distributing monopoly Lenenergo for EUR 295 mln. 3.3% of the package is purchased by RAO UES, and the remaining 30.2% goes to the consortium of the Russian bank VTB and company Electricity Distribution Investments 1 Ltd. (a fund controlled by Russian magnate Victor Vexelberg).
- Company Karelian Trains Oy, a daughter of RZD (Russian railroad monopoly) and Finnish VR Ltd. signed a EUR 120 mln purchasing contract with French concern Alstom. The latter is supplying 4 high-speed trains for a new railway route between St. Petersburg and Helsinki which would be launched in 2010.
- Magnitogorski Metallurgicheski Kombinat (MMK), one of the largest Russian metal producers, started to construct a metal-processing plant in Kolpino, St. Petersburg. The plant would supply metal parts for automobile factories (Ford, Toyota, GM, Nissan) and producers of house appliances (Bosch, Electrolux). Planned investment totals nearly EUR 100 mln.
- Two metal producers, namely ThyssenKrupp AG and Ruukki, announced their plans to invest in their warehouses and service centres for metal components in St. Petersburg, the sums of EUR 30 mln and EUR 20 mln respectively.
- Taiwanese company Hon Hai Precision Industry Co invests EUR 40 mln into the creation of an IT-component plant in St. Petersburg. The plant would manufacture PCs, monitors and other hardware.

St Petersburg - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	as of
Regional GDP (y-o-y %-growth, constant prices)	10,5	4,5	17,7	8,4	7,2	8,4	8,4		1-12/2006
Industrial production (y-o-y %-growth)	26,2	0,2	31,4	5,8	14,1	4,2	-7,0	7,9	1-8/2007
Regional inflation (CPI, y-o-y %-change)	23,5	16,3	16,6	13,0	12,7	12,0	10,0	10,2	1-8/2007
Gross average wage (monthly, EUR)	n/a	n/a	217,1	209,3	284,9	344,5	406,9	480,0	7/2007
Unemployment (% average annual)	7,9	4,4	3,5	4,3	2,8	2,4	2,4	2,4	H1/2007
Exports (EUR million, current prices)	2736,1	2133,8	1839,3	2428,5	3209,7	3953,1	5498,6	3061,4	H1/2007
Imports (EUR million, current prices)	2692,9	4422,7	5158,0	5122,9	5559,5	8081,3	10298,7	6225,1	H1/2007
FDI inflow (EUR million, current prices)	158,4	126,8	88,9	62,1	90,0	200,5	512,4	286,4	H1/2007

Sources: Petrostat, Rosstat, Central Bank of Russia, European Central Bank

Leningrad region

Deceleration of economic development

In June-August 2007 the Leningrad region experienced a visible deceleration of growth or even a decrease in two basic sectors of its economy, namely industry and construction. A slight improvement was observed in agriculture and trade. Growth in transport and communication was strongly affected by higher tariffs and was, in fact, decelerating during the of summer 2007. Deceleration influenced the investment decisions; as investment activity decreased by 16.2% y-o-y.

Dynamics of regional economic development, Leningrad region

	2006	Jan-August 2007
Industrial production, y-o-y,%	26.9	10.9
Construction, y-o-y, %	7.9	-9.3
Transport, y-o-y, %	20.1	20.5
Agriculture, y-o-y, %	8.2	0.4
Communication, y-o-y, %	15.7	12.1
Retail trade, y-o-y, %	22.0	16.3
Investment in real assets, y-o-y, %	30.0	-16.2

Source: Petrostat

Industrial production was growing mostly due to one branch, namely automobile production. In the first 8 months of 2007 it increased by 36.2% y-o-y and its share rose to 12.8% of all regional manufacturing output. The largest branch of regional industry, food and tobacco production with its 27.8% share of total output, experienced an 11.6% decline y-o-y.

The cargo turnover of the regional transport sector increased in January-August 2007 by 11.0% y-o-y, driven by the development of local seaports: Vyborg, Primorsk, Vysotsk, and Ust-Luga. Stevedore companies for these seaports processed 65 million tones of cargo in the reviewed period of 2007, which by 19% exceeds the result from January-August 2007.

Construction in decline

The regional construction sector is slowly slipping into recession ever since April 2007. This contrasts with its 7.9% growth in 2006. The reason might be the overproduction of residential buildings, already exceeding solvent demand. Indeed, in January-August the space of residential apartments and houses finalised grew by 60.0% y-o-y, whereas, a year ago, during the first 8 months of 2006 it decreased by 1.4% compared to January-August 2005. Despite this booming supply, demand is limited by the low incomes of the residents. Real incomes from January 2006 until June 2007 grew by 40.7% y-o-y whilst real estate prices in the Leningrad region more than doubled during these 18 months, following the trends of the St. Petersburg's estate market.

Agriculture develops slowly

The 2007 summer season showed much diversified development of the regional agricultural sector. Some branches of agriculture grew quickly while others stagnated or decreased their output. Hog-breeding, a comparatively new and competitive industry in the region increased its livestock by September 2007 by 11% y-o-y, in line with its 17% growth y-o-y in September 2006. At the same time cattle stock has almost stagnated for the two last years, and sheep stock diminished (by 8% in January-September 2007 y-o-y). The regional poultry industry is competitive due to its large farms and economies of scale; it grew by 4% in the reviewed period of 2007. The basic problems it meets are demand limitations. The poultry industry of the Leningrad region has almost 20 million heads of chicken, supplying meat and eggs to the common market of St. Petersburg and Leningrad region with 6.2 million inhabitants. By comparison, the Finnish poultry industry with 3.4 million heads of chicken supplies to almost the same market of 5.2 million potential consumers.

FDI decreases

In the first half of 2007 foreign investment grew by 8.0% y-o-y. Nonetheless, this increase was driven by other investment, especially by commercial credits which increased by 29.8% and loans which almost doubled y-o-y. At the same time FDI decreased by 17.6% in January-June 2007 y-o-y. That forms a sort of "FDI pause" which might be either a result of general investment fall in the region or a temporary slowdown before the next rise. 25.1% of all FDI came in the first half of 2007 into agriculture and forestry, which was the maximum share of this sector for attracted FDI during the last two years. Finland with 26.6% of total foreign investment and 43.8% of all FDI became the leader among the region's investment partners in January-June 2007. Other large investors were offshore Luxembourg and Cyprus with shares of 13.1% and 10.0% of foreign investment inflow. Exports from the Leningrad region increased by 16.2% and imports grew by 24.4% y-o-y in the first half of 2007. Despite the quick growth of imports they still comprise just 34% of foreign trade turnover, with the remaining 66% occupied by exports.

Some business highlights

- In the first half of 2007 the reported financial income (profits minus losses) of all regional enterprises totalled EUR 935 mln and grew by 36.1% y-o-y.
- State nuclear monopoly Rosenergoatom started to build the first of four new nuclear reactors at Leningrad Nuclear Plant (LNP) in Sosnovy Bor. Total investment in LNP reconstruction would be EUR 5 bln.
- One of the largest Russian container operators, NKK, plans to invest EUR 600 million into its new container terminal which would be constructed at the Ust-Luga seaport until 2020.
- St. Petersburg large construction materials supplier, LSR Group, decided to build a new brick plant in Otradnoje, Leningrad region. The plant's annual capacity would be 220 million bricks. This would enable the LSR Group to remove production facilities (which are at present located in the city of St. Petersburg) to the Leningrad region and to use the released urban territories for residential construction.
- The first stage of the regional Energy System Reconstruction Programme financed by RAO UES was fulfilled. The modernisation of Leningradskaja, the largest power distributing station in the North-West of Russia located in Tosno, was completed and required EUR 80 million.
- In August Leningrad regional authorities and Indian company Jindal Stainless Limited agreed upon creating a stainless steel production in the region with initial investment of EUR 45 million and another EUR 70 million invested at a next stage.

Leningrad Region - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	as of
Regional GDP of Leningrad Province (y-o-y %-growth, consta	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	10,9	1-8/2007
Regional inflation (CPI, y-o-y %-change)	23,5	19,6	14,8	13,0	14,9	12,0	9,9	8,1	1-8/2007
Gross average wage (monthly, EUR)	105,5	141,3	151,7	173,2	189,7	259,1	324,1	365,6	7/2007
Unemployment (% average annual)	12,7	10,8	9,6	9,2	7,5	7,8	6,2	5,5	H1/2007
Exports (EUR million, current prices)	1786,5	2349,7	2301,1	2579,7	3886,5	4861,9	5443,5	2874,0	H1/2007
Imports (EUR million, current prices)	328,1	810,0	939,0	1061,4	1371,9	2561,9	2858,0	1466,1	H1/2007
FDI inflow (EUR million, current prices)	222,5	266,0	121,9	104,5	106,6	178,7	288,0	89,1	H1/2007

Sources: Petrostat, Rosstat, Central Bank of Russia, European Central Bank

Kaliningrad region

Industrial production growth slows down

As we expected, growth in industrial production declined to 45.9% in January-August 2007 y-o-y compared with 53.5% in the first half of the year. Manufacturing continued to drive the industrial sector's expansion but its growth rate was slightly down. Given recent problems at automaker Avtotor (see business news) it is highly unlikely that the production in car manufacturing – the fastest growing manufacturing sector – will be expanding at the same rates as earlier this year. Performance in the other manufacturing sectors was quite uneven. Production in food processing – the largest sector after car manufacturing – fell by 4.8%; pulp and paper production declined by almost 50% while production in textile and apparel increased by 120% (all for the first eight months y-o-y).

The main power station in Kaliningrad (CHPP-2) was down for maintenance work for most of July. As a result output in the utilities sector in July dropped significantly and dragged down the growth rate in the sector for the first 8 months to 2.5% from 19.4% in the first half of the year.

Growth rates by sectors, y-on-y, %

	2006	Jan-Aug 2007
Industrial production	68.2	45.9
Mining	17.0	1.7
Manufacturing	40.6	113
Utilities	370	2.5
Construction	-8.9	22.1
Retail trade	16.1	16.9

Source: Kaliningradstat

Construction and investment

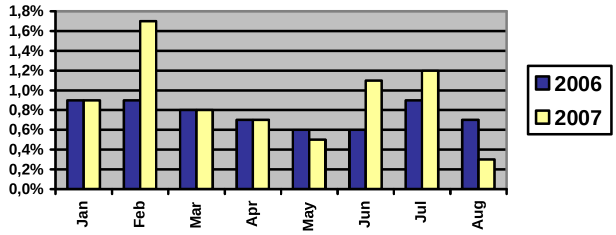
Residential construction fell in July and August relative to the June level but y-o-y growth remained strong: 55% in August and 57% for January-August. However, there might be some troubling spots on the horizon. The credit crunch on the world financial markets has affected the ability of Russian banks to refinance their mortgage loans. As a result some banks increased credit requirements for new borrowers, delayed the processing of loan applications, raised interest rates on new mortgages etc. It is not clear yet to what extent financing difficulties affected the bank's credit behaviour but unless we see rapid improvements in the credit market, growth in banks' mortgage portfolios will be curtailed. Effect on the demand side is likely to be limited because mortgage financing is still relatively small in Russia. But it is still likely that it will constrain growth in residential property prices that remained much weaker than last year, even before these events.

Growth in fixed capital investment for the first eight months of the year dropped to 25.8%. One reason for the fall was an eroding low base effect that pushed up growth rates in the beginning of 2007. Observely, foreign direct investment (FDI) increased to EUR 20.7 mln in first half of the year: while it is still small in absolute value it is already higher than the FDI inflow for the whole of 2006.

Employment, wages and consumer prices

The most evident signs of a strong economic growth in Kaliningrad are rising employment and wages. Kaliningradstat reported that total employment in July 2007 increased by 32,500 or 10.1% y-o-y. The average monthly wage in July reached RUR 12460 (EUR 357), up by 26.8% y-o-y. The robust growth in wages is helped by a growing pressure on companies to pay wages officially and companies with wages significantly below average risk attracting a lot attention from the tax authorities.

Consumer price inflation declined in August to 0.3% pushed down by a seasonal effect of lower food prices.



Whilst monthly consumer price changes generally followed the pattern of the previous year, higher inflation in February (due to utility price increase) and in June and August (mainly because of food prices) kept cumulative inflation for the first 8 months of 2007 higher than in 2006 and above government target.

At the end of September a sharp increase in the price of sugar and vegetable oil caused a small panic in Kaliningrad that led to a jump in demand for these goods and empty shelves at some grocery stores. Authorities blamed unknown political opponents that spread rumors before parliamentary elections but also opened criminal investigations against some retailers accusing them of using their monopoly positions.

Some business highlights

- Lithuanian-owned construction company Roslitstroy operating in Kaliningrad decided to sell its business. This decision followed the disappearance of the company's head and co-owner Stanislovas Jucjus in April and the killing of the next chief executive Alexander Semkin in August. The Lithuanian Ministry of Foreign Affairs voiced its concern about the safety of Lithuanian investors in Kaliningrad.
- Kaliningrad retailer Vester plans to raise RUR 1.5 bln (EUR 42 mln) by placing a debut 3-year bond issue this fall to finance its rapid expansion in Russia. In September the company just opened hypermarkets in four Russian regions.
- Problems for Kaliningrad automaker Avtotor continued: it announced that it would not be able to meets its production plan targets for 2007 because the Customs Service had been delaying customs clearance of imported parts and filed a related lawsuit against the Customs Service. Shortly afterwards customs authorities filed several lawsuits against Avtotor for underpaying customs duties, claiming in total around RUR 2 bln (EUR 57 mln).
- Kaliningrad shipyard Yantar started construction of the first of three frigates for the Indian Navy, under a contract signed in 2006.
- The Russian government decided to cancel export customs duties for oilseed rape, which is one of the main export products for local agriculture. It should help local producers to increase production and exports.

Kaliningrad - main economic indicators	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**as of**
Regional GDP (y-o-y %-growth, constant prices)	6,8	15,2	3,4	9,5	9,4	12,9	12,0	11,6	n/a	
Industrial production (y-o-y %-growth)	3,9	32,4	12,9	10,2	4,7	26,6	18,9	68,2	45,9	1-8/2007
Inflation (CPI, end of period, y-o-y %-change)	34,5	17,5	21,0	9,8	17,5	11,7	11,1	7,9	9,3	8/2007
Gross wage (period average, EUR)	47	67	99	125	137	155	193	285	357	7/2007
Unemployment (% end of period, LFS data)	15,8	15,6	10,6	7,1	7,5	6,4	5,9	5,9		Q4/2006
Exports (EUR million, current prices)	303	514	508	497	507	876	1 470	1 973	495	Q1/2007
Imports (EUR million, current prices)	761	947	1 169	1 701	1 894	2 419	3 283	4 187	1 053	Q1/2007
Exports (sales) to Russia (EUR million, current prices)	n/a	459	691	802	989	1 449	1 901	2 471		1-12/2006
FDI inflow (EUR million, current prices)	3,9	7,1	3,6	6,3	12,4	18,0	15,1	16,9	20,7	H1/2007

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

Baltic Sea region – at the head of the reform process

By Günter Verheugen

The Baltic Sea region is one of the most dynamic parts of Europe. It is a region of high growth rates and an example of economic dynamism and reform. The Baltic Sea countries have demonstrated their capacity to adapt to the accelerated pace of globalization and stiffer international competition, defying their peripheral position and sparse population and achieving high and sustained levels of growth. They built their success on stable institutions, well developed infrastructure and highly skilled labour. The region is a good example of how European integration and globalization can benefit individual countries and wider regions.

According to the latest European Innovation Scoreboard (EIS) published in 2007, the Baltic Sea region includes two types of countries, namely those which are among innovation top-performers in Europe and those which are catching up.

The EIS statistical analysis confirms that in the Nordic countries there is a well-balanced high performance across practically all innovation indicators. This is an interesting observation revealing a rather solid basis of the innovation system in these countries and a promising trend for their innovation performance in the coming years. This rather constant Nordic countries' high performance but also the promising efforts in the other Baltic Sea countries will be vital for further accelerating the pace of innovation in the whole region in the close future.

The National Reform Programmes (NRPs) prepared in the context of the re-launched Lisbon process in 2005 show a high level of ambition and reflect the different challenges facing the various countries in the region, which, despite high growth in the Eastern countries, is still characterized by large heterogeneity. It is therefore appropriate that every country reform programme reflects its own reality rather than merely transposing measures from neighbours.

On the backdrop of the overall positive assessment of the progress of reforms in 2006, the Commission noted that particular attention should be paid to the level of competition in services. Similarly, a study for the Baltic Development Forum noted that high price levels are likely to originate in weak competition, which can be a deterrent for investors and has already contributed to a decrease in foreign direct investment flows.

Boosting innovation through regional clusters

Industrial clusters are an efficient way of developing core regional capabilities and help companies based in the region to exploit new market opportunities. Clusters assemble a critical mass and build linkages in areas where countries, regions or companies would otherwise find it difficult to develop a competitive position. Moreover, interactions within clusters result in increased innovation of the whole group, thus further increasing the region's competitive advantage.

Cluster development efforts have a positive history in the Baltic Sea Regions and especially in the Nordic countries such as Denmark, Finland, Sweden and Norway. We noted with pleasure that the Baltic Sea countries remain conscious of the synergies that can be gained from building an attractive region through a coordinated cross-border approach. Examples of successful clusters in the region abound. For example, ScanBalt and Cruise Baltic are two cross-border clustering initiatives established in the sectors of medicine and tourism, respectively. Both clusters have more than 20 members from almost all Baltic rim countries.

At policy level, the on-going EU-funded Baltic Sea Region (BSR) Network project brings together policy authorities from all countries of the region in order to identify concrete areas for cooperation in the field of clusters and to design cluster policies over national borders. The BSR Network is considered as a strategic project for initiating cross-boarder innovation programmes in the Baltic Sea Region.

To further promote cluster development in Europe, the Commission has recently launched the European Cluster Observatory that tries to identify clusters and assess their evolution over time in EU27 as well as in Iceland, Israel, Norway, Switzerland, and Turkey. Moreover, the Commission supports the trans-national cooperation between public authorities as well as between clusters as a way to assist clusters to develop international relationships, share information, mutually exchange technical competences, share research infrastructure and production facilities and develop joint business strategies and strong partnerships in the same or in different business sectors. In the period 2007-2013, the Community CIP programme and its foreseen actions will be instrumental for defining and implementing in close association with the Member States a European cluster strategy and providing the appropriate tools. Furthermore, the two European networks, namely the Innovation Relay Centres Network and the Euro Info Centres Network, that have recently jointed their forces into one network funded under the CIP, will further boost innovation culture in Europe and strengthen the innovation capability of firms in all European regions including the Baltic Sea Region. Besides this, one should keep in mind the numerous possibilities for public authorities, private firms and research organisations to participate in international projects under the INTERREG and 7th Framework Programmes and further increase cooperation with neighbour non EU countries such as Russia, which is an eligible partner in these programmes.

Future challenges and opportunities

Another common point observed in the national reform programmes is the emphasis on sustainable development as a prominent source of future growth. The Commission strongly supports efforts in this area. Whilst European entrepreneurs and investors must take the leading role in exploiting the growing opportunities offered by the growth of environmental markets, policy makers should contribute by creating conducive market conditions that stimulate the successful commercialisation and early deployment of new environmental technologies. Europe needs to develop lead markets for environmental technologies, products and services.

At the beginning of the re-launched Lisbon strategy in 2005, the Commission President called the Baltic region "a beacon for the rest of Europe". It is essential that the appropriate measures to upgrade the business environment continue to stimulate local enterprises and attract foreign investors. A policy framework conducive to investors and a dynamic business environment offer the best opportunity for sustainable development and further income convergence between the eastern and western rim of the Baltic Sea.

Günter Verheugen

Vice-President of the European Commission
and Commissioner for Enterprise and Industry

European solidarity is the best investment into the future

By Petras Vaitiekūnas

Twenty years ago the idea of restoring the independence of the three Baltic States - Lithuania, Latvia and Estonia - was still considered a risky political project. However, with the support and solidarity of the Western democracies, we not only rebuilt our statehood, but also established competitive and fast-growing free market economies.

Our road to success was built on democratic values, economic pragmatism, the culture of social and political dialogue, and a firm perspective of European and transatlantic integration.

Today the three Baltic States represent a successful political and economic 'trademark'. And the cooperation between the Nordic countries and the Baltic States, which also includes Germany, Poland and Russia, has changed geopolitics of the Baltic Sea region.

Our geographic location on the frontier of the European Union is a big advantage; but it also poses new challenges. One of them is to bring the European Union and Russia closer to each other. The more Russia will become integrated with the European values and economic cooperation, the more will we exploit the potential of the Baltic Sea region.

Unfortunately, the EU border infrastructure in our region today hardly corresponds to the growing needs of businessmen and investors. We need to address this challenge together. Through cooperation and integration we can transform our region into one of the most progressive and competitive regions in Europe.

Ambitious projects of Rail Baltica and Via Baltica are already underway. However, the energy security issues still need further progress. The Baltic States continue to exist as 'an energy island' having access to mainly one energy supplier – Russia.

Lithuania has taken first steps towards increasing of our energy independence. We focus on two strategic projects: development of a new nuclear power plant and connection of our energy grids with those in the EU.

We are grateful to our Northern neighbours, first of all, Finland and Sweden, for their continuous assistance to the security of the old Ignalina Nuclear Power Plant, which is due to be closed in 2009. But we also look forward to learning from the Nordic experience and expertise, especially in the environmental field, as we proceed with the construction of a new nuclear site.

During the years of the EU membership Lithuania established close economic business cooperation and investments links with the Nordic countries. More than a quarter of Lithuanian exports today go to the Nordic markets. Sweden, Denmark and Finland are among the largest foreign investors in Lithuania. Therefore, it is natural that common EU energy infrastructure is essential to guaranteeing stable economic and social development of the region. I am certain that our success, as well as the successful realization of energy projects, will only strengthen the economic potential of the whole Baltic Sea region and stimulate its future growth.

It is worth remembering that the present-day European Union also takes roots in energy. 50 years ago the European Coal and Steal Community and EURATOM offered a unique way of overcoming disputes among the European nations, which later was established in the European acquis.

In 21st century coal and steel is replaced by oil and gas. However, supranational structure to govern the supply and demand for those resources is not yet established. We have a common EU trade policy, but we do not speak in one voice, when we have to deal with energy issue. Competition among the Member States regarding energy recourses has no clear rules.

So why the EU supports, politically and financially, the development of the EU transport infrastructure in the new Member States, but the development of energy infrastructure is left to the discretion of individual countries?

I believe that suppliers also suffer from this situation as they lack incentives to invest more in new fields and technologies. Monopolistic presence in the region prevents from creative thinking.

As a result, the name "Responsible Energy for Responsible Partners" chosen for Vilnius Energy Security Conference, which is held on 10-11 October, is not accidental.

We trust that this forum, to which representatives are coming from the countries of Northern and Southern, Eastern and Western Europe, Central Asia, the Caspian Sea and the Black Sea regions and from the USA, strengthens transatlantic energy dialogue and helps to create a constant high-level consultation mechanism, and an open cooperation among the countries, which have energy resources at their disposition, transit countries and consumers.

While the dependency of the European Union on the external countries is constantly increasing, it is high time to tackle the EU energy issues in solidarity not just inside the EU, but also to speak in the solid EU voice with its external partners. The EU energy partners not only talk loudly about their policy interests, but also implement their energy policy actively. In the meantime, the EU countries still function mostly on the bilateral basis and speak, I would say, tentatively with Georgia, Azerbaijan and Central Asian countries. But do we have an efficient strategy of relations with these countries, and, even more so, a strategy coordinated with the USA, our most important partner on the American continent?

The European Union has to take a rational opportunity to avoid the situation, when even in Europe democratic countries compete between themselves and fall prey to their own egotism and failure to agree. Moreover, can Europe shut eyes to the fact that the oil dollars and oil euros increase not the welfare of the common people, but the wish to use power politics in the dialogue with partners, and manage business affairs in this way?

The European Union does not threaten anyone to become an energy policy dictator. I think that Europe does not need this, because it is not within our interests to impose our will on other countries of the world. The strength of the EU is our firm foundation of values, solidarity and strong transatlantic relation, as well as the open dialogue with all of our partners. We should learn to use this potential to guarantee secure and prosperous future of European people, while the countries, which are rich in energy resources, should invest their income into reforms promoting social progress.

Petras Vaitiekūnas

Minister of Foreign Affairs

Lithuania

Iceland and her companies in the Baltic Sea region

By Ingibjörg Sólrún Gísladóttir

As a Nordic country, Iceland has close links with the Baltic Sea region, both politically and economically. This fact may be best illustrated today by the active interest that Icelandic companies and investors have shown in the region.

I am delighted to contribute an article that gives me a platform to highlight the deep and growing ties between Icelandic companies and the Baltic Sea region, in particular the three Baltic States.

It is no secret that the Baltic rim is one of the fastest growing and business friendly regions in Europe. This fact was reconfirmed by the World Bank's recently published Doing Business 2008 report, where all three Baltic States ranked in the top 30 economies in terms of their business friendliness. Icelandic companies and investors were quick to realize the advantages of these conditions. In the past 15 years, their presence has grown both in terms of volume and value, expanding into diverse and non-traditional sectors that would have been unimaginable just a decade ago. Icelandic economic participation reflects above all the huge potential of this region.

The dynamism in our economic cooperation is impressive. Since 2001, trade in manufactured goods between Iceland and the Baltic States of Estonia, Latvia, Lithuania and Poland has increased by almost 350%, to 330 million USD in 2006 (Global Trade Atlas). And this does not take into account the tremendous growth in services and foreign direct investment, the establisment of local presence.

Icelandic companies: investing in the region

Icelandic companies and investors entered the region immediately after Baltic independence in 1991. Among the first Icelandic companies to enter the region was Byko, a construction and do-it-yourself store, and Hnit Baltic, an engineering consulting firm. These companies were soon followed by others, attracted by the potential of a region teeming with creativity and innovation. Indeed, the latent energy and spirit of the Baltic Sea region was fully unleashed after independence.

Icelandic business interests are diverse and dispersed throughout the region. Their success has been facilitated and encouraged by factors of globalization and structural changes in the Icelandic economy itself. Both have obviated geographic distance and expanded the potential sectors for cooperation and integration. The following overview is by no means exhaustive but does paint a revealing picture of Icelandic business investments in the area.

In the retail sector, Smaratorg ehf. operates a growing number of furniture outlets under the name Jysk, with plans for more in the pipeline.

The clothing and fashion house 66° North manufactures all of its goods in Saldus and Aizetje, two cities just outside of Riga. In Lithuania, Icelandic investors bought and renovated one of Europe's largest shirt factories in a small city outside of Vilnius. The factory now produces over 900.000 shirts a year under leading brand names.

In the fishing and seafood sector, Hampidjan Ltd, which is one of the largest suppliers to the fishing industry, moved all its production of rope and netting to a new 20 thousand square meters factory in Lithuania in 2004.

In the shipping and transport sector, companies like Eimskip, Samskip and a company under Byko's ownership are active throughout the region, supplying Baltic goods to Iceland, Europe and beyond.

In the banking sector, Norvik Bank and MP Investment Bank have established a sizeable presence in the region. MP Investment Bank is the only Icelandic company listed on the Tallinn, Riga and Vilnius Stock Exchanges, and on 11 October 2007, it will host a conference to introduce an innovative pension fund in the region. The presence of Icelandic banks and investment partners in the region, which have created many business opportunities in the past 3 years, augurs well for future ventures.

In the technology and services sectors, Hnit Baltic provides general engineering consulting services, ranging from engineering services to software development. Icelandic architectural firms like Arso, which is jointly owned by Arkis and Hnit Baltic, have also established a presence in the region.

In the aviation sector, Icelandair Group recently purchased Latcharter, a Latvian charter airline which operates flights to destinations worldwide from its hub in Riga. The Group sees the Baltic region as a small but important market with a high potential for growth.

Icelandic companies have also made their mark in the pharmaceutical sector. Lyfja established a presence in Lithuania in the mid 1990s and now operates around 45 pharmacies under the well known Farma name. Actavis, a leading player in the generic pharmaceuticals market, has operated in the region since 1999.

Natural partners

It should come as no surprise that Icelandic companies and investors are active in the region. Indeed, Iceland and the Baltic States are natural partners. We share many of the same economic values and characteristics such as open and vibrant markets, dynamic and well-educated labour forces and the desire to meet proactively the challenges and opportunities of the 21st Century. Increased Icelandic investments in this region did not come about as a result of any coordinated effort or intervention from the official level, but simply from the huge economic potential of this region.

However, commercial and economic success does not emerge in a vacuum. The fact that Icelandic companies and investors are able to benefit from, and contribute to, the economic success of the region is closely related to the broader context, in particular the special relationship Iceland shares with the Baltic States. The decision of the Government of Iceland to recognize the independence of the Baltic States in August 1991, the first foreign government to do so, signalled our long term commitment and solidarity with the region.

The presence of Icelandic companies and investors in the region is also facilitated by the institutional framework of the European Economic Area. Standardized rules and regulations of the single market have created a more transparent and predictable business environment. Indeed, the Baltic process of accession to the European Union contributed to making the regional market complementary, significantly mitigating any problems of economies of scale and attracting foreign investment directed towards the larger European market.

Outlook

The potential for further commercial and economic cooperation has by no means been exhausted. There are still many possible areas that remain underdeveloped, including the travel and tourism sector. There are many opportunities to increase commercial traffic between Iceland and the Baltic region, whether through direct flights or through hubs in the Nordic States. Such traffic from Iceland to the region has already increased significantly and the interest is there. For example, Icelandic companies are increasingly chartering direct flights to destinations in the Baltic States for corporate seminars.

The Baltic rim has managed to blend social responsibility with entrepreneurial innovation, and the results speak for themselves. In the past fifteen years, this region has once again emerged as an economic power house. In fact, with such a diverse membership this region has every possibility of being among the most exciting growth areas in the global economy in the years to come.

Ingibjörg Sólrún Gísladóttir

Minister for Foreign Affairs

Iceland

Estonia protects the Baltic Sea along with its neighbours

By Jaanus Tamkivi

Estonia is one of the nine countries on the coast of the Baltic Sea. As the Baltic has been declared a particularly sensitive - marine area, we need to work together to preserve what there is to preserve and to improve what we need and are able to improve.

Much of the responsibility for protecting the Baltic Sea falls to HELCOM. In 2005 the convention adopted a new approach to reducing pollution in the Baltic and dealing with damage caused to the marine environment. The necessary measures and operations have been brought together in the Baltic Sea Action Plan, for which Estonia has made its own proposals. Estonia also plans to develop a maritime strategy, which will in turn require changes to be made to its maritime legislation.

Maritime operations require a permit for the special use of water

Human activity on the coastal and open sea in Estonia is regulated by permits for the special use of water, which the Ministry of the Environment issues around 60 of to private citizens and businesses alike each year. These permits are required for such activities and operations as dredging; dumping; loading and unloading of dangerous substances and solid bulk goods that are volatile in windy conditions; ship repairs; and fish farming in open sea pens. The permits are also needed for any activity which may lead to changes in the biological or chemical quality status of the water or the physical characteristics of the waterbody. The permits set out the requirements and restrictions such activities and operations must observe, as well as monitoring obligations.

Local requirements are perhaps more stringent than elsewhere

One of the most important objectives of protecting the Baltic Sea is to limit the pollution load from point and diffuse sources of pollution. Markedly more stringent requirements have been set in Estonia than in many other member states on effluent directed into receiving bodies of water in order to minimise the pollution load from urban wastewater. Additionally, Estonia has adopted measures to reduce industrial pollution. Although we have few industries, we advocate the use of the best possible technology and the least possible influence on the environment.

Estonia has made significant investments designed to prevent environmental pollution. Between 2000 and 2006 we directed more than 2 billion kroons (128 million euros) into the restructuring of our wastewater systems. A large number of wastewater treatment plants have also been modernised, and new ones constructed. 89% of the population in wastewater collection areas with a p.e. of more than 2000 are connected to the public sewerage system. Since Estonia as a whole is characterised as a low density area, this makes the national coverage 72%. Further major investments in the updating of wastewater systems are planned for the 2007-2013 programme period.

Accession to international conventions

Estonia has joined or is in the process of joining the majority of International Maritime Organisation conventions on the marine environment. For example, the International Convention on the Control of Harmful Anti-Fouling Systems for ships (the AFS Convention) is currently being prepared for ratification. Accession is also pending to the Convention on Liability and Compensation for Damage in Connection with the Carriage of Hazardous and Noxious Substances by Sea (the HNS convention) and the 2003 protocol to the 1992 international convention on the founding of the International Fund for the Compensation of Oil Pollution Damage, which saw the establishment of an international Supplementary Fund for compensation of such damage.

Within the next few years we also plan to prepare to join the 2004 International Convention for the Control and Management of Ships' Ballast Water and Sediments, which has not yet entered force internationally, and the 1972 London Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter.

But it is not enough to simply sign on to the conventions if we are to fulfil the obligations and requirements they set. More important is to ensure that the conventions are able to be implemented and that their requirements are observed at the national level.

Preparedness for pollution controls

As a result of the increase in the environmental requirements placed on ships and of the larger volumes of oil and chemical transport in both Estonian and neighbouring waters, it is vital to ensure the administrative capacity needed to detect pollution from ships, to check the ships themselves and to apply sanctions in the event of infringements. It is important that those who breach requirements be handed sufficiently severe penalties so as to avoid situations in which it is cheaper for the owners of vessels to pay fines than it is to meet their obligations. In connection with the adoption of European Union directive 2005/35/EU (dealing with maritime pollution caused by ships and determining penalties for infringements involving such pollution), Estonia has already bolstered its sanctions against ships dumping pollutants at sea. In the short term we also plan to review pollution by ships with other substances and the penalties imposed for such offences.

In order to reduce damage from ship pollution in the generation phase, the polluter's obligation to avoid or where necessary deal with environmental damage must be implemented in Estonia, as the polluter's obligations are currently limited to compensating for any damage that has already been caused.

Hazardous substances

The bioindication method is used in Estonia to determine the presence of hazardous substances in organisms. The method measures the hazardous substance content of the Baltic herring, tellin and aquatic sow bugs in Estonia's coastal waters. The concentrations of heavy metals (cadmium, mercury, lead, copper and zinc) and organic pollutants (polychlorinated biphenyls and chlororganic pesticides) in the organisms are ascertained. The content of chlororganic compounds is also measured, as a rule, in the fishes' muscles.

The concentrations of copper, cadmium and zinc in the organisms in Estonia's coastal waters are relatively even and comparable to the average values for the Baltic Sea as a whole. The content of cadmium, zinc and organic pollutants (HCH, DDT and PCB) is lower in the open sea than in the Gulfs of Riga and Finland. It can therefore be concluded that the content of hazardous substances in organisms in Estonia's coastal waters is not in contravention of the quality objective set out in EU water protection norms that the content of hazardous substances must not increase significantly over time.

Monitoring provide us with an overview

Estonia's monitoring programme is based on the traditional HELCOM programme. Between 1994 and 2006 the sub-programmes "Phytobenthos monitoring," "Operational monitoring or Automatic measurements performed from ferries" and "Intensive monitoring or monitoring with increased frequency of measuring in Tallinn, Pärnu and Narva Bays" were added to the main programme. "Monitoring of fish colonies in coastal waters," launched in 1995, was incorporated into fish stock monitoring in 1997.

In addition to eutrophication monitoring, hazardous substances monitoring is also carried out, primarily to determine the presence of heavy metals, oil products and persistent organic pollutants (the latter of which are measured in fish and molluscs). Added to the coastal waters monitoring programme in 2005 was remote monitoring, which requires high levels of operativeness.

The results of the monitoring play an important role in the evaluation of the state of the sea, in the protection of the Baltic as a sensitive ecosystem, in determining the pollution load and in planning economic activities.

Jaanus Tamkivi

Minister of the Environment

Estonia

A Baltic Sea Strategy – acting regionally, thinking globally

By Ojārs Kalniņš

At the 14th Ministerial Session of the Council of Baltic Sea States in June 2007, Carl Bildt proposed the development of a new Baltic Sea Strategy which would promote the Baltic Sea Region as a priority area for the European Union. Since 2001, Uffe Ellemann-Jensen has led the Baltic Development Forum in exploring the possibilities of another strategy for the Baltic Sea Region: branding it as a coherent region with a distinct profile that can compete more effectively in the global marketplace. Both have emphasised the region's place at the "top of Europe" not only geographically, but also in terms of economic growth, educational levels, innovation, research and development.

Time magazine seems to agree. In its May 2007 issue, Latvia's capital of Rīga was described as "one of string of economic miracles" in Europe's "Sea of Plenty". Time's glowing report of a booming region where eight of nine countries are growing faster than the EU average reads like a Baltic Sea Region public relations man's dream.

For Latvia, which has taken over the presidency of the Council of Baltic Sea States, this emphasis on the Baltic Sea region as a potential political, economic and marketing powerhouse couldn't have come at a better time. From the moment we restored our independence in 1991, many of us in Latvia's foreign policy establishment were convinced that the rebirth of our own country was organically linked to the rebirth of the Baltic Sea Region as a whole. What was good for us, was good for the region, and vice versa.

As the Iron Curtain that once divided the Baltic Sea sunk into the oblivion of Davey Jone's locker, many shared this vision of a region reborn. Images of a phoenix-like New Hanseatic League emerging from the ashes of the Cold War even shaped the Clinton Administration's Baltic policy in the 90's. State Department strategists Strobe Talbott and Ron Asmus were strong supporters of Baltic Sea regional cooperation and worked closely with Carl Bildt and the Baltic countries in developing Clinton's 'Northern Initiative'. The creation of the Council of Baltic Sea States in 1992 was enthusiastically received in the White House. The Americans liked it so much they wanted to join, but for obvious geographic reasons, had to eventually settle for observer status.

As Latvia's Ambassador to the United States at that time, I welcomed this initiative and even took an early stab at 'branding' this newly reconstituted Baltic Sea region by proposing that it be called 'The Amber Gateway'. As a former advertising and marketing professional, I couldn't resist thinking about the packaging, even though the product had barely come into existence. I was encouraged in part by Darrel Delamaide's book "The New Superregions of Europe". Published in 1994, the book called the region 'The Baltic League' and described it as one of the most dynamic of all new superregions:

" …it already has one of the strongest identities. Its diffuse structure of overlapping networks makes it one of the most advanced superregions. Above all, there is a widespread awareness of the regional dimension, and an understanding of the role and functioning of a superregion."

Like my 'Amber Gateway' marketing slogan, Delamaide's optimism may have been a bit premature. At the outset, awareness of the Baltic Sea's regional dimension was far from widespread, and its function as a 'superregion' was neither totally understood nor fully appreciated. But over the last 13 years, his predictions of booming regional economic growth and development have withstood the test of time.

The recent CBSS proposal for a Baltic Sea Strategy envisions the directing of EU funds to sectors such as infrastructure, energy, environment, education and research. But any strengthening and development of the region itself through cross-border cooperation and collaboration must be accompanied by a coordinated external dimension. While a common foreign policy may be a task for the European Union, this doesn't replace a need for the countries of the Baltic Sea Region to develop a common branding policy.

As Uffe Ellemann-Jensen rightly points out, the Baltic Sea Region needs to create more awareness and develop a more distinct profile "so it can stand out in an increasingly competitive global environment." The European Parliament's proposal for a Baltic Sea Strategy aspires to "systematically create a brand for the region as one of the most attractive and competitive areas in the world."

For those who recoil at the crass commercial connotations of the word 'branding', Simon Anholt (the originator of the concept of nation branding) offers a more precise phrase – 'competitive identity'. In Anholt's view, you increase the competitive identity of a city, country or region, not through advertising a brand, but by building on strengths that enhance its reputation. This falls in line with the June 2007 Declaration of the CBSS in Malmo, which talks about 'enhancing the competitiveness of the region'.

Whether you call it branding, marketing or reputation building, it seems clear that a truly comprehensive Baltic Sea Strategy must include an agreement between all stakeholders that, a) the Baltic Sea Region is a coherent and viable entity, b) promotion of the region as such adds value to the promotion of each country individually, and c) any attempt to build positive awareness of the region must be unified and coordinated.

Is this possible? The experts will say this is an uphill struggle for, until now, no region has ever tried to establish itself as a global brand. In the countries that surround the Baltic Sea, diversity may overshadow commonality. And yet, organizations, institutions, concepts, strategies and conferences based on 'the Baltic Sea Region' continue to proliferate.

If the yea-sayers in favour a Baltic Sea brand hope to win against the nay-sayers, several steps need to be taken. First, we need to come to an agreement on what we want to call the region. 'Scandinavia' and 'Nordic' already enjoy some brand recognition around the world, but they are no longer sufficient to cover the much broader, post-Cold War liberated 'Baltic Sea Region'. "The Top of Europe", "Amber Gateway", "New Hanseatic League" and other creatively catchy designations have a limited utility for promotional materials, special events or projects, but are hardly recognizable outside the region.

Some Scandinavians are wary of building an identity around the word 'Baltic' because to many, it simply refers to the Baltic countries of Latvia, Lithuania and Estonia. And yet, if we build an identity around the sea that unites us, in English at least, the word 'Baltic' is inescapable.

In addition, we need to identify and empower some institution in the Baltic Sea Region that would take on the responsibility of researching, developing and implementing a regional strategy. Henry Kissinger once asked who he should call when he wanted to speak to Europe. Who are we going to appoint to man the Baltic Sea hotline?

By default this responsibility has fallen upon the shoulders of the Council of Baltic Sea States. The CBSS has been tasked to reform itself, in order to be "better equipped to focus on priority actions, including the capacity to develop regionally important and strategic projects." The CBSS is also undertaking the development of a Baltic Sea Strategy.

Perhaps one of the tasks that CBSS could undertake is to begin some serious market research on the strengths, weakness and identity of the Baltic Sea Region in the global marketplace. In this spirit, the Latvian presidency of CBSS has initiated a ‘Balticness’ campaign, to promote the idea of shared cultural identity and common values in the region. If there are shared values, they can and should be exploited to the common advantage.

Like the weather, everyone is talking about the Baltic Sea brand, but until now, no one has done anything about it. Here I would fully agree with Uffe Ellemann-Jensen. It’s time to just do it.

Ojārs Kalniņš

Director, The Latvian Institute

Latvia

What Europe has done for competition

By Jerzy Samborski

President Sarkozy's question which he asked at the EU Summit in June this year "Competition as an ideology, as a dogma, what has it done for Europe?" was part of his explanation on why he had wanted the replacement of the phrase "an internal market where competition is free and undistorted" with the words "a single market" in the new proposed EU Treaty .

The question since has been seen by some analysers as a provocation whereas others have been treating it rather as an invitation to the fundamental debate explaining the economic success of Europe and its possible future development for the benefit of the European citizens.

According to the former, competition is what made Europe successful and prosperous for such a long period of time. Johnny Munkhammar, for instance, believes that to a very large extent, it made Europe what it is – not only in the economic sense. Free and competing artists created a massive cultural heritage. Free and competing scientists paved the way for knowledge. Free and competing explorers discovered the world. And the very idea of being free to compete is to a very large extent European, developed in theory and practice in our continent.

Others, like Peter Jungen, would add that "the Bourgeoisie had produced more economic wealth since industrialisation than all generations of mankind before (…) And the combination of the values of the bourgeoisie and of capitalism, based on the best ideas Europe ever brought about - the Scottish Enlightenment and the Austrian School of Economics, have kicked off industrialisation and made Europe rich. At the heart of this economic dynamic process lies innovation created by unfettered competition. The American Revolution started only after these ideas and thoughts, and their connected values of the bourgeois had been exported from Europe to America and to many other parts of the world.

All these what have happened and, consequently, made us successful is that Europeans have invented and implemented competition.

But recently, at a time when we can watch the world adopting competition to the high extent the old member states of the EU become reluctant to make it flourish in Europe.

So, at this point, whereas agreeing to these elucidations what competition has given to Europe, one might naturally wonder "And what has Europe done for competition?" The answer to this question is just as compelling as to President Sarkozy original one as indeed, the history of this continent is brimming with excellent examples of European attempts to resist competition. Historically, in Europe, competition had sometimes been confused with confrontation, and aggressive political and economic foreign policies did much damage to the notion of fair and well regulated competition.

From this perspective, the Industrial Revolution played a definitive role in challenging the forces that suppressed the freedom to compete (for the revolution does, in essence, challenge the status quo). The Industrial Revolution liberated the people's desire to embrace innovation and provided them with increased opportunities to implement their ideas into practice. Industrial expansion curbed state interventionism and ensured that Europe became the economic leader of the world.

Nonetheless, in truth, the subsequent establishment of the Common Market or the EEC, with six and later fifteen member states, has significantly reduced competition in Europe. The tendency to safeguard a particular state's economy by means of interventionism and over-regulation, as well as an outdated belief that European superiority is to last forever, has led to economic stagnation and compromised the people's very desire to compete. Believing themselves to be the natural champions in the world, the Europeans had lost their competitive drive and began to expect to win the economic race without actually trying. This stance has proved to be extremely dangerous in the era of globalisation which saw the sleeping tigers of the East rise and successfully compete with Europe, using our own innovative tools and borrowing European methods, which had been already borrowed and improved by our brothers and friends from the United States of America.

Competition is not just an abstract ideology or a dogma: first and foremost it is a part of human nature. The affluent, relaxed Europeans devoted themselves to different, more spectacular competitions, leaving economic aspects of competition to others. The Europeans have embraced sport, especially football, as well as other mass social and cultural contests, sublimating their natural competitive spirit in these distractions. The results are evident: at present, largest European nations battle over trophies in the soccer championships, while their economies are deep in stagnation.

The Europeans eventually renounced this sort of denial of the economic reality, but not as a result of external pressures. It was their fellow Europeans, recently invited to join the European Union that opened their eyes. The new members came from ten ex-communist countries, bringing with them enormous competitive drive, which they had been quietly accruing for dozens of years. This ardent desire for innovation, a desire to achieve ensured that Polish plumbers, Czech dentists, Lithuanian nurses have arrived at their neighbours' doorstep, offering services and goods at a competitive price, sometimes many times lower than that of their western European business counterparts. Most of the established EU members have prudently closed their own markets against intruders, in visible and more often, invisible ways. Some, like UK and Ireland, were brave enough to welcome internal competition. We did not have to wait too long for the results: the UK and Irish economies are booming now, whereas those of other member states are still facing an uncertain future, as their leaders hold on to the bygone days of European economic supremacy.

Let us hope that President Sarkozy's question about competition is just an invitation to the discussion and not the attempt to pull out France and EU from globalization process.

Jerzy Samborski

Executive Director

European Enterprise Institute, Belgium

Islands are part of the main

By Urve Tiidus

No island is an island, entire of itself, every island is a piece of a continent, a part of the main. These words can describe any island in the world. The Baltic Sea washes the shores of hundreds of islands. Out of the ten biggest ones in the Baltic, three are located in the western part of Estonia. The biggest of them is Saaremaa.

Comparing the population of islands to that of the whole Estonia, islanders make just a fraction. Still, it does not mean that the importance of the cultural, economic and political aspects of islands fall in the same category. Questions often asked by the people responsible for the local development are: how flexible are islands in the quickly changing world and do islands have any advantages or only disadvantages in a regional competition? There are emotional answers to these questions.

Being flooded by waves and flown by winds makes one always aware of the threat of losing one's identity and intuitively fight against it. On the other hand, the sea and winds make people strong and persistent. On Saaremaa historical findings prove four thousand years of human activity. In the 11^{th}-13^{th} centuries, wealth based on agriculture and trade, high density of population and a good location made the Saaremaa islanders a considerable power. The number of inhabitants has decreased during the last century. 12 people per square kilometre is almost nothing compared to the places of the densest settlements in the world, like Honkong with 6,352 people per square kilometre. Islands reflect in their own way the urbanisation process of the recent decades. Also on islands people move from villages to towns or leave islands for new homes on the mainland. Kuressaare, the capital of Saaremaa has attracted a number of people from neighbouring municipalities and even mainland as a place for living, but for the future it is vital to attract more people.

Actually, the existence of human settlement on islands depends on the quality and choice of transport. The ports connecting Saaremaa County and the mainland are passed by 1.3 million people every year. From 2001 to 2006, the increase in the number of vehicles crossing the Suur Strait was about 10 % a year. The predicted increase in traffic until the year 2010 is 5.5% a year. However, a significant traffic increase of 25-28%, is predicted in case of the possible opening of a fixed link in the year 2014.

Slower pace of time has been one of the characteristics of islands. Things have changed considerably. Ten years ago people were patiently waiting for hours to get on the ferry for a 30-minute crossing. A kilometres long line of cars in the ports during the biggest summer event, Midsummer Day, used to be like a ritual dance. But it is not acceptable any further. Time has become the most precious resource for everyone. Everybody, be it local inhabitants, business people or tourists, lose from logistics of yesterday, that prevents travelling to islands.

Preparations for establishing a fixed link between the biggest island of Estonia and the mainland were started 10 years ago. An economic and environmental analysis carried out in cooperation with foreign experts, determined that the fixed link is justified both technically and economically. Further assessment of the strategic environmental impact and socio-economic aspects has been launched, the results are expected next year. The possible fixed link brings about different opinions. Some fear the loss of an insular character, some deny it. One of the most sensible opinions has been expressed by a Danish diplomat who stressed that one should never forget the figurative positive meaning of bridges. Bridges unite people and improve communication both directly and indirectly. Indeed, a well functioning communication is an essential development advantage for islands. To be more specific, Saaremaa is lucky to have a contemporary deep water port. Air-connections to Tallinn, Riga and Stockholm and airport infrastructure improvement underway give the island an advantage in this highly competitive world.

There are issues on islands, that can most efficiently be dealt in cooperation. Since 1989, seven Baltic islands are involved in B7 cooperation network. The objective of this network is to facilitate the development and keep the islands an attractive living environment with a developing and diverse economy and wealthier, more educated and happier people. From the point of view of Kuressaare, this objective is not too idealistic and is in good harmony with the development plan of the biggest municipality on the island. Kuressaare is really proud of good cooperation with higher educational institutions both in Estonia (Tallinn University of Technology and Tartu University) and in Finland (Turku University). Despite that one of the challenges remains to attract and keep educated people on the island.

For Kuressaare the city development plan has set an objective to increase the number of tourists for several times during the coming seven years. A healthy weekend in one of the wellness-spas, a bike tour in the pure and clean nature, a unique golf-course to be opened next summer, a retreat from stressful city life, these are just a few reasons to travel to Kuressaare and Saaremaa. Small and medium businesses have invested in tourism enterprises hundreds and hundreds of million krones. For the local decision makers it is quite a task to keep the balance between tourism and production oriented economy.

When speaking of the uniqueness of islands, we can not skip the special culture of islands that is dialects, patterns, traditions and skills passed from fathers to sons and mothers to daughters. In these, the features brought along from far off countries got blended with local customs. Next year, the Estonian Ministry of Culture is launching a new programme focusing on the research and retaining the traditional culture of islands. Distinctiveness and individuality, clearly appearing in the cultural heritage of islands, are gaining more importance in the world often too fond of mainstream.

Saaremaa holds a similar to many other inhabited small islands position in the global competition. Resources are limited, transportation connections are time and resource consuming, the natural environment is more demanding. These issues can be considered disadvantages. But an island that is home for 38,000 people and hosts less than 400,000 annually has several advantages. A very long experience of living on an island, openness to new ideas, cooperation ability at every level and the wish of the Estonian government to reduce the regional differences on islands – this is not bad at all.

A thought from another island in a different end of the world would draw the conclusion: depart with a brave heart, if you have to leave the islands. Live with a firm belief, if you have to remain. This belief has also lived on the biggest island of West-Estonia.

Urve Tiidus

Mayor of Kuressaare

Estonia

The Baltic Sea – threats and expectations

By Eeva-Liisa Poutanen

The Baltic Sea has always provided a livelihood and gateway to the outside world for the coastal countries and the 85 million people living on its drainage basin. It has given a transport route for both people and goods and a living for fishermen. At the same time it also offers us the opportunity to enjoy its natural beauty.

The Baltic Sea ecosystem is extremely fragile. Since the Baltic is a product of the last glacial period, many of its characteristics are quite unusual. The Baltic Sea is a semi-enclosed, shallow, cold and brackish water body. Its water is a mixture of salt water from the ocean and fresh water supplied by numerous rivers. It hosts a community where both marine and freshwater organisms live side by side with a number of living relict species. The Baltic Sea is poor in terms of species diversity when compared to oceans or lakes.

The Baltic Sea is an ecosystem under extreme stress. The four main threats are eutrophication from excessive inputs of nutrients from human activity, contaminant loading from industry, overexploitation of living marine resources, and invasive species, mainly introduced through ballast water. In addition, the consequences of climate change and accident risks arising from ever-increasing oil transportation are concerns that require special attention.

The Baltic Sea is subject to considerable amounts of pollution from the countries bordering it, and the pressure generated by human activity is intense. Pollution has persisted for so long that even if discharges were reduced, the Baltic Sea would only recover slowly.

According to the Helsinki Commission, the majority (more than 50%) of losses and discharges of total nitrogen and total phosphorus originate from diffuse sources. Agriculture is the main contributor of diffuse losses in all countries around the Baltic Sea, but scattered dwellings and storm water overflows can also play an important role. In Russia and Poland point sources are also important contributors to the total load. To combat eutrophication problems, joint and coordinated nutrient reduction measures should be implemented for the entire Baltic Sea drainage basin. The impact of agriculture should receive particular attention. Whilst several decisions and attempts to reduce the nutrient load in the Baltic Sea have already been made, further action will still be needed.

Intense algal blooms, which currently occur every summer, are a result of heavy nutrient loading. In addition to algal blooms, slime accumulation on shores and in fishing nets are visible signs of eutrophication. The ecological impacts of eutrophication are even more severe than the visual nuisance. Dead benthos, increases in internal loading and changes in species composition and predominance are examples of eutrophication effects in the Baltic Sea.

Persistent harmful substances are among the most urgent challenges. Reductions in DDT, PCB and lead concentrations are commonly used as positive examples of the success of remedial actions taken. But, this does not mean that we no longer have to worry about harmful substances. There are still high concentrations of mercury as well as dioxins, which are formed as by-products of impurities in several different industrial processes as well as during most combustion processes. Dioxins are only one example; there are a great number of other persistent harmful substances, and we do not have enough information about their sources, concentrations or effects. Cyanobacteria blooms are also known to produce liver toxins that are able to accumulate in the liver of flounders, for example. This is yet another effect of eutrophication.

The safety of maritime traffic in the Baltic Sea - and oil transportation in particular - is among our current challenges. A common fear is that an oil tanker accident will take place somewhere in the Baltic Sea. In recent years there has been a heavy increase in maritime traffic. In 2006 the volume of oil transported via the Baltic rose to about 150 million tonnes. Estimates for the future predict annual volumes as high as 250 million tonnes by 2015.

The increase in the amount of oil transportation also means more ballast water discharges in Baltic harbours. Therefore the introduction of invasive species from the ballast water tanks of ships is among the most serious environmental issues of the Baltic Sea. The risk of non-indigenous species invasion is not merely hypothetical. On a monitoring expedition in August 2007, scientists aboard the Finnish research vessel Aranda found large colonies of comb jelly *Mnemiopis* in the deeps of the Åland Sea and the Bothnian Sea. In some locations, their population density was as high as 600 individuals per square metre. *Mnemiopis* has been found to be extremely adaptable and can reproduce in the northern Baltic Sea in colder conditions than previously observed. It does not rise to the surface layer but rather seems to thrive in the halocline or below it at a depth of approximately 80-110 metres. *Mnemiopis* appears to have adapted to Baltic conditions by becoming smaller than it is in other habitats - a common phenomenon among flora and fauna.

In the early 1980s, this comb jelly was accidentally introduced to the Black Sea through the ballast water of ships. It had a catastrophic effect on the entire ecosystem. Later it invaded the Azov, Marmara and Aegean Seas and recently also the Caspian Sea. Its effects on the Baltic Sea ecosystem remain to be seen.

At the global scale the International Maritime Organization (IMO) adopted the Ballast Water Convention in 2004 in order to prevent, minimize and ultimately eliminate the transfer of harmful aquatic organisms and pathogens through the control and management of ships' ballast water and sediments. All Baltic Sea riparian countries have signed the convention, but unfortunately none of them have ratified it yet.

Communities and decision-makers around the Baltic Sea are becoming increasingly concerned about the state of the marine environment and its very slow recovery. Discussion about major polluters and insufficient implementation of prevention measures starts every summer as soon as the massive algal blooms appear yet again. Ordinary citizens are becoming very worried about the future of the Baltic Sea, and the pressure on politicians for additional measures increases. Nevertheless, the steps taken remain rather small.

The Helsinki Commission is elaborating new provisions of the ambitious HELCOM strategy - The Baltic Sea Action Plan - with the aim of drastically reducing pollution in the Baltic Sea and restoring its good ecological status by 2021. This plan is already widely seen as a pilot project for the European seas under the EU Marine Strategy and a model to be followed by other regional marine conventions around Europe. These new steps taken are important, but new strategies alone will not help. What is urgently needed is implementation.

Eeva-Liisa Poutanen

Director General

Finnish Institute of Marine Research

How can we find the motivation required to protect the Baltic Sea?

By Pauliina Kainulainen

There is a massive amount of knowledge about environmental problems available, which raises the questions: Why is so little being done to improve the environment? Why does that knowledge not result in a change of attitudes and action that leads to concrete political decisions? We all know about the tragic state of the Baltic Sea and we probably also share the view that the ecological state of the Baltic is crucial for the well-being of all people and their economies in the Baltic region. In addition, other challenging problems, such as accelerating climate change, also affect peoples' lives and economies in every part of the world, including our region.

In the following I shall briefly present an overview of the deep cultural levels of Western thinking i.e. philosophy and theology, upon which our attitudes and concepts of reality have been based. There are age-old models of thinking that draw upon these sources, models that still influence our relationship towards those parts of the natural world that are not human.

More holistic thinking is necessary

Since the industrial revolution in the 17th and 18th centuries the dominant Western concept of reality has been mechanistic. Even nature is seen as a machine without a soul that obeys strict mathematical laws. Human beings were expected to reveal the secrets of nature and develop new technologies in order to use all possible natural resources.

Such thinking has indeed created much well-being for humankind. However, in our era more and more people are asking if something has gone too far, if well-being is turning into being ill. The excessive fragmentation of nature and human knowledge are damaging the ecological balance of the earth and the spiritual integrity of many human beings.

What could be an alternative to mechanistic thinking? Many philosophers, feminists, and ecologists are turning their gaze towards an older way of understanding nature. The old model can be called a holistic or organic model as it uses the image of an organism, a living body where all parts are interdependent. In this case the whole is more than the sum of the parts. Knowledge is integrated and brings together reason and emotion, the body and respect for mystery. If updated to meet today's challenges, this kind of thinking may prove to be a strong basis for a relationship between humankind and non-human nature that is more sensitive to the needs of the natural world.

I claim that in the Baltic Sea region a new kind of integrated thinking is needed in order to save the sea from complete ecological disaster.

The role of religion

Christianity is the main religion in the Baltic Sea region. During recent decades, Christianity has been accused of having accelerated humankind's destructive domination of nature. It is true that the biblical ideas of human beings' hierarchical right to dominate the earth have for too long been used in a way that does not convey the original biblical message of humankind being responsible caretakers for all life.

Christian communities have – finally – awoken to the massive challenge that is posed by the environmental crisis. A new kind of theological thinking is surging forward in many parts of the world and the countries that share the shores of the Baltic Sea. This kind of theology is often called ecotheology. It radically re-interprets many old traditions, but at the same time it finds important but neglected elements from the tradition itself. For example, the Orthodox tradition has always maintained a remarkably holistic view of nature and resisted some Western nature-hostile philosophies.

Symbols powerful enough: the Baltic Sea is sacred

The Lutheran ecotheologian Larry Rasmussen has said that now we need symbols powerful enough to awaken us, to help us to transform our knowledge into action. I suggest that one powerful symbol could be that the sea is sacred. All the earth is sacred and carries the presence of the Holy Mystery. Thus, the Baltic Sea is sacred. Recognising this sacredness has concrete implications: It leads us to the need to restrict some economic endeavours in the short term in order to heal the sea and enjoy its riches in the long term.

The strongest sources of motivation for the protection of the Baltic are not found in a sense of responsibility or guilt. The deepest sources are found in a feeling of interdependence, of communion with all living things, in respect and love. Do these ideas sound strange when combined with issues of ecological and economic well-being? If so, that tells us much about the way in which Western culture has tended to keep different areas of life very separate. However I am delighted to notice that even in the world of economy a new kind of interest in the theme of integrating knowledge is dawning.

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HSE expanding operations in the Eastern Baltic Sea Region

By Eero O. Kasanen

The Baltic Sea Region economic area has been reintegrating ever since the fall of the Iron Curtain. The era of globalization accelerates the pace of change. As a result, in business, many Finnish firms have expanded their home market to cover the entire Baltic Sea region with special focus on the Baltic States. In politics and administration, various kinds of pan-Baltic Sea networks and organizations have been formed. Also universities are following the development and actively form inter-regional networks. In addition, it seems increasingly important to integrate the pan-Baltic Sea networks into the wider European academic community. Helsinki School of Economics (HSE) has been actively responding to the new needs stemming from the business community in its education, research and management training strategies. Doing so, we are active members in various business school associations built in the former Eastern Europe (such as CEEMAN, BMDA and RABE) with the aim to link the Baltic Sea Strategy with our memberships in high-quality European Communities such as the CEMS.

The HSE has decades of experience in research, education, student exchange and management training in the Baltic Sea region. The collapse of the Soviet Union and the clearing trade clearly pointed to new needs arising from the business community towards the university. While the bilateral clearing trade was mainly conducted by large companies, the opening up of the markets in Russia and the Baltic States rapidly attracted also small firms. Simultaneously, there was increasing need to train the local managers. As the result, the HSE Small Business Center established a subsidiary in St Petersburg already in 1993 to provide expert training, information and support services for Finnish and Russian SMEs. A related subsidiary was established in Tallinn in 2004. HSE also participated in a pan-Nordic management training program NORLET (Nordic-Russian Leadership Executive Training) conducted in cooperation with St. Petersburg State University and a consortium of large Nordic companies to educate Russian managers in western business theory and practice. This five-year program was continued on a bilateral basis between Finland and Russia in the form of JIPROFIN management training program in 2000-2004 financed by the Ministry for Foreign Affairs of Finland. In Poland, management training took the form of tailored executive MBA education in Poznan.

The new challenges were tackled also in Master's education, and a multidisciplinary study track specializing in Russia and Eastern Europe was established under the Area Studies program. At the end of the 1990s, the HSE established the Center for Markets in Transition (CEMAT) to coordinate and develop the university's operations related to Eastern Europe. CEMAT soon managed to build up long-term research and training projects both with Finnish partners as well as with Russian and Baltic partners. A good illustration is the Economic Monitoring of North-West Russia (www.economicmonitoring.com) project that has been conducted in cooperation with Finnish and six Russian partners since 2000.

In the 1990s, the transfer of knowledge in the Baltic Sea region was largely one-sided, i.e. from West to East, not only in business operations but also in the cooperation of universities. The East European universities made radical changes to their curricula in order to correspond to the needs of the market economy. Often, this was supported by help from Western universities and EU financing. HSE's experience of curricula development at the St Petersburg State University School of Management aimed at developing the expertise and mentoring the academic staff via student exchange, academic exchange and development of teaching materials. Today, both student exchange and academic exchange of scholars continues with various partners in the Baltic Sea region.

In all its operation, HSE seeks to integrate high academic quality with relevance to the business community. Here, the well-established cooperation with administration of the Helsinki metropolitan area and our partners in business is pivotal. This is reflected in the nature of research carried out by the departments and centers of the HSE, where the share of outside funding has skyrocketed. Within the Baltic Sea region, this has facilitated our aims to rapidly increase true research cooperation with our local partners. It has been a delight to document the fast accumulation of learning of the Baltic Sea partners. HSE hosts annually young researchers from the Baltic Sea region and their capabilities seem to be improving. The knowledge transfer is no longer predominantly one-sided, but rather an increasingly two-way process as it should be.

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Connecting competitiveness and regional sustainable development

By Paula Lindroos

On 13th September, 2007, a high level meeting of the Council of the Baltic Sea States (CBSS) was held in Riga under the auspices of the Latvian Presidency. The main objectives of the meeting focused on the role and possible contribution of higher education and science in the promotion of sustainable development and competitiveness in the Baltic Sea Region.

In the discussions representatives from the Ministries of Education and Science from the Member States of the CBSS; Denmark, Estonia, Finland, Germany, Latvia, Lithuania, Norway, Poland, Russia and Sweden reflected on the best ongoing practices as well as current and future challenges in the field of higher education and science. Moreover, the meeting agreed that education is an area for concerted action and improvement if the Baltic Sea region wants to meet the challenges and use the opportunities of globalization, thus promoting the implementation of the Lisbon Strategy goals.

In cooperation with the CBSS, the Baltic 21, or the Agenda 21 for the Baltic Sea Region, is advancing sustainable development in the region. The Baltic 21 Education sector was launched in 2002 together with a strategy for education for sustainable development (ESD). The Education sector has enhanced the work with national strategies, action plans and curriculum development on ESD.

Based on a recommendation from the Johannesburg Summit in 2002, the UN General Assembly proclaimed a consensus in December 2002 a UN Decade for Education for Sustainable Development (DESD) 2005-2014, with UNESCO as the lead agency to promote the Decade. In his follow-up report on Agenda 21 in 2002, the UN Secretary-General Kofi Annan writes: "..Education should provide students with the skills, perspectives, values, and knowledge to live sustainably in their communities. It should be interdisciplinary, integrating concepts and analytical tools from a variety of disciplines. Few successful working models of education programmes for sustainable development currently exist."

The UN's ECE Strategy on Education for Sustainable Development, a DESD for Europe, was adopted in March 2005 in Vilnius, Lithuania. This European DESD has been "constructed" along the lines of the strategy for ESD adopted by the countries participating in the Baltic 21 – the regional agenda 21 process for the BSR.

The Finnish vision and strategic lines for ESD in the education system are based on national education policy documents, the Baltic 21E programme, the ESD strategy of the United Nations Economic Commission for Europe (UNECE), and the University Charters for Sustainable Development. It is no exaggeration to say that the promotion of sustainable development is an integral part of the objectives of Finland's education policy.

The CBSS high level meeting also expressed support to the activities of the Baltic University Programme as a focal point in the region for higher education on sustainable development. The Programme has made valuable contributions through courses and projects since 1991 when the first satellite mediated course was produced. The Programme has developed into on of the largest university networks and which focuses on regional aspects of sustainability, with the Baltic Sea region in the forefront. National centres in all BSR countries coordinate the activities and participate in the development of the Programme together with the coordinating secretariat at Uppsala University. Over the years the centres have developed considerable expertise in sustainable development. Strengthening of these centres in each country would be an important task in order to increase impact and visibility of ESD in higher education. Finland has – as a forerunner - supported the centre with project funding since 2004.

UNESCO does not offer a ready-made, universally applicable plan of action for the implementation of the DESD, as sustainable development is intricately tied to local social, cultural, economic and ecological circumstances. One can generally say that in order to learn about sustainable development, one must be acquainted with several different branches of science. Learning about sustainable development is guided by a principle of organizing science and at the same time focusing on the problem solving capabilities of the students. Sustainability science is often defined as a systems study, where the system to be studied is the nature-society system. Therefore education needs to emphasize a systems understanding, in parallel with management skills, handling of conflicting interests and ethics.

According to the traditional division in academic institutions, however, research which is multi- or interdisciplinary becomes even more problematic than multi- or interdisciplinary education. The first problem is the divide between the cultures of different disciplines. This cultural gap is wider the longer the distance between the academic disciplines is. The second gap is between research and application, where traditions and systems for cooperation with the surrounding society often are lacking.

Easy to agree on is the fact that the most central position in the education strategy for sustainable development is the improvement of the human capital and that this is a prerequisite for all other sustainable development strategies.

The CBSS high level meeting in Riga considered the role of higher education most important in the sectors of resource, energy and demand management, sustainable production and development, all subjects which are essential to meet the global challenges. At the same time higher education institutions should also increase their role and responsibility towards sustainable development and act as models of sustainable development by implementing and promoting principles of sustainable development.

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The new law on special economic zones (SEZ): a better catalyst for the region of Kaliningrad?

By Horst Brezinski

The Kaliningrad region which was lagging behind the Russian economic development in the mid 1990s seemed to do much better when its status of a Free Economic Zone was transformed into a Special Economic Zone (SEZ) in 1996. The scenario for Kaliningrad was aiming at becoming a pilot region of EU-Russia co-operation. The SEZ of 1996 can be regarded as a kind of free trade area, because the foreign goods imported in this region were exempted from customs duties and taxes and so were the goods exported from Kaliningrad to other regions of Russia if the commodity classification code had changed at the level of any of the first four digits and the share of the value added amounted at least to 30%. Thus, since the beginning of this decade the growth rates of Kaliningrad's GRP was all years 4 to 5 % higher than that of Russia. Industrial growth was in most years at the two digit level. The rate of unemployment level went continuously down to a moderate 5.9% in 2006. Exports and imports went up since 2000 by more than 400%. Wages increased by 3.3 times and the inflation rate went down to the one digit level. Why to bother about the results of the economic strategy of opening up and leading the region to a sustainable development which no longer seemed to lag behind that of Russia?

A second look revealed that this economic boom was artificial. The enterprises benefited from boom due to the tariff and tax exemptions. Only few industrial goods such as TV sets, vacuum cleaners and cars were produced, or these products were just assembled. Consequently, no production networks were created. Due to the enormous tariffs on these industrial goods being imported from other countries to Russia, the business was flourishing, but it had no profound impact on the overall economic situation in the Kaliningrad region. In addition, we have to keep in mind that in 1996 the Kaliningrad region started from a very low level. The volume of industrial production in 1996 was only 27% of the level of 1990 compared with 46% of the Russian Federation. The average wages were even in 2006 more than 12% lower than in Russia and more than 30% below that of the St. Petersburg. There was a net migration flow from the Kaliningrad region. The innovation potential was seen at the 60th place out of the 88 Russian regions in 2006. 75% of the normal exports consisted of oil and oil products. The inflow of real direct investment amounted in 2006 to only about 20% of the Russian per capita level. Foreign investors were not satisfied with the institutional environment and the economic development. The corruption perception index of Transparency International listed Russia in 2007 only at rank 143 (out of 179 countries) after rank 79 in 2001. There were inconsistencies in the legal framework, a large amount of bureaucracy, the administration intervened into entrepreneurial activities and infrastructure development was lagging behind when looking at the neighbour states. In a nutshell, there was an artificial development which was driven by rising fuel prices on the export side and an increasing demand for relatively cheap consumer goods in the Russian market.

The New SEZ from 2006 did not cancel the privileges of the previous investors and enterprises. The privileges will last until the end of March 2016. Under the new law firms starting a capital investment of at least 150 million RUR (about 6 million US $) in the region over more than 3 years may use tax benefits. These foresee a reduction of the corporate income tax and property tax to 0 % for the first 6 years following that investment and a 50% reduction from tax for the years 7-12 after the investment. The law will be in force until the end of March 2031. Moreover, measures are foreseen for the promotion of an ecological and sustainable tourism and for establishing a gaming centre.

This new law will have some profound changes on the economic structure. The new investors, which can be already seen concentrate on the traditional exports that is on the oil and mining business and on industries which sell their products and services in the regions such as construction materials and the construction business. Moreover, the Association of Russian Car Manufacturers has intervened at the prime minister in asking him to revoke the duty free region because the increased production of cheap Chinese cars in Kaliningrad has upset the traditional Russian producers. Consequently, the new law as well as the lobbying of Russian manufacturers may lead to an economic structure that will not create internationally competitive industries and enterprises. This may lead in the future to a slow down in the economic development and also have negative impacts on the demographic and social situation. This can already be seen at present. The percentage of population in the working age is decreasing from 65% in 2005 to 60,2 in 2015 and the number of pensioners is increasing to 23,1 in 2015. The number of students in vocational education is going down and quite often the well educated population lacks namely business competences. Are there perspectives to change that path of development?

From the above mentioned deficiencies we can conclude that the Kaliningrad region needs investment in professional training and the retraining of specialists in order to offer to potential investors skilled labour and to meet the requirements of a modern knowledge-based economy. Further on, a concept has to be set up, how to promote the innovation and technology transfer from research institutions to the enterprises. Only then the region could participate to a larger extent in the national and international value chain and offer competitive products to the Russian as well as to the international market. Moreover, the enterprises in the region will be able to increase wages and to stop the brain drain from the Kaliningrad region. The cross-border relations which are extremely important for a small region can only develop when the barriers to travel are very low. This would increase the inflow of tourists. Thus, Russia and the EU have to improve the current status of relations and will have to work out a more flexible solution for cross-border relations for the Kaliningrad region. Without such an improved solution there will be no emergence of the tourism, because the major part of foreign tourists are coming from the EU.

The new SEZ concept does not cover these points which are relevant for the economic emergence of the Kaliningrad region. The SEZ concept will bring only some short-term benefits. In the long run it will not contribute to a real sustainable development.

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China's 'Go-abroad' strategy and the case of Baltic Sea region

By Matti Nojonen

China's 'red' capital is reshaping the global economic architecture. China's central government has become increasingly active in utilising its massive $1.3-trillion foreign exchange reserves. This strategy shift will be the most dramatic macro-economic shake-up of global economy in the near future. The central government has begun an active 'Go-abroad' investment strategy (*zouchu qu zhanlüe*) that is supported by various governmental institutions. We can identify three different patterns of Chinese foreign investment strategies in the Baltic Sea region countries; resource, market and know-how based investment strategies. Most recently, we have witnessed a strategic shift in Finland where China has for first time established a policy driven industrial organization, lobbying bureau for Chinese chemical industry, in EU.

Institutional backing

The powerful National Development and Reform Commission (NDRC) of China has announced number of policies and instruments for Chinese companies and industry sectors to realize the 'Go-abroad' strategy. In spring 2007 the NDRC published the third edition of an industrial directory for investing abroad. The purpose of the directory is to provide information about countries, regions and industrial sectors for Chinese companies going abroad. Naturally, this directory also reflects the policy and strategic interests of the central regime of China. This directory should be subjected to detailed analysis[1].

The actual powerhouse of China's foreign direct investments is the China Investment Corporation (CIC) that has a fixed capital of $200 billion. The importance of CIC's role in world economy and in China's political system has been paid very little attention to. The management of this fund has created a race between different ministers and other government agencies. The hardliners are willing to use the money to build up the strategic reserves of China; others demand China to purchase shares in foreign high-tech companies or to acquire foreign high-tech companies to develop China faster. Yet, there are some influential scholars close to the top who openly demand China to use the money for stabilizing and developing the poor and remote areas of China. The investment portfolio and practices of CIC has been under strict secrecy. It is assumed that the 17th National Congress of Communist Party, in October 2007, will shed some light on the CIC's strategies.

Four investment strategies

By studying Chinese domestic and international reports we can identify three different investment patterns that are used in the Baltic Sea Region.

The resource based investments strategy aims at securing the increasing demand of energy consumption of China's growing economy. At the same time China is gradually building up its strategic reserves. Naturally, Russia plays a key role in this respect and is the fourth biggest source of energy to China.

China has launched a sustained diplomatic campaign in recent years aimed at increasing supplies of oil and natural gas from Russia. These efforts have culminated in promises of building two natural gas pipelines from Siberia to China, which eventually will be finished by 2011. The Chinese have also shown active interest in purchasing shares and rights in Russia oil and gas-fields and companies. However, the Russian's have been very reluctant to sell to the Chinese any strategic parts of their national reserves, like in the case of resent Rosneft's IPO. Beside of economic issues, Russia and China share common strategic issues, like fight against terrorism in Central Asia and the need to create a multipolar world system. This political strategic relationship has also been manifested in arms-sales to China, joint-conferences between finance specialists and in actual business deals.

The emerging strategic partnership between the countries is also visible at the Russian Baltic Sea shores where Chinese investors are building a $1.5 billion office, shopping and residential apartment complex, the Baltic Pearl. The Chinese construction company is also building $1 billion tunnel under the River Neva. It is claimed that both projects are good-will gestures on the Chinese side and can be seen as strategy to tie-up Russia closer to China. Even more investments are taking place. In June 2007 Chinese companies signed up contracts worth of $2 billion in the northwestern Russia.

In market based investment strategy Chinese companies establish their presence at the local markets and seek various market based benefits. There exist a small number of Chinese companies that have established greenfield operations in the Baltic Sea region. The household appliance producer TCL Ltd., the biggest TV maker in the world, runs its plant in Poland from where it sales to EU market. The Chinese car producer Chery has a factory in Kaliningrad and sell cars first in Russia, but naturally aims at EU market. The Chinese companies enter into local markets also by acquiring existing local companies. For instance, in 2003 Huapeng Trading, purchased a German pressurized container producer, Welz Gas Cylinder, in order to be able to produce faster customer tailored containers.

In the Baltic Sea market we have not yet seen Chinese acquiring factories and then moving them back to China, like was the case with the traditional British crown jewelry MG car factory. In the case of machine tool producer Schisess, the new Chinese owners moved only parts of the high-end German engineering knowledge back to their own factories in China while it continues part of the production in Europe.

In the know-how based investment strategy Chinese acquire local technologically advanced companies. Within this investment pattern we can see two different practices. Chinese investors identify Western high-tech companies that are in financial problems, acquire them and keep running the business within EU; like TCL bought the bankrupt German Schneider Electronics in 2002; the Shenyang Machine Tool Group bought the German machine tool maker Schiess in 2004. The Chinese are also acquiring healthy high-tech companies that provide them access to technology, patents and educated specialists. So far, Sweden, Denmark and Germany have been active in attracting Chinese investments in ICT, renewable energy and life sciences sectors. As these sectors are also at the top of the Chinese governments 'wish-to-develop' list, it is likely that these countries will get important advantages over other countries in this region.

A new strategic opening in China's foreign trade and investment

In October 2007 China opened a new front in its 'Go-abroad' policy, which has a central strategic importance in Baltic Sea region. The China Chamber of Commerce of Metals Minerals & Chemicals Importers & Exporters (CCCMC), a semi-private industrial interest representative organization that has 4000

1 The directory was not accessible on the NDRC Chinese or English language homepages for a closer analysis.

members, established its office in Helsinki. The reason for this move was strategic and got the blessing of Chinese government. The function of CCCMC is to follow closely the work of EU's Chemical office in Helsinki. The aim of CCCMC is to inform and help its members to invest and do trade with EU. Another objective of the organization is to enhance the interests of Chinese chemical industry in EU, in other words, do lobbying in Helsinki and EU. This is the first Chinese industrial interest office abroad and therefore we need to follow closely the modes and patterns of its work.

China is truly reshaping the global economic architecture. However, it is evident that within China's elite there is strong tug-of-war what to do with the $ 1.3 trillion national reserves. The 'Go-abroad' strategy is still mantled in secrecy. At the moment we do not know what the actual importance of Baltic Sea region has in China's global chess-game – at the moment we can only identify different patterns of Chinese investment strategies and the establishment of first Chinese industrial lobbying office in Helsinki. This all indicates that the Chinese 'game' has begun on this sea that unites Russia and EU countries.

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High export duties for roundwood in Russia?

By Matti Palo

Increasing export duties of roundwood during 2007-2011 in Russia and its consequenses have been the most frequently commented business news in Finland during 2007. About 16 million cubic metres or one fifth of the utilization of wood by the Finnish forest industries in Finland has lately originated from Russia. According to a common view the duties will become fully reflected in increasing demand for roundwood in Finaland. Consequently, the respective increase in domestic supply should take place.

The timber prices in Finland have already during 2007 increased in real terms more than in 17 years. If the demand for timber in Finland would increase by the amount of the imports from Russia, it would be possible to bye this large amount only at further increased prices. The price increases would not be only restricted on the additional demand but on the total domestic demand, which definately would make this operation non-profitable.

Therefore, the Finnish companies are considering alternative options to react on this change. The independent sawmills have only a limited number of such options. One option is to change technology to be able to saw also pulpwood-diameter logs. The four large integrated companies, especially the globalized companies, Stora Enso and UPM, have, however, more options available.

Socialistic forestry is practiced in Russia, because all forests are owned by the state. The stumpage prices (prices of standing timber) are administratively set remarkably below the market prices. These prices have recently been 4-5 euros per cubuc metre, which is a tiny faction of the respective prices in Finland. The logging contractors have hence been able to operate profitably, when at the border they have been able to sell the timber at high Finnish prices. In the official statistics, however, lately losses have been reported, which indicates low productivity in logging systems or biased reporting.

Low stumpage prices have also been a main source for huge corruption in forestry in Russia. Transparency International has assessed Corruption Perceiption Index in Russia as 2.5, while Finland scores 9.6. Russias rank among 163 assessed countries is 121 as counted from the least corrupted end (Finland, Iceland, New Zealand). It is one possibility that the new export duties will not be fully included in export prices but payments for corruption or profits could be somewhat decreased. In this alternative the imports of roundwood to Finland would not be totally stopped.

The rise of duties of birch pulpwood will take place not before 2011. Therefore, a change of policy may appear by the follower of President Vladimir Putin. Stora Enso and UPM are the two largest importers of roundwood fron Russia to Finland. Both of them operate globally, which also have invested in fast growing tree plantations in The South. If the import prices from Russia will increase too much, the companies have two major options available.

The companies can close down some low productive mills in Finland and thus decrease the demand for domestic wood. This strategy would increase the global profitability, if the remaining mills would have higher productivity. Furthermore, the companies could avoid bying more high-priced wood in Finland, which also would improve their profitability. Both giants have already tested this strategy in Finland with highly critical public opinion due to increased unemployment. Now the increased export duties in Russia would be a reliable excuse to continue on this line.

Botnia company has this year already imported four giant shiploads of Eucalyptus chips from Uruguai to its pulp mill in Kaskinen western Finland. This outlet will be closed down still in 2007, when the 1 million ton new pulp mill by the same company will start production. However, roundwood, chips and pulp are supplied at competitive prices in a number of other countries in the South.

The export duty in Russia is ordered by a presidential act. Therefore, it most likely that Mr Putin himself will not cancel it. If it will become fully implemented during 2009-2011, it will total to 50 euros. It is an outcome of strong lobbying by the Russian forest industries, against global efforts to liberalize international trade. If true, the markets will adjust the the future of the Finnish forest industries in various ways.

Mr Jouko Karvinen, the CEO of Stora Enso, declared last July that “The export duties are an issue of life or death for the Finnish forest industries”. This view seems to be more lobbying the Finnish government than anything else. The government should not due to this publicity rumba change the tax system of forestry as suggested lately by a forest economist. The present system is clear and operational. As a policy analyst I am doubtful, if even any other instruments to support domestic wood supply will be needed.

Socialistic forestry is the predominant regime in the world, when 84 % of global forests remain owned by states. No socialistic forestry country has proven by facts its way towards Sustainable Forest Management, not even Canada. In corrupted Russia sustainable forestry is even less likely option. A first step had been to raise the stumpage prices instedt of export duties. In this way the basic source of corruption within forestry had been eliminated. Neither the Russian forest industries nor the politicians wanted this effective policy instument.

Increasing the stumpage prices had produced the same additional income to the government as the export duties. Simultaneously, it had improved the profitability of investments by the forest owner (state) in forest management intensification. Under such intensified of silviculture logging could be immediately expanded profitably within the best economic-geographic locations.

The higher stumpage prices would make logging unprofitable in the old-growth natural forests of Siberia and elsewhere in the periphery. The financial accessibility of forests for logging could even be shrinked due to rising stumpage prices. Consequently, under higher stumpage prices and values of Russian forests the markets could even be supportive for more forest conservation.

Higher stumpage prices and consequent lower corruption would also decrease the country risk for major foreign direct investments in pulp and paper in Russia. Under the present situation there exist a few announced investments from Finland in this front but the increased export duty will not decrease the country risk. Major increases in stumpage prices with its benefits are most unlikely under the prevailing socialistic forestry regime.

Ad hoc privatization or decentralization of Russian forests under heavy corruption would lead to the worse. This is the Gordion knot of Russian forestry behind the curtains of the export duties.

Russia has about 40 times the volume of the standing timber in Finland. Russia can annually log only three times more than Finland. In both countries the forests are to a large extent located in similar ecological conditions. Finland is relying primarily on the private ownership and the market system of forestry, Russia on socialistic forestry.

Matti Palo

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Increasing traffic in the Gulf of Finland presents challenges for winter navigation

By Atso Uusiaho

Many factors have shown that the traffic in the Gulf of Finland is increasing at a notably rapid rate. The majority of the discourse surrounding this issue concerns the increase in oil tanker traffic to Russia, and the accompanying risks of possible oil spills. I would, however, like to point out that the volume of commercial and passenger traffic has also increased. The overall increase in traffic correspondingly increases the risk of accidents, not just because of the traffic frequency, but also because of the varying condition of the vessels and the varied expertise of their crews. Furthermore, every vessel, whether it be a container vessel transporting dry cargo or a luxury cruiser, carries tens to hundreds of tonnes of oil on board as fuel.

The pressures to ensure smoother and safer traffic connections are intense, but the characteristics of this particular sea region also present their own difficulties. For instance, winter navigation in the Gulf of Finland, with its shallow and rocky coastlines, is very challenging. This is particularly true for seafarers who are not accustomed to travelling on icy seas. The ability to safely manoeuvre through icy waters requires knowledge, expertise and extensive experience.

The Gulf of Finland freezes practically every year. The thickness of the ice and the permanence of the ice cover depends upon the number of days when the temperature is below zero. In the east, at the bottom of the Gulf of Finland, the sea may be covered with ice for up to 120 days, whereas, to the west, off the shore of Hanko, for example, the number of icy days is around 30. During a harsh winter, the Gulf of Finland can completely freeze over. The thickness of the ice at the bottom of the Gulf of Finland is generally about a half metre, but the drifting pack ice can rise up to several metres above the ice and under the water.

The frozen sea does not restrict navigation, since it is facilitated by icebreaking services available to vessel traffic. The task of simply opening the fairways for vessels is not, however, necessarily enough to guarantee safe winter navigation. It is easy to assume that the ship's passage through the channel forged by the icebreaker or that the process of following behind the icebreaker is simple and straightforward. This is not the case. In icy seas, the ship's officers must be able to predict how the channel opened by the icebreaker might move or change as a result of heavy winds or refreezing, in addition to being able to prepare to deal with pack ice. Passing through the channel also requires experience, for example in overtaking or head-to-head situations. Co-operation with an assisting icebreaker or tugboat is not without its dilemmas either, if the ship's officers are inexperienced or unskilled in ice navigation.

A high percentage of oil transports and goods traffic is primarily handled by modern ships that are in good condition. The development in this area has been good, but the reverse side of this coin is that the size of the ships has also grown. The increased size of the vessels also presents challenges for winter navigation since the icebreaker's channel is approximately 25 metres wide, but the largest tankers are 40 metres wide or more.

The direction of the development has been clear for some time already, and, at the same time, measures have been planned and taken into use to further secure navigation at sea. The coastal states of the Baltic Sea region are working together more than ever before. One example of this is the GOFREP (Gulf Of Finland Reporting) system that was introduced in 2004 and requires all vessels with a gross tonnage of more than 300 GT to make notification of their location.

A risk analysis concerning traffic in the Gulf of Finland was ordered by the Finnish Maritime Administration, and on the basis of the analysis, the GOFREP system would reduce the likelihood of ship collisions by up to 80 per cent. Technical equipment and monitoring systems do not, however, eliminate the risk completely, since there remains the possibility of accidents caused by human error, equipment malfunction or difficult conditions.

One additional method for reducing dangerous situations is to ensure that there is an experienced professional on the bridge who is familiar with local waters and conditions. Last year, the Finnish State Pilotage Enterprise, Finnpilot, and the Shipping Enterprise, Finstaship, jointly established Ice Advisors Ltd, a company providing ice advisory services to shipping companies operating in the Baltic Sea.

The ice advisory service is a tool which helps shipping companies to increase the efficiency of their transports by improving, among other things, the predictability and reliability of transport schedules, but which also oversees the safety of the vessels, their crews and the environment. While ice guidance is also an important part of the job of local pilots along their own specified routes, an ice advisory expert is free to operate within the entire sea region. The service is also very important in a social and cross-border sense.

The experts at Ice Advisors are experienced pilots and masters of icebreakers that work for Finnpilot and Finstaship. They and the organisations behind the company have decades of experience in winter navigation and the special conditions related to ice fields. The ice advisor also has access to real-time information on weather and forecasts, and on the ice conditions in the Gulf of Finland.

The task of the ice advisor is to guide and assist the officers of the vessel in selecting the safest route, and to ensure that the vessel stays in motion and on the proper fairway. The ice advisory service has, thus, a significant environmental value since there is a great risk of accidents involved with inexperienced navigation through ice.

As I mentioned above, the ability to travel through ice requires highly specialised expertise. The officers of the ship must be able to co-operate with the assisting service and to predict other traffic obstacles. When travelling on their own, the officers of the vessel must also be able to properly interpret the conditions around them, such as rapid changes in the weather and the movement of ice fields, since ice can cause significant problems or damage for the vessel. The vessel might, for example, end up stuck in pack ice, and might sustain damage or drift with the ice into shallow waters. Furthermore, there is always the risk of an accident resulting in damage that will require long-term efforts to correct.

The service does not provide a guarantee or remove the risk of accidents, but it is one means of reducing these risks.

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Finland

Safe seaway connections are our life blood

By Bo Österlund

We are used to regular seaway connections and regard them as self-evident. In the good times, goods are sufficient to fill the shop shelves, the raw materials and components of industry are in the right place at the right time, and industry is run by means of either domestically produced or imported energy. We are used to our country's prosperity and the export income which fundamentally affects our standard of living, and also regard them as self-evident, since already over 50% of our national product is generated beyond the borders of our country. However, even a small disturbance in our seaway connections could change these circumstances in a decisive manner.

A logistics chain in which the components and spare parts are under the control of the manufacturer and the user has the goods requiring manufacture for a limited time only achieves even substantial savings. The expected outcome is that the prices of commodities will fall. This "just in time" system increases, however, dependency on the smoothness of deliveries as well as, most significantly, the vulnerability of logistics. This requires an already continuous, functional and safeguarded transport chain to the production facilities.

The freight traffic of the Baltic Sea's entire area of influence comprised, according to the statistics of 2003, 1,788 million tonnes in total. The share of export was 1,044 million tonnes and share of import was 744 million tonnes. The proportion of marine traffic is about 50% of all transport. The Baltic Sea is too wide from the perspective of overall supervision, but it is nevertheless highly sensitive to disturbances at the same time, owing to its limited scope.

Globalisation not only increases possibilities, but requirements as well, to rapidly deliver goods, services, information and other commodities round the world. The Baltic Sea is almost entirely surrounded by EU countries, but at the same time highly central to Russia's foreign trade, which is growing from year to year. This year, as much as 40% of Russia's foreign trade proceeds by container via this inland sea. Oil shipments make up the largest part of this sea transport.

Calculated from the year 2000, EU export to Russia has tripled and, at the same time, EU import from Russia has doubled. Europe will still be dependent for quite some time on Russia's fossil energy, though it is attempting to improve its self-sufficiency and establish new import routes via Southeast Europe.

Some alarming statistics figures

According to last year's statistical data, ship traffic on the Baltic Sea consisted of over 60,000 vessels either entering the area or leaving it. Each moment round the clock and throughout the year, over 1,350 merchant ships ply the Baltic Sea. This "movable storage system" conveys over 730 million tonnes of cargo—which is over 15% of the world's deliveries of goods. The traffic level of about 900 vessels at the turn of the new millennium has grown approximately 50% to the present day. At the same time, 150 – 200 rather large tankers carrying oil are resting at about 20 ports in the area.

On the basis of Russia's economic growth in particular but also that of Poland and the Baltic countries, the growth prognosis for marine traffic on the Baltic looks quite significant. This belief for the future looks set to bring new ship orders as well as increasing the number of expansion projects at ports. The Vuosaari Island Port Construction Project to the east of Helsinki is currently the Baltic's largest.

Russia shows some of the area's largest economic growth figures. The handling of containers at the base of the Gulf of Finland, the Port of St Petersburg, has increased over 20% during the last two years, and oil exports from Primorsk Port have simultaneously grown over 15%. Russia is currently strongly dependent on its exports of oil and gas. Together with the metal field and still operational timber exports, these fields correspond to over 80% of Russia's overall exports. Russia's oil proceeds make up to over 40% of the country's gross national product. In 2006 as in the previous year, oil exports from Russia reached at least 250 million tonnes, 66 million tonnes of which were conveyed via Koivisto. The capacity of the Port of Koivisto is set to grow to over 100 million tonnes within a few years.

The Port of St Petersburg handled over 54 million tonnes of goods last year, a new oil/chemical port is being planned, and its capacity is assessed to be approximately five million tonnes. Deepening the entrance route to 13 meters is also under planning. The capacity of the Port of St Petersburg currently acts as a bottleneck in the logistics chain. At present, the waiting periods for ships to enter the port may stretch to up to ten days.

The East Laukaanlahti Bay Port Project on the south shores of the base of the Gulf of Finland close to the Estonian border is progressing and is expected to be ready this year, at which point the port will comprise a coal and motor vehicle terminal as well as a dry cargo terminal. In connection with the expansion of the Port of Vysotsk towards the farthest reaches of the Gulf of Finland, its cargo-handling capacity will grow from 11 million tonnes to 15 million. The capacities of the ports of Varandey and Batareinaya are almost doubling.

Russia has stated that its intentions are to reduce the *transito* transport occurring via the Baltic ports which, together with the transit traffic directed via Finland, currently reaches over 80 million tonnes annually (the figure corresponds to almost the entire volume of goods respective to Finland's marine traffic) and that it will transfer this share to its own ports and oil- and gas lines. At the end of May, the Russian government decided to build a new oil line extending to the shores of Koivisto. The volume of oil to be conveyed via Koivisto with the completion of the new pipeline will almost double. At the same time, the number of oil tankers will double in the Gulf of Finland. As a result of the completion of the new pipeline, the 'friendship' line proceeding to Western Europe will become redundant. As the Port of Koivisto has been expanded, Russia has already terminated oil shipments to Latvia's Ventspils and Lithuania's Butinge earlier this year. These oil deliveries have also been transferred to the Gulf of Finland. A safety zone with a width of 200 metres on each side—whose project managers say "shall be enforced"—is to be established along the North Stream gas line, which is 1,200-kilometre long, 1.2 metres in diameter and designed to proceed across the Baltic Sea on the bottom of the base of the Gulf of Finland. This will also on its part affect maritime use. The compressor station planned for construction in the area of Sweden's Gotland will be the only structure extending above the surface.

The Baltic nations' ports handled a total of over 138 million tonnes of goods last year. During the last ten years, the cargo quantities at the Port of Tallinn have grown about 300% to 41 million tonnes. The share of *transito* transport is no less than 34 million tonnes. According to the announcement issued in mid-July by Sergei Lavrov, Russia's Minister of Foreign Affairs, Russia will halve the transit oil transport going on via Estonia. This 25-million tonnes export consignment will also switch to the Gulf of Finland for delivery. In Estonia, plans are being made to raise China's container traffic and to simultaneously reduce the handling of mineral oil products.

In the strategy approved a few years ago a few years ago by Russia's government, attention is being given to transport routes which Russia can control itself and thereby avert the economic as well as the political risks thereby caused. Russia has two logistics centres within its region which it can control itself. One is the base of the Gulf of Finland, where the oil port of Koivisto has become Russia's most important individual oil export port, and the other logistics centre is situated in the Murmansk area.

Of Finland's foreign trade, about 85% proceeds by sea and, amongst the countries of the Baltic, we are the most dependent on maritime transport. We are in a position close to the status of an "island state". Marine traffic comprises of roughly 95 million tonnes of cargo quantities. On the basis of this cargo quantity and the number of visits by vessels, we come to an average of 2,300 tonnes for the cargo ship size. These sorts of average ships arrive in or leave Finland at a rate of 114 per day throughout the year, summers and winters. The cargo quantity of these vessels is equivalent to 11,400 train cars or 34,200 full-trailer combination lorries of goods. About half of the ship traffic heads to the east or west side of Åland to the ports of the Gulf of Bothnia, and about half to those of the Gulf of Finland. We are dependent on this sort of uninterrupted activity in the flow of goods. Even so, the goods travel in ever greater quantities by foreign keel.

According to the statistics from the 1960s, about half the foreign traffic in terms of the flow of goods was transported by Finnish vessels. Of the transport from 1990, domestic tonnage remained responsible for only 35% of this share. Last year, the proportion of domestic tonnage already declined to below 30% (27.7%). Abroad, Finnish vessels transported only under 17% of cargo deliveries, with slightly over 35% of domestic tonnage dedicated to import. Supply and operational reliability using foreign tonnage are, under emergency conditions, surely not on the same level with Finnish ships sailing under the Finnish blue and white flag. We are also relinquishing our commercial fleet with respect to the nationality requirements of captains. According to the change in legislation under preparation, the master of a merchant vessel sailing under the Finnish flag will no longer be required to be a Finnish national. A more important factor than the nationality of the shipmaster, however, is the ownership status of the vessel. On domestic ships, the status of command remains under national control. Our transport by sea is vulnerable to interruptions.

Baltic cargo transport is expected to grow faster than other areas and, by the year 2020, as much as 64%. The flow of goods is thus going to grow by almost 500 million tonnes. The ports of Germany, Poland and the Gulf of Finland are anticipated to gain the most benefit from this growth in traffic. The sizes of vessels—particularly in container traffic—also appear to be growing in order to achieve the desired cost effectiveness. Oil transport is increasing faster than other types of transport. The Baltic nations now bring 64 million tonnes from Russia and 86 million more tonnes from other European countries. It is calculated that by 2010 oil transport in the Gulf of Finland will grow to slightly less than 200 million tonnes, which means an increase of six thousand (6,000) approximately 32,000-tonne container ships per year. This means about 16 tankers per day will be travelling east or west. According to the assessments of the State Technical Research Centre, the risk of oil disasters in the Gulf of Finland has dramatically increased. It is assessed that by 2015 this risk will further double from that of the current level. With the growth in ship size, it is anticipated that the size of ports practising foreign trade will also grow. The number of ports engaged in foreign traffic appears as a consequence should decline, since it is not possible to make large ports out of all of them. Far-sighted subsidiary traffic by wheel and rail will probably be developed on the basis of these development trends.

Safe seaway connections represent the life-blood of our society's survival as well as in our global trade and international collaboration. As a result of this dependency, we may of course ask: which sort of threat scenario with our vital marine traffic as its object could there be?

In dealing with a threatening scenario, it is also of course necessary to evaluate the likelihood of a possible threat. This point of view is fundamental, but it is virtually impossible to answer the question. During the period of the Cold War, assessment was made even more difficult because those interests which could truly pose a threat attempted at the time to conceal their intentions as long as possible. These days, the matter must also be examined from the opposite side: Do those who now publicly and via the media pose a threat really have the capacity to implement their intentions?

Selecting terrorism as a modus operandi requires, as operational resources, not only money, individuals eager for action and a strong motivational ideal, but also some sort of operating concept. Many international specialists assert that terrorism and crime have warmed up to each other. This cohesion has opened up financing channels to terrorism as well. Terrorists have utilised ships for transporting both their materials and personnel. Transportation of explosives by means of other modes of transport may be problematic.

Fortunately, to our knowledge there are no situations these days in which vessels carrying dangerous loads would be used in the manner of 'suicide bombers' at ports with vigorous traffic. On the other hand, ships have been selected as targets. In October 2000, an American destroyer at the Port of Aden was attacked. The offensive was realised with a small boat loaded with 250 kg of explosives. The attack killed 17 Americans and the economic losses were reckoned at 250 million dollars.

In October 2002, the *Limburg,* an oil tanker, became the object of an assault by a boat carrying explosive agents. The consignment burst into flame and one of the crew members lost his life. The consignment, totalling 75,000 cubic metres, discharged 15,000 cubic metres of oil into the sea. Between May and June, three Saudis were arrested in Morocco. They had plans to use boats with explosives to attack American and British warships in the Strait of Gibraltar. This plan remained unfulfilled. Tips have also been obtained concerning suspicious characters who have sought diver training, at least in the Netherlands at the end of 2002. This reference does provide reason to also examine the underwater threat to ships. A few years ago, a rather major ship-owner with 200 vessels that sailed the world's seas was asked about the effects of this sort of underwater threat. He stated that greater detriment would be achieved by closing strategically important maritime passages. A mine in the Strait of Malaka or at the front of the port city of Aden would mean that we could not enter the port. According to this ship-owner, navigation would come to a halt in 1 – 2 weeks and the interruption would immediately be felt in the global economy. Many of the clients of this shipping company, too, have only enough reserves to allow operations for less than a week. Their reserves as well are also transported by sea.

The capture of the Danish vessel *Donica White* at the fore of the coast of Somalia at the outset of June was the most recent incident of an attempt to disrupt or prevent international trade and interfere with the freedom of the seas.

NATO has reacted to the possibility of this kind of threat, and has implemented, among other things, the 'Active Endeavour' operation on the Mediterranean Sea to make the area safe for marine traffic. Through area supervision, escorts of merchant vessels and mine searches and eradication, marine traffic routes have been kept safe. Port security has been increased and through traffic is the object of special supervision and inspection. The same sort of activity has been practised on the Indian Ocean. A corresponding threat in, e.g., the Denmark Strait would immediately impact the marine traffic on the Baltic Sea. With a trade embargo, it would also be possible to prevent shipping through some marine area or prevent access to a port.

It is particularly important to protect the traffic routes and the ships plying them at Baltic marine traffic nodal and passage points and in areas in which traffic is restricted to certain routes as well as in the archipelagos.

The point of emphasis in our naval defence has become the protection of seaway connections. This task represents both the military protection of our country and the safeguarding of the nucleus of vital functions on the sea and along the coasts. Juhani Kaskeala, Chief of Defence of the Finnish Defence Forces, declared in his editorial in *Rannikon Puolustaja* [Defender of the Coast] (1/2007) that the safeguarding of seaway connections has always been part of the task of our naval forces. It is only that at times its emphasis has been rather minimal.

The protection of seaway connections is multidimensional and requires the collaboration of all maritime authorities and actors. The naval forces are responsible for the whole and harmonise the measures. Maritime situation awareness creates the need to do something or provide the rationales for conscious non-intervention in events: without reliable situation awareness, this sort of requirement is not established.

The naval forces compose and maintain the required situation awareness required as the foundation for marine activities as a whole and distribute it to the authorities that need it for the evaluation of the situation and as the basis for decision-making. The maritime situation awareness composed in collaboration between Finland and Sweden expands the possibility of decision-making far into the Baltic. Mikael Odenberg, Sweden's Minister of Defence, reported during the Defence Ministers' Conference in Sandham, Sweden between May and June that Finland and Sweden are offering other Nordic nations the opportunity to join as observers in their cooperation involving the supervision of the Baltic Sea. Sweden is also engaging in discussions with Denmark about assembling combined maritime situation awareness.

The formation of situation awareness to accompany the safeguarding of our seaway connections requires the supervision and regulations of marine traffic, protection of seaway connections, close and remote protection of ships against the threat of air, surface and underwater threats. Ensuring routes that are important to us, rescue services, inspection of vessels and the maintenance of port accessibility are also important tasks to acknowledge.

Preparedness for various circumstances challenges the community to develop, together with other actors, multilateral performance competence to safeguard vital functions in our society in the manner required by the government's basic programme from November of last year. Naval defence ensures our vital seaway connections which keep the wheels turning also under emergency conditions.

The time has not run out. Yet!

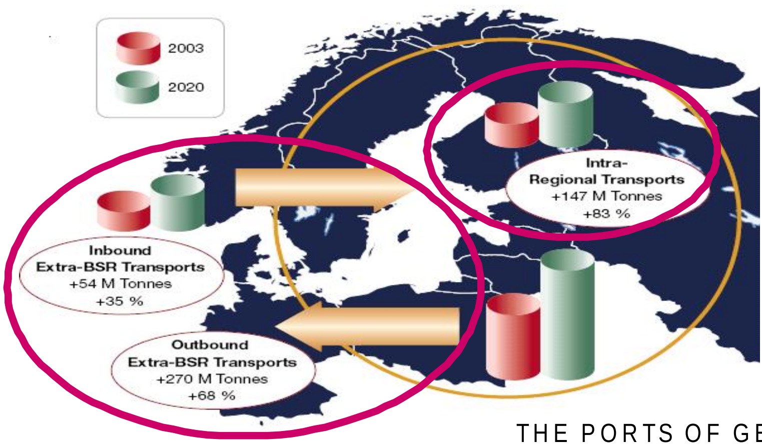
"TEMPORA MUTANTUR NOS ET MUTAMUR IN ILLIS"

Bo Österlund

Commodore

Finland

BALTIC SEA: DEVELOPMENT PROSPECTS FOR FREIGHT TRAFFIC



Internal market Baltic Sea transport represented 24% of total freight volume in 2003.

=178 million tonnes.

In the inspection period extending to the year 2020, sea transport is expected to grow

=147 million tonnes, 83% growth from year 2003 level

In the external traffic of the Baltic Sea transport represented 76% of the entire traffic in 2003

=553 million tonnes.

In the inspection period extending to the year 2020, sea transport is expected to grow on the part of import and export by a total of

=324 million tonnes, 58% growth from year 2003 level

THE PORTS OF GERMANY, POLAND AND THE GULF OF FINLAND ARE EXPECTED TO BENEFIT THE MOST FROM THIS GROWTH

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