Baltic Rim Economies

Estonia - Latvia - Lithuania - Poland - Baltic Russia
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POLAND
ST. PETERSBURG
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Estonia

Economic growth slowed down
According to a flash estimate by Statistics Estonia, the growth rate of the Estonian economy slowed down towards the end of 2007. In the Q4 of 2007, GDP grew by 4.5% which is the slowest growth rate of the Estonian economy in eight years. According to the preliminary calculations, value added decreased in transport, storage and communications, real estate, renting and business activities. On the other hand, value added continued to grow rapidly in financial intermediation. Seasonally adjusted GDP grew by 0.6% in the fourth quarter of 2007 compared to the third quarter. The Estonian Central Bank stated recently that the outlook for the Estonian economy seems somewhat unfavourable due to external risks as world financial markets and the slowdown of the US economy as well as domestic risks such as rising inflation curbing domestic demand. On the other hand, the Estonian economy is heading for a soft landing and thus avoiding economic meltdown, according to the Economist.

Foreign trade deficit decreased towards the end of 2007
According to preliminary data by Statistics Estonia, the foreign trade turnover was approximately EEK 27 bln (EUR 1.7 bln) in November 2007. This is 6% higher than in November 2006, but 2% lower than in October 2007. The trade deficit decreased compared to the year before as well as to the previous month, and stood at EEK 3.6 bln in November 2007. The value of exports was EEK 11.7 bln (43%) and imports EEK 15.3 bln (57%). The exports of goods increased by 11.6% and the imports of goods only by 1.8% in November 2007 y-o-y. The slowdown in the imports of goods explains at least partially the decrease in the foreign trade deficit.

Source: Statistics Estonia

In November, the EU27 countries accounted for 70% of Estonia’s exports and 80% of its imports. The majority of Estonian exports went to Finland (19% of total exports), Sweden (14%) and Latvia (10%). Finland was also the most important trade partner for imports, since 15% of Estonian imports originated from Finland. Other significant consignment countries were Germany (13% of total imports) and Sweden (12%). The exports of agricultural products and food preparations, mineral products, transport equipment and wood and wood products increased compared to November 2006. On the other hand, the exports of machinery and equipment decreased considerably during the same period. The imports of mineral products, agricultural products and food preparations as well as transport equipment increased, whereas the imports of machinery and equipment and metals and metal products decreased in November 2007 y-o-y.

Growth in industrial production slowed down
According to preliminary data by Statistics Estonia, the industrial production increased by 6.1% in 2007 y-o-y. The growth of energy production and mining continued strongly; the first grew by 16.6% and the latter by 11.5% y-o-y. The slowdown of the total industrial production was mainly affected by the manufacturing sector, which grew only by 4.7% y-o-y. Within the manufacturing sector, the manufacture of wood and wood products decreased by 6% y-o-y. This was mainly caused by a lack of raw materials as well as by a rise in the price for raw materials. The manufacture of textiles decreased by 6.3% y-o-y, and this was mainly due to a decline in competitiveness of Estonian textile products both in the domestic and external market.

On the other hand, the manufacture of electrical machinery grew by 27.2% y-o-y.

Consumer prices increased in January 2008
Consumer prices grew by 11.0% in January 2008 compared to January 2007. The prices for goods increased by 10.2% and for services by 12.6% reports Statistics Estonia. The increase in the consumer price index was mainly influenced by increases in prices for food, housing expenditures and motor fuel. When compared to December 2007, consumer prices grew by 2.2% in January 2008. On the monthly level, the increase was mainly affected by higher prices for transport, which grew by 4.6% compared to December. Prices for motor fuel rose due to excise changes, and ticket prices for ferry boats, urban transport and trains increased as well. Prices for food and housing continued to rise as well.

Some business highlights
- OU Krimelte, one of the leading manufacturers of constructions foams and joint sealants, expands its production by building new production facilities in Tallinn. The estimated cost for the project is EUR 6.5 mln.
- Swedish industrial group Trelleborg has invested EUR 3.2 mln in plant manufacturing metal and rubber products. The plant is located in Kuressaare, in the Western Estonian island Saaremaa.
- Nordea Bank Estonia, reported a 44%-increase in its profits for 2007, thus amassing a profit of EUR 20 mln. Asset volume grew by 41% y-o-y and their loan portfolio increased by 50% y-o-y.
- Two of Estonia’s largest oil terminals, Pakterminal and E.O.S, have filed for approval to establish a joint venture. The aim of the merger is to use the combined available terminal assets in the region more effectively.
- A survey by KPMG ranks Estonia’s tax system among the top five in Europe. 400 businessmen ranked Estonia above average in all categories, especially in stability and low tax rates, both of which got an 80% approval rating.
Latvia

**Strong economic growth continues**

GDP growth remained strong in Latvia in the last quarter of 2007 reports the Central Statistical Bureau of Latvia. According to provisional data, GDP grew by 9.6% in Q4 of 2007 compared to the corresponding period for 2006. However, even if this is still a relatively fast rate of growth, it indicates that the peak of record fast growth has been passed. Even if the total growth rate for 2007 remained high, the rate of growth somewhat abated towards the end of the year, which would indicate that the Latvian economy might not face a hard landing. The final GDP growth figures for 2007 will be released in March.

**Industrial production declined**

Industrial production output decreased by 3.2% in December 2007, compared to the previous month. The y-o-y decrease of total seasonally adjusted industrial production was 5.4% in December 2007. Manufacturing output decreased by 7.5% y-o-y, whereas in electricity, gas and water supply there was an increase of 2.0% and mining and quarrying increased by 7.8% y-o-y.

Manufacturing of food products and beverages lessened by 14.8% y-o-y, which was largely affected by the discontinued production of sugar. Other manufacturing sectors experiencing a decline in production were the manufacturing of rubber and plastic products (by 19.3%), non-metallic mineral products (by 18.6%), chemicals (by 18.2%) and furniture (by 15.5%). On the other hand, the manufacture of fabricated metal products, except machinery and equipment, increased by 56.1%, motor vehicles and trailers by 11.1% and basic metals by 5.9% y-o-y.

**Consumer price inflation soars high**

In January 2008, consumer prices were 15.8% higher compared to January of the previous year reports the Central Statistical Bureau. The price increase for consumer goods compared to January of the previous year reports the Central Statistical Bureau of Latvia. The price increase for consumer goods was 15.1% and for consumer services 17.5%. The most drastic price rises were in the following commodity groups: food (by 20.6%), alcoholic beverages and tobacco (by 39.1%) and housing, water, electricity, gas and fuels (by 19.7%). Prices for communication, on the other hand, fell by 3.0% and for clothing and footwear by 0.5% y-o-y.

<table>
<thead>
<tr>
<th>Price changes by commodity groups</th>
<th>weight</th>
<th>y-o-y change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan 2007-Jan 2008</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>Food</td>
<td>24.0</td>
<td>20.6</td>
</tr>
<tr>
<td>Alcoholic beverages and tobacco</td>
<td>7.1</td>
<td>39.1</td>
</tr>
<tr>
<td>Clothing and footwear</td>
<td>7.4</td>
<td>-0.5</td>
</tr>
<tr>
<td>Housing, water, electricity, gas and fuels</td>
<td>12.2</td>
<td>19.7</td>
</tr>
<tr>
<td>Transport</td>
<td>13.9</td>
<td>15.5</td>
</tr>
<tr>
<td>Communication</td>
<td>4.6</td>
<td>-3.0</td>
</tr>
</tbody>
</table>

Source: Central Statistical Bureau of Latvia.

On the monthly level, the consumer prices rose by 2.8% in January 2008 compared to December 2007. Price changes were mainly influenced by growing prices for cigarettes, transport and food products, whereas the prices for clothing and footwear slightly decreased. The prices for tobacco products grew by as much as 38.1%, due to change in the excise tax, reports the Central Statistical Bureau.

**Value of foreign trade increased in 2007**

The total value of exports reached EUR 5.7 bln and the total value of imports was almost EUR 11.0 bln in 2007. According to the Central Statistical Bureau, the value of exports grew by 22.2% and of imports by 21.0% compared to 2006. In December 2007, the value of exports of base metals and articles thereof increased by 66.2%, of chemical products by 48.3%, and of agricultural and food products by 38.8% as compared to December 2006. During the same period, the value of imports of fats and oil increased by 48.2%, of live animals and animal products by 31.1%, and of mineral products by 28.9%.

The most important export articles in 2007 were wood and articles thereof (18.8% of total exports) agricultural and food products (17.1%) and base metals and articles thereof (16.8%). The most significant import articles, on the other hand, were machinery and mechanical appliances (19.1% of total imports), mineral products (16.3%) and agricultural and food products (13.9%).

**Some business highlights**

- Swedish-Finnish telecom operator TeliaSonera has announced that it has made a non-bonding bid to the Latvian government for the shares in fixed line operator Lattelecom and its mobile unit LMT. Currently TeliaSonera owns 49% of Lattelecom. The value of the bid is estimated EUR 0.7 bln.
- LLC Joint Venture Baltic Oil Terminal plans to build a 7.5 mln tonnes refinery and a 10 mln tonnes oil terminal in Latvia. The refinery is planned to be built in Daugavpils, and the oil will be delivered form Kazakhstan or Russia by pipeline. The project is valued at EUR 2.5 bln.
- Foreign investments in Latvian companies increased by 23% y-o-y in 2007. The largest foreign investments were made in the financial and real estate branches. The most significant foreign investments were made towards Hansabanka, worth EUR 100 mln.
- In 2007, large banks lost market share to smaller banks. The three largest banks, Hansabanka, Parex banka and SEB Unibanka, increased volume but less than small banks thus decreasing their market share. Currently Latvian banks are the most profitable in Europe, and ranked fourth in efficiency, whereas premiums have been high as well.
- Latvijas Gaze, Latvian natural gas utility, plans to invest EUR 43 mln in an underground gas storage facility. The investment will be made in upgrading and expansion of its Incukalns facility. Latvijas Gaze controls 31.5% of Latvia’s gas market. The company imports, stores, sells and transmits natural gas throughout all of Latvia.
- Samsung, the consumer electronic giant opened a new sales unit in Latvia to coordinate its sales in the Baltic countries. The company projects strong growth of demand for LCD televisions and mobile phones in the three countries. It estimates that the sales will be up 29% in 2008. Samsung also plans to open a production and assembly plant producing LCD televisions and mobile phones in one of the three Baltic countries. The company hopes for higher presence in the Baltic region due to its high economic growth.

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Lithuania

Strong growth in 2007
According to the flash estimate by Statistics Lithuania, GDP grew by 8.7% in 2007 compared with 2006. The growth of the value added in 2007 was mostly stipulated by increases in value added in the following sectors: agriculture, construction, wholesale and retail trade and transport, storage and communications. The growth rate of the GDP somewhat abated towards the end of 2007, as the GDP grew by 7.9% in the Q4 of 2007 y-o-y and decreased by 1.1% compared to Q3 of 2007 when seasonally and working day adjusted. This indicates that Lithuania avoided the risk of overheating and moderated some of the imbalances of the economy. The largest changes in the valued added in the Q4 of 2007 were made by enterprises engaged in electricity, gas and water supply, construction, wholesale and retail trade, transport, storage and communications.

Statistics Lithuania reports that the Lithuanian economy has been growing on average by 2% per quarter since 2001 when the random fluctuations have been eliminated. The per capita GDP was approximately EUR 8300 at current prices in 2007, which is 9.3% higher than in 2006. The Lithuanian economy and its future competitiveness will be analysed in February 2008 by IMF experts as they evaluate Lithuania’s macroeconomic situation, general economic development, financial sector development and implementation of the budget policy.

Inflation accelerates in Lithuania
According to Statistics Lithuania, the annual inflation in December 2007 was 8.1% compared to December 2006. This means that the rate of inflation has almost doubled compared to the year before; in December 2006 the annual inflation was 4.5% when compared to December 2005. In 2007, prices for consumer goods increased by 7.9% and for consumer services by 8.9%. The most drastic price increases were recorded in prices for food and non-alcoholic beverages, which grew by 15.5%, for housing, water, electricity, gas and other fuels (up by 14.1%) and transport (up by 9.6%). On the other hand, the prices for clothing and footwear dropped by 5.8% and for communication by 7.3%.

In 2007, the lowest monthly consumer price inflation was recorded in January when the inflation rate was zero, whereas October was the month of highest inflation with a monthly rate of 1.5%. The monthly inflation rate stayed relatively high from September to November, but in December the rate of monthly inflation lowered to 0.5%. According to the latest data by Statistics Lithuania, the inflation rate accelerated again in January 2008, when it was 1.6% compared to December 2007. Again, rising prices for housing, food and transportation were the main contributors to the rising price level.

Number of unemployed decreases
The number of unemployed was 69,700 as of 1st January 2008, reports Statistics Lithuania. The number of unemployed persons decreased by almost 10,000 in December 2007 y-o-y. 60.6% of the unemployed are female. A majority of all the unemployed persons, 53.2% have general upper secondary education. 9.1% of unemployed people have a higher university degree and 16.4% a college degree.

Industrial production
The index of total industrial production shows steady growth. The value of industrial production grew by 7.2% in December 2007 y-o-y. Mining and quarrying increased by 10.9%, manufacturing by 5.6% and electricity, gas and water supply by 15.2% y-o-y. Within the manufacturing sector, the manufacture of tobacco grew by 40.0%, basic metals by 41.2% and office machinery and computers by 77.1% y-o-y. However, the total industrial production declined slightly in December 2007 compared to November 2007, as the volume of total industry declined by 1.2%.

The prices for total industrial production increased by 1.2% in January 2008 against December 2007. The price change in Q4 of 2007 was 15.7% y-o-o for total industrial production. The producer prices for mining and quarrying increased by 25.6%, for manufacturing by 17.0% and for electricity, gas and water supply by 13.9% y-o-y, reports Statistics Lithuania.

Some business highlights
• Lithuanian Railways plans to improve its railway communications and ensure better international compatibility of the Lithuanian national railway. The construction project costs EUR 60 mln according to estimates and will be finished in 2010. Part of the project is funded by the EC’s cohesion fund for regional development.
• Lithuanian banks reported record-high profits in 2007. According to preliminary data, net profits of Lithuanian banks increased by 73% y-o-y. The profitability of the Lithuanian banking system has been growing for six successive years.
• Lietuvos Energija and Svenska Kraftnät finished a feasibility study concerning a power bridge between Lithuania and Sweden. The study concluded that an interconnection between Lithuanian power grids would be both feasible and profitable. The project could be implemented in 2015 and the cost would be between EUR 516-637 mln depending on the cable.
• Telecommunications company Tele2 achieved the best result in Lithuania in 2007. The number of customers increased by 43,000 and its earnings increased by 15% y-o-y. In Estonia, Tele2 increased its customer base by 3,000 whereas in Latvia it lost a few thousand customers in 2007.
• Lithuanian railway operator Lietuvos Gelezinkeliai transported 20.9% more cargo in 2007 than in 2006. In absolute term this is 4.8 mln tons of cargo. The volume of international cargo increased by 20.4%.
Poland

Strong economic growth fuelled by domestic demand in 2007

Gross domestic product grew by 6.5% in 2007, according to initial estimates by the Central Statistical Office of Poland. This is the highest growth rate by the Polish economy for a decade. However, some of the macroeconomic indicators deteriorated towards the end of 2007, which would indicate that the rate of growth is slowing down. Strong growth in 2007 was spurred by booming domestic demand; both consumption and investments were strong. Also exports boomed, thus balancing the negative trade balance. The Polish Market Review reports that one positive outcome of the strong domestic demand was the flexibility of Polish companies to increase their productivity and to remain competitive in foreign markets, despite strong demand for imports by home markets. In 2007, trade deficit stood at approximately 5.5% of GDP, and is expected to deepen due to the strong growth of foreign trade.

FDI boomed in 2007

The value of foreign direct investment inflows into Poland reached close to EUR 14 bn in 2007, states preliminary data by the National Bank of Poland. This is slightly less than in 2006, but still a record high. The outlook for 2008 FDI inflows seems a bit less optimistic due to the worsening world economic situation which might increase the cautiousness of investors.

The current account deficit widened in December 2007, amounting to EUR 1.9 bn. This was higher than the deficit of EUR 1.3 bn that the markets had anticipated. The deterioration of the current account balance was a consequence of a higher trade account deficit and a lower surplus of the current transfers account, reports the National Bank of Poland.

The value of exports increased by 14.5% y-o-y in January-November 2007. The value of imports increased by 16.9% during the same period. In November 2007, the trade deficit stood at EUR 14.8 bn. Poland’s trade balance was positive with the EU countries as a whole but negative with the group of countries in the euro area. This indicates that Poland imports from the old EU members and exports to the new member countries.

Consumer price inflation

Consumer prices increased by 4.0% in December 2007 compared to December of the previous year, announces the Central Statistical Office of Poland. There was an increase of 1.6% in the prices for consumer goods and services in the Q4 of 2007 when compared to the previous quarter. What was noteworthy in the price development was that contrary to Q4 of 2007 when compared to the previous quarter. What was noteworthy in the price development was that contrary to December of the previous year, announces the National Bank of Poland.

Inflation (CPI, end of period, y-o-y %-change) 8.5 3.6 0.8 1.7 4.4 0.7 1.4 4.0 12/2007

However, the development of the inflation is still far from alarming in Poland, where the inflation rate is much more moderate than in several other EU member countries.

Strong growth in manufacturing

Manufacturing output grew strongly in 2007. The high expansion of output was spurred by strong domestic demand, the high employment rate and investment growth, reports Polish Market review. Output rose in 19 of 21 manufacturing sub sectors, and total manufacturing output increased by 10.9% y-o-y. The most significant growth was recorded in the manufacture of machinery and equipment, followed by the manufacture of medical and precision equipment, metal products, leather products and electrical machinery and apparatus. Output fell in some sectors, such as in clothing and furs, as well as coke and petroleum products. The largest share of manufacturing output was held by the production of food and beverages, with a share of 20%.

Source: Central Statistical Office and Polish Market Review

Some business highlights

- PKP Intercity, the Polish rail company plans to invest EUR 140 mln to upgrade its customer service. In 2008, the company will also invest approximately EUR 120 mln to modernise its rolling stock and buy new train cars. This is continuation to its last year’s project worth of EUR 55 mln. PKP Intercity hopes to increase its sales in 2008 by at least 10% compared to 2007.
- LOT Polish Airlines, Poland’s national air carrier, will float on the Warsaw Stock Exchange in six to eight months. At the moment, the government holds 68% of LOT. The air carrier plans to invest EUR 1.6 bn in new aircraft and planes.
- Foreign investors planning to invest in Poland will receive more transparent service starting in 2008, the Polish government has promised. The Polish Information and Foreign Investments Agency will work closely with special economic zones and analyse the needs of a given company to obtain the best possible location for them.
- A group of companies recently gaining clearance to begin operation in Lodz SEZ are planning to invest approximately EUR 110 mln and create 800 jobs. The largest investment will be made by an IKEA supplier, Correct, with its investment of close to EUR 50 mln and 100 new jobs.
- Special economic zones in Poland are hoping to attract over 200 new companies, 16,000 new jobs and investments worth more than EUR 3 bn in 2008.
- NTT, Poland’s largest computer manufacturer launches new production lines later this year. Expansion of production is LTT’s response to increased demand for notebooks, and the company plans to produce 500,000 new computers this year that will be sold both at home and abroad.

![Manufacturing output, y-o-y change](chart)

Source: Central Statistical Office, National Bank of Poland, Eurostat, author’s calculations
St. Petersburg

Stable growth of GRP

The year 2007 was a period of fast and well-balanced growth for the St. Petersburg economy: all sectors in the regional economy experienced a substantial increase during 2007 and thus contributed to a 7.9% rise of the city's gross regional product. Industrial production grew by 10.0% y-o-y in 2007, bringing up the annual trend broken by a sudden -7.0% fall of industry in 2006. Construction, transport and communication sectors increased their real output even faster: by 21.6%, 20.6%, and 20.4% y-o-y respectively. Retail trade had a bit less impressive growth of 15.1% y-o-y in 2007. The absolute value of St. Petersburg GRP reached EUR 30.7 bln in 2007.

Certain changes took place inside the branch structure of St. Petersburg's industries: the production of plastic and metallic components used for construction had the best performance in 2007 (a growth of 42.9% and 30.6% y-o-y respectively), compared to other branches, e.g. the food industry with its relatively modest 4.8% rise. The quickly growing regional construction sector created a huge demand for goods and services. On the other hand, big changes are quite possible for more knowledge-intensive industrial branches in the nearest future. For instance, transport machine-building, an outsider of the year 2007 among industrial branches with a 17.3% y-o-y decline, might experience significant growth after the launching of the Toyota and Nissan automobile plants in 2008-2009. Regional industry and economy, in general, have huge potential for future growth, taking into account a record 27.8% y-o-y increase of total investment in 2007. Moreover, the region was ranked number one among 87 Russian regions by investment attractiveness in 2007 according to the nationwide Expert Rating Agency.

Construction follows the demand

The construction sector became the engine for regional economic growth in 2007. Its output increased both in monetary and physical volumes. Regardless of rising costs of building services and construction materials, both the number of finalised apartments and residential space grew in 2007.

<table>
<thead>
<tr>
<th>St. Petersburg construction sector development, main annual indicators, 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Volume</td>
</tr>
<tr>
<td>-------------------------------------------------</td>
</tr>
<tr>
<td>Total volume of construction completed, EUR million</td>
</tr>
<tr>
<td>Total residential space finalised, thousand of square metres</td>
</tr>
<tr>
<td>Total number of residential apartments completed</td>
</tr>
<tr>
<td>Residential space finalised, square metre per resident</td>
</tr>
</tbody>
</table>

Source: Petrostat, 2008

The reason for this boom was the constant increase of solvent demand. Real estate prices continued to grow in 2007, from EUR 2000 per square metre of residential space in January 2007 up to EUR 2326 in January 2008. This process contrasted with stagnation by real estate markets in Moscow and other Russian regions. The conditions of mortgage financing became more favourable during 2007 despite the US mortgage crisis. In addition to that, the real incomes of St. Petersburg residents increased in 2007 by 10.1% y-o-y and real wages by 14.6% y-o-y.

Inflation overrunning the national average

In 2007, inflation in St. Petersburg accelerated substantially, especially at the end of the year. Regional prices grew by 13.2% in December 2007 compared to December 2006, whereas the average increase was 11.9% in the rest of Russia. This phenomenon could be partly explained by reasons common to St. Petersburg and Russia as a whole: rising communal tariffs in the beginning of the year and growing prices of imported food in September-December 2007. Other reasons refer more to the region itself: the increasing incomes of the residents; huge investment projects raising salaries and employment; relatively poor infrastructure which requires significant investment to be modernised or expanded. By December 2007, food prices demonstrated an impressive 18.1% growth from December 2006 level, whilst industrial goods and services experienced more moderate price rise of 7.9% and 13.1% respectively.

Some business highlights

- St. Petersburg government adopted a Programme for retail market development. The Programme is aimed at increasing an amount of “close-to-door” shops and creating an interregional fish market in the city. Annual volume of St. Petersburg retail trade is expected to grow to 50% and to exceed EUR 25 bln by 2011.
- A Hungarian developer TriGranit signed an investment agreement with the St. Petersburg government. TriGranit invests nearly EUR 1 bln in the construction of a large movie factory with hotel and parking facilities on Basil Island, and creating a multifunctional commercial complex in the Moskovsky district.
- A tender for a complete reconstruction of Apraksin Yard, the largest marketplace in the city centre, was won by a large Russian developer Glavstroy-Spb. The winner is a part of a nation-scale Bazel holding, owned by aluminium magnate Oleg Deripaska. Glavstroy-Spb intends to invest EUR 700 mln in this project.
- Russian bank VTB announced its plans to become a key investor in regional construction projects. The first step would be a so-called Nevskaya Ratnusha project: a new administrative complex for regional government would be created near Smolny; planned investment accounts for EUR 550 mln.
- A new Innovation Support Programme was launched by the St. Petersburg government in January 2008. The aim of the Programme is to increase the share of innovative production from today's 5% to 10% of regional output. The regional budget allocates EUR 270 mln within 2008-2011 for this purpose.
- Flextronics, a Singapore producer of electronics and IT-equipment, decided to create its plant in St. Petersburg. The plant would produce monitors, TV-sets, PCs and laptops. Annual turnover of the subsidiary is expected to be initially EUR 70 mln, and after planned extension might reach EUR 350 mln.
- Zvezda, a regional machine builder, finally rejected the proposal of Russia’s lead-ing automobile company Avtovaz to produce engines for the company’s new car VAZ-2116. Instead of allocating new production facilities, Zvezda decided to use a half of its territory for building a logistic terminal on it; planned investment accounts for EUR 70 mln.
- The dockers of Fourth Stevedore Company of St. Petersburg Sea Port ended a large walkout. The employers agreed to raise wages substantially, thus creating a precedent. The wage increases vary from 10% up to 51% depending on workers' speciality.
Leningrad region

Economic growth decelerates

Economic deceleration has been forecasted for the Leningrad region, even though the GRP for the year 2007 has not been estimated yet. Industry, the region’s main engine, reported a sharp decline of 18.6% in December 2007. As a result, in 2007 industrial output grew 2.6% y-o-y, only, showing the worst result within the last eight years. Among the top-5 of the region’s main industrial branches, only two, namely automobile production and industry of construction materials experienced certain increases in output: 10.7% and 9.0% y-o-y respectively. Meanwhile, the remaining three most important industrial branches, namely food and tobacco production (a leading branch with its 29.1% of total output), the petroleum refining industry and pulp and paper production reduced their annual output in 2007 by 10.5%, 4.1%, and 1.5% y-o-y correspondingly. This deceleration was linked with decreasing investment activity in the region: in 2007 total investment fell by 15.6% y-o-y. Nevertheless, this fall might be a temporary phenomenon, explained by a cyclical character of regional development based on large-scale investment projects. An economic boom in neighbouring St. Petersburg attracted many potential investors, choosing between the city and the region. But rising costs and higher inflation in St. Petersburg might soon become an obstacle for investors. Despite the increase of CPI for Leningrad region in December 2007, inflation in the province is more moderate than in St. Petersburg.

Construction and transport

In January-December of 2007 the construction sector of Leningrad region experienced an 8.9% decrease of output. One of the reasons was the relative saturation of the regional real estate market: the amount of residential space finalised in 2007 grew by 25.7% compared to 2006. This surplus exceeds the corresponding figure for St. Petersburg more than twice. Construction of commercial and industrial facilities in 2007 was linked with the activities of large foreign investors. Philip Morris and Henkel expanded the production facilities of their enterprises, and IKEA’s supplier, Swedwood, created its new timber-processing factory in Tikhvin, Leningrad region. Huge construction projects were launched and continued in the transport sector of the region. Further development of Ust-Luga seaport’s infrastructure and enlargement of the regional road network were among the most important ones in 2007. The transport sector of Leningrad region continued to grow in 2007, with an annual result of 10.6% y-o-y.

Growth of agriculture

The year 2007 showed the first signs of improvement by the regional agricultural sector which grew by 4.2% y-o-y. This was the first positive result after several years of decline and stagnation: the annual output of regional agriculture accounted for EUR 1.1 bn. Rising prices on the world market of agricultural goods led to more expensive food imports, and this trend was followed by the local producers. By December 2007, the price index of Leningrad region’s producers of agricultural goods rose 35.3% compared to December 2006. However, not every branch of agriculture had a positive performance in 2007: the rapid increase of grain and potato production by 19.0% and 15.0% y-o-y respectively has been balanced by a more modest 1.7% growth of cattle breeding.

Employment and wages set a record

In 2007 unemployment decreased to 3.3%, setting a historical record for a region with some rural areas. Excessive labour moved to St. Petersburg with even higher employment and bigger salaries. Real wages and incomes continued to rise in 2007, but slower than at the end of 2006. By the end of 2007 the average wage in Leningrad region exceeded EUR 400.

A general increase of personal incomes is attended by a growth of social inequality. During 2007 the Gini coefficient for Leningrad region rose from 0.38 to 0.40 y-o-y. The Gini index is still lower in the province than in St. Petersburg, where it reached 0.47 by the end of 2007.

Some business highlights

- The Russian Ministry of Transport revised the planned capacity of the Ust-Luga seaport, raising it from 36.0 to 120.6 mln tonnes of cargo by 2015. While state and private operators of Ust-Luga enlarge their investment plans, a forecasted shortage of labour might quite soon become the main limitation for this mega-project.
- Russian higher technical and environmental authorities approved the project of building a second nuclear power plant (LAES-2) in Sosnovy Bor, Leningrad region. The new plant would supplement the existing LAES-1, as energy consumption in the region grows 15% annually.
- A group of 11 South Korean producers of automobile parts plan to create a techno park close to the constructed Hyundai car plant. The companies intend to invest nearly EUR 150 mln, but are still choosing between Leningrad region and St. Petersburg and looking for a convenient location.
- Finnish company, Fazer Group, announced its plans to invest EUR 70 mln in the creation of a new bakery in Leningrad region. Fazer has already invested EUR 130 mln in its Russian assets, and is about to raise this figure to EUR 200 mln in the near future.
- The first Russian plant producing ATM’s would appear in Leningrad region; before that all the ATMs used in Russia were imported. The co-investors of the project are the Russian company Krizo and Chinese Beijing C&J Technology; building this plant would cost EUR 35 mln.
- Danish company H+H International started to build a plant producing aero concrete. The plant would be launched in 2008 already, and in 2009 its capacity might reach 400 thousand cubic metres. Initial investment was EUR 30 mln.

<table>
<thead>
<tr>
<th>Leningrad region - main economic indicators</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>as of</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regional GDP (y-o-y %growth, constant prices)</td>
<td>12.8</td>
<td>8.5</td>
<td>16.3</td>
<td>14.6</td>
<td>8.8</td>
<td>8.3</td>
<td>8.1</td>
<td>n/a</td>
<td>1-12/2007</td>
</tr>
<tr>
<td>Industrial production (y-o-y %growth)</td>
<td>26.8</td>
<td>10.7</td>
<td>35.6</td>
<td>20.9</td>
<td>10.3</td>
<td>5.9</td>
<td>26.9</td>
<td>2.6</td>
<td>1-12/2007</td>
</tr>
<tr>
<td>Regional inflation (CPI, y-o-y %change)</td>
<td>23.5</td>
<td>19.6</td>
<td>14.8</td>
<td>13.0</td>
<td>14.9</td>
<td>12.0</td>
<td>9.9</td>
<td>9.3</td>
<td>1-12/2007</td>
</tr>
<tr>
<td>Gross average wage (monthly, EUR)</td>
<td>106</td>
<td>141</td>
<td>152</td>
<td>173</td>
<td>190</td>
<td>259</td>
<td>324</td>
<td>403</td>
<td>11/2007</td>
</tr>
<tr>
<td>Unemployment (% average annual)</td>
<td>12.7</td>
<td>10.8</td>
<td>9.6</td>
<td>9.2</td>
<td>7.5</td>
<td>7.8</td>
<td>6.2</td>
<td>3.3</td>
<td>1-12/2007</td>
</tr>
<tr>
<td>Exports (EUR million, current prices)</td>
<td>1786</td>
<td>2350</td>
<td>2301</td>
<td>2580</td>
<td>3886</td>
<td>4862</td>
<td>5443</td>
<td>4385</td>
<td>1-9/2007</td>
</tr>
<tr>
<td>Imports (EUR million, current prices)</td>
<td>328</td>
<td>810</td>
<td>939</td>
<td>1061</td>
<td>1372</td>
<td>2562</td>
<td>2858</td>
<td>3313</td>
<td>1-9/2007</td>
</tr>
<tr>
<td>FDI inflow (EUR million, current prices)</td>
<td>222.5</td>
<td>266.0</td>
<td>121.9</td>
<td>104.5</td>
<td>106.6</td>
<td>259</td>
<td>324</td>
<td>403</td>
<td>1-9/2007</td>
</tr>
</tbody>
</table>

Sources: Petrostat, Rosstat, Central Bank of Russia, European Central Bank, author’s calculations

Baltic Rim Economies, 29.2.2008

Bimonthly Review 1•2008
Kaliningrad region

Robust growth on the demand side of the economy
Consumer spending and fixed investment were the main drivers of economic growth in Kaliningrad. Retail turnover increased by 17.9% in 2007 and its growth rate accelerated in Q4 to 22.8% y-o-y. Retail companies were also the most optimistic regarding the outlook for the Q1 of 2008 in business confidence surveys.

Growth in retail sales was fueled by rising household incomes. Real wages grew by 16% in January-November. The increase in wages was especially strong in some manufacturing sectors, driven by a lack of qualified personnel, in social services due to strong state funding and in retail and wholesale trade. Real growth in disposable income was slightly lower than wage growth – 12.9%.

Fixed investment increased by 27.5% in January-September y-o-y with companies in oil, food manufacturing, transport and telecommunications being the most active investors – they together accounted for 60% of all fixed investment.

Growth in car production propels industrial output
Industrial output grew by 40.3% in 2007 compared to 2006 driven by a rapid growth in manufacturing production. While production in the extractive industries and utilities remained stagnant in 2007 - it grew by 1% and by 0.3% correspondingly, growth in manufacturing was very strong but uneven. Car production increased by 2.6 times over 2006 but situation in many other manufacturing sectors was not so bright. The situation surrounding Kaliningrad car producer Avtotor remains uncertain and the federal government is considering introducing quotas on duty-free imports of car assembly kits to the region.

Monthly manufacturing production (December 2005=100%)

<table>
<thead>
<tr>
<th>Month</th>
<th>Jan-06</th>
<th>Feb-06</th>
<th>Mar-06</th>
<th>Apr-06</th>
<th>May-06</th>
<th>Jun-06</th>
<th>Jul-06</th>
<th>Aug-06</th>
<th>Sep-06</th>
<th>Oct-06</th>
<th>Nov-06</th>
<th>Dec-06</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth rates</td>
<td>9.9</td>
<td>19.8</td>
<td>25.6</td>
<td>26.3</td>
<td>26.9</td>
<td>25.6</td>
<td>23.8</td>
<td>22.8</td>
<td>17.5</td>
<td>15.4</td>
<td>14.4</td>
<td>10.5</td>
</tr>
</tbody>
</table>

Source: Kaliningradstat

Construction jumps in December
A spurt in construction activity in December facilitated by warm weather helped to increase residential construction by 49.8% in 2007 y-o-y. A total of 752 thousand sq. metres of new residential properties was completed in 2007. After rapid growth in 2006 and in Q1 of 2007 residential property prices have slowed significantly and grew only by 7.6% from April to December. Slower demand for new housing due to higher prices and tighter conditions for new mortgage loans might put the brakes on the further rapid expansion of residential construction. The construction of non-residential properties increased by 35.1%.

Consumer inflation accelerates at the end of 2007
Consumer prices rose strongly in November and December (by 0.9% and 1.4% correspondingly) pushing up the annual inflation rate to 11.2%. Food prices increased by 15.2% in 2007 and were the main driving force for consumer inflation. The rapid growth in food prices in the election season (with elections to the Duma in December of 2007 and presidential elections in March of 2008) became a big headache for federal and regional authorities. It was worsened by the fact that inflation for their low income population was significantly higher than these figures might suggest. For example, the price of a subsistence food basket increased by 19.6% in 2007. Authorities tried to curb inflation by administrative methods such as 'voluntary agreements' with retail companies on price freezes but they did not help much and food prices increased strongly in November and December – by 1.3% and 2.2%. Agricultural producer prices increased even more strongly – by 3.9% in December and by 24.5% for the whole of 2007 – this does not bode well for consumer inflation in the near future.

Some business highlights
- RAO UES and the Kaliningrad governor G. Boos signed an agreement on reforming the Kaliningrad electricity sector, which is isolated from the Russian grid. Regional electricity monopoly Yantarenergo will be split into three companies: a generating company, a retail company and a system operator. Kaliningrad government will get a 25%+1 share in the system operator. The reform plan also includes roughly RUR 30 bln (EUR 840 mln) of investment in upgrading and expanding generation and distribution assets.
- In a separate agreement RAO UES and Gazprom agreed to set up a joint venture where Gazprom will get 51% of equity to finish construction of the second block of the Kaliningrad co-generation power plant CPP-2. As a part of the agreement Gazprom will conclude a long-term gas supply contract with the powerplant.
- Prime Minister V. Zubkov signed a government decree establishing an exact site of the gaming zone in Kaliningrad in January. The total area of the zone will be approximately 4.8 sq. km. It will be located on the Baltic Sea coast, 60km from city of Kaliningrad.
- International Personal Finance Ltd bought 52% of the Kaliningrad Maritime Commercial Bank. The British company wants to use this bank as a platform to develop its consumer credit business in Russia.
- St. Persburg’s company VAD won a tender for the construction of highway from city of Kaliningrad to Zelenogradsk (a tourist town on the coast) and airport Khrabrovo.
- Construction should start in 2008. Its total cost is RUR 6.6 bln (EUR 185 mln).
- Russian rating agency Expert RA, in its annual investment rating of Russian regions, assigned the Kaliningrad region a rating A (minimal risk).
Estonia’s development perspectives

By Andrus Ansip

Estonia’s development has been much quicker than most of us dared to hope 16 years ago. Within the last 12 years (1995–2006), the Estonian economy has grown 2.3 times. According to the estimates of Eurostat our GDP per capita has reached the level of 72% of the EU average (1995: 41%), outperforming most other countries that joined the EU in 2004.

Accession to the European Union and NATO in 2004 has given extra guarantees to the Estonian economy. It has significantly stimulated internal investments and increased the credibility of Estonia in the eyes of foreign investors. As of September 2007 foreign investors have invested as FDI’s 10.8 billion euro, which is about 8050 euro per capita, into the Estonian economy. This figure is in fact the second highest amongst the Central and Eastern European countries, with only Czech Republic having higher per capita investments. It is of great significance to us that most of the foreign direct investments come from the Baltic Sea Region: around 40% from Sweden, 25% Finland, 4% Denmark, 3% from Germany and 1.2% from both Latvia and Lithuania.

Foreign direct investments have definitely been one of the key factors, which has contributed to the economic growth of Estonia. Over 8 quarters (from the second quarter in 2005 to the first quarter in 2007) our growth figures has exceeded 10 percent. However, from the spring of 2007 we have seen a small slowdown in growth figures: in the second and third quarter our figures were 7.6 and 6.4 percent respectively. The strong competitive status of our economy can be described by rising productive investments and the increase of employment and decreases in unemployment. In the third quarter of 2007 the number of people employed rose to 662100, which is the highest figure over the last ten year period. Unemployment levels have declined to 4.2 percent, which is also the lowest figure since the starting of market reforms in Estonia.

Estonia is systematic and continuous in its choices and decisions

Since the beginning of 1990s Estonia has invested significantly into the development of an attractive business environment (e.g. monetary system based on currency board arrangement, trade liberalization, non-taxation of reinvested earnings, flat-tax system, avoidance of tax exemptions etc.) and complemented this with an active privatization process. We have and will base our policies on a principle that the government shouldn’t act as an entrepreneur, but should create its businesses a fair and competitive environment to act in.

The government will complement these developments with a sound and conservative budgetary policy. I’m very proud to state that from 2001 onwards government net incomes have always exceeded its spending. General government budget surplus in 2006 amounted to 3.6% of GDP and in 2007 it is estimated to be around 3%. Government debt on the other hand reached 4.0% of GDP at the end of 2006, the lowest figure in Europe.

High international rankings

Our right decisions and high potential is reflected also in various studies and indexes developed by internationally acknowledged international bodies. According to the last Heritage Foundation’s Index of Economic Freedom Estonia ranks 12th, similar index developed by the Fraser Institute places Estonia 14th in the world. On a global scale both the International Institute for Management Development and World Economic Forum describe Estonia’s competitiveness highly: in these rankings we position 22 and 27th respectively. I find it a remarkable achievement for a country who was less than 20 years ago a state-planned economy.

All this lets us assume that our economic growth will be around 5 to 7 percent in the medium term future. We also acknowledge that one crucial precondition to our growth are structural reforms and the ability together with the willingness of people to go ahead with it. Our keywords have to be globalization, flexibility and shift towards knowledge-based production.

Openness – yes! Protectionism – no!

We welcome outside trade and competition. Rather than trying to fight globalization, we opened up our markets to foreign companies since the beginning. Estonia chose not to build up the so called “import subsidizing industries”. We believe that direct comparison with the best will be one of the preconditions to a strong industrial sector.

I believe that this paradigm has succeeded to a full extent. Today we can see that it didn’t create the so called “competitiveness adjustment”: a state where companies would have had to adjust their behavior due to the step by step liberalization of our trade policies and the opening up of a common market with the European Union. In other words, we didn’t build obstacles that would have had to be torn down in a short while anyway.

In 2006 the exports of goods and services accounted about 79% of the Estonian GDP.

Structural challenges and R&D

In the period from the 1 of July 2006 to June the 30th 2007 188 000 people found new jobs in Estonia, which is about 30% of the total workforce in Estonia. A person’s readiness to accept a new job, is the key factor that describes the flexibility of an economy. Saving the jobs of yesterday, doesn’t contribute into the competitiveness of our economy nor solve any social problem in the long run.

We see one of the key factors contributing to our growth openness to new technologies, especially IT solutions. In the period of 2001 to 2006 the absolute growth rate of R&D expenditure in Estonia was the highest compared to other European Union Member countries. In 2006 alone our R&D investments increased 45%. However, we must still take into consideration that in real terms the values are still very low and need to be increased significantly. The government takes R&D as one of its top priorities: we have stated in our work program that Estonia should reach its goal of 3% of R&D investments by the year 2015.

The only way that we can be winners in the globalisation process is by being even more open, investing into new technologies and stimulating new reforms and flexible adjustment. We should not cheat ourselves by believing that in the long run it is possible to compete in low-skilled sectors on the world market. We should not fear structural changes in the economy. Some adjustments and more flexibility in the labour market are inevitable, if we want to be competitive in
the future. Our future success - as well as the success of other Nordic countries - lies in knowledge-intensive products and services where most of the value is created in today’s global production networks.

To support these changes, two additional development triggers have a critical role to play. Firstly - high quality education and skills development. And secondly - enhanced regional economic, political and cultural cooperation, especially in Nordic region.

Andrus Ansip  
Prime Minister, Estonia
A new European Policy: the Integrated Maritime Policy, an ocean of opportunity for Europe

By Joe Borg

Europe has a longstanding and rich relationship with the seas and oceans that surround it. Its citizens have traversed vast ocean spaces in search of new opportunities, profiting from fair winds to ply their trade, and, when the going was a little rougher, pitting all their ingenuity and resourcefulness against the elements to save their lives and make their fortunes. In the process they have contributed to Europe's heritage a strong and vibrant maritime dimension. Thus, Europeans have been pioneers in the use of the potential of the sea, and sadly also in the unsustainable overexploitation of some of its resources.

Today, there is hardly a European citizen who does not, in some way or another, have a stake in our oceans and seas.

Almost 90% of the EU's external trade and over 40% of its internal trade is carried by sea, 90% of Europe's oil imports arrive by sea, and the maritime sector alone employs some 5 million people. Nor is this activity limited to Europe's coasts; the marine equipment industry in Austria, for example, employs 7000 people. We not only derive many of our jobs and our prosperity from the myriad maritime activities that exist, but most Europeans depend on these activities literally for the food on their table.

Yet our maritime environment is not solely the concern of sailors, fishermen, shipbuilders or seaside hotel-owners. It also plays a vital role in regulating our climate and in mitigating many of the mounting risks from global warming. We know that it can also hold the solution to many of our environment a strong and vibrant maritime dimension. Thus, it is not developed before in Europe a comprehensive strategy for the seas and oceans. Even more important, with this initiative we have looked at our oceans and seas for the first time as a subject of our policy-making. This unprecedented initiative we have taken as result of the compelling argument that there is a maritime dimension to virtually every major course of action has its origins in the Lisbon Strategy, no climate change and energy policy, nor even the creation of a true barrier-free European Maritime Transport Space in the internal market and to support Europe's external trade in this era of globalisation.

In more concrete terms what we have in mind for the coming years is to take action on the following critical issues:

- Develop a European Strategy for Marine Research and a commitment to excellence in research, technology and innovation, to help meet the Lisbon goals for growth and jobs and to fully exploit the opportunities that lie in new technologies.
- Better regulate maritime transport, helping the creation of a true barrier-free European Maritime Transport Space in the internal market and to support Europe's external trade in this era of globalisation.
- Recognise the crucial role of seaports in driving economic growth for their hinterlands.
- Examine how EU funding can best reinforce sustainable growth and boost prosperity in remote and disadvantaged coastal regions and islands.
- Ensure that all forms of economic development take account of their environmental impact, by fostering the construction of environmentally friendly shipping, reducing pollution risks and promoting ecosystem-based fisheries.
- Better use planning tools, data networks and horizontal coordination to support decision-making for marine spaces and coastal areas and to ensure international compliance with rules.

From this list it is possible to see that a careful balance between growth and environmental considerations is always at the heart of our concerns. In fact, despite the tensions between economy and ecology, I believe prosperity and jobs can go hand in hand with preserving the marine environment. To achieve this, it is often technology and innovation that hold the key. Hence, we are witnessing an increasing number of operators taking responsibility for the future of the oceans and seas by applying innovative technology on board their ships.

It is that combination of being willing and able to innovate that can render the economy and ecology mutually reinforcing: cleaner and less fuel consuming engines, recycling of ballast water and biodegradable material are increasingly being employed on board ships and off-shore platforms. Taking this one step further through eco-innovation, we find that businesses can also actually reap benefits, through new market development or reduced costs, from protecting the environment.

Our Integrated Maritime Policy needs therefore to be

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underpinned by the so-called eco-system approach. Impacts on our environment from increasing activities can and should not be pinned down to individual causes and effects. Instead, it is both the eco-system as a whole and our interaction with it which need to be the basis for the environmental and sustainability aspects of our new policy.

At the same time, there is a political imperative for us to grow, to provide jobs and wellbeing for our citizens. The integrated maritime policy is therefore not a strategy for economic growth only, or a strategy for the protection of the marine environment, but it is very much a strategy for both of them.

This is the only way we can change our current policies and move in the Twenty First Century into truly sustainable use of our oceans and seas.

Joe Borg

European commissioner for Fisheries and Maritime Affairs
Europe and Russia, new relations

By Yegor Gaidar

“God forbid us to live in time of change” – this is ancient Chinese wisdom. In 1985 the Soviet Union was a global superpower. In 1991 it was a bankrupt state begging for humanitarian aid from Europe. Today Russia is a dynamically developing country whose rate of economic growth in the past 9 years was at the level of 7% of GDP, whose budget surplus amounts to more than 7% of GDP, and which is on the third place in the world by the rate of growth of its gold and foreign currency reserves. It is not easy to get adjusted to such rapid changes – both for the Russian and for the European sides. In a situation of such radical changes, it is rather easy to make mistakes entailing very high costs.

These are the mistakes the Russian authorities may be prone to: to accept as reality the illusory belief that, because of Europe’s dependence on Russia’s energy carriers, the latter may have an upper hand and do anything it may fancy. This can indeed be true in the short term. But only in the short term. As shown by the experience of the late 1970s – early 1980s, energy-based blackmail in not an efficient weapon in the long run. I wish the key decision-makers in my country would understand this very clearly.

I should like to say a few words about the European standpoint in relations with Russia. The European Union’s policies in the East during the last 15 years have been focused on its eastward expansion. When and if one discusses issues relating to somebody’s membership in a club, is does not mean negotiating – one simply explains to the candidate the rules of game and the requirements to comply with in order to be accepted. One may, when he is ready to accept the rules, discuss the issue of possible slight exceptions from the rules which the new member might be ready to tolerate. But essentially this is not negotiations – this is explaining the behavior rules to an applicant for the club’s membership. As the minister of foreign affairs of one big East European state once told me: to be in the European Union is paradise, but to negotiate the entry into the European Union is hell.

The problem of European policy towards Russia, in my opinion, is in its habitual inertia, in that it does not take into consideration the realities of the changing world, and largely builds upon the standards applied in the negotiations with the countries – candidates to the membership in the European Union. No one has ever suggested that Russia join the European Union, this is an issue beyond the sphere of political discussions. We are the European Union’s neighbors, the European Union is Russia’s most important partner in trade, and we are an important partner for the European Union, primarily in terms of supplies of energy carriers. Negotiating with neighbors is not the same thing as negotiating with one’s family – no terms of comfortable coexistence can be dictated to one’s neighbors unilaterally. One has to negotiate. The decisions made unilaterally, when they involve the interests of many parties, give rise to problems that have to be understood. One specific example of such problems is the forthcoming decision of the 27 members of the European Union concerning the recognition of Kosovo’s independence in late January – early February, 2008*. Of course, this is a sovereign right of European states; but, when making such a decision, one should not think that it would be possible to convince anybody in the world that this case is unique, that it is not going to establish precedents, that it has nothing to do with the development of other regions in the Balkans or Transcaucasia.

I, for my part, would be very glad if no such problems develop, but I am afraid that this is beyond my power.

Yegor Gaidar

Director of the Institute for the Economy in Transition

Former Prime Minister of Russia

* The article has been submitted in December 2007.
Affluent Baltic region must increase its assistance

By Jan Egeland

During my years in Secretary General Kofi Annan’s senior management team I saw, first hand, how effective multilateral action with heroic local and regional efforts, helped build progress and peace in such hopelessly war torn societies as Liberia and Sierra Leone, Eastern Congo and Burundi, Angola and South Sudan, Northern Uganda, Kosovo and Nepal. We also coordinated through the United Nations massive, life saving international relief in the Indian Ocean tsunami, the South Asian earthquake, the Horn of Africa, Southern Africa, the Lebanon war and the Darfur crisis. In several of these overwhelming emergencies hundreds of thousands of lives were predicted to perish. In all of these wars and disasters these sombre predictions were averted because multilateral action, building on local capacities, is today infinitely more effective than what is recognized in much of world media and national parliaments.

We fail as a collective humanity when multilateral action lacks the unity of purpose among UN member states. We fail, tragically and repeatedly, when the United Nations and regional organisations are not provided with the political will and the minimum of economic and security resources needed from their member states. The endless ongoing suffering in Darfur, in Iraq, among Palestinians and among the growing numbers of climate change victims in southern nations is a product of lack of action by all those that could have unlocked the situation.

The political leaderships in the increasingly affluent Baltic nations will have to follow the regional lead of Sweden, Norway and Denmark and invest more to fulfill the United Nations agreed goal that at least 0.7 % of Gross National Income (GNI) should go to foreign assistance. It is now a measly 0.25 % among the 22 major donors organized in the OECD. The goal of providing 0.7 % to combat poverty, disease and hunger has been reaffirmed several times by world leaders in New York, in Monterrey in Mexico and, importantly, as a legal commitment by the European Union member states. It is not an overambitious goal. When economies on all continents see exploding consumption of luxury goods, it is simply pretty stingy that most of these economies have endorsed no realistic domestic plans to achieve the 0.7 % goal. The Scandinavians and the Netherlands have, in spite of unmet domestic needs, for decades over fulfilled this goal and see public support for giving one percent or more to the poorest and the neediest.

The G-8 nations, the self-proclaimed group of the worlds leading economies, agreed in 2005 upon the good initiative of the British hosts to pledge an additional USD 50 billion in foreign assistance by 2010 of which half would go to Africa. In 2006 these same leaders and countries gave less, not more, to the two billions living on less than two dollars a day. Except for the UK hosts, all the others failed to honour their commitments. The OECD could report a decrease of 5 % in foreign assistance overall from 2005 to 2006 and the G-8 richer nations froze their assistance. The total registered foreign assistance registered was a mere USD 104 billion and less than the annual US cost to wage war in Iraq. Many of these “world leaders” now administer pitifully small investments in combating poverty, some of them less than 0.2 % of GNI, meaning that 99.8 % is spent on other public and private purposes.

But it is not only the G-8 nations that have to be the object of aggressive advocacy campaigns. The many newly rich nations in South-East Asia, in the Gulf region and elsewhere should be held accountable for taking their part in the effort to end mass misery. Today we are still far from achieving the goal of predictable minimum levels of support. Each year from 2003 to 2006 I launched the global humanitarian appeals with Secretary General Kofi Annan for 25 to 30 million of most vulnerable war and disaster victims in the world. We did not ask for more than 3 – 4 billion dollars each of these years, the equivalent of less than two café lattes per person in the industrialised world or less than two days of global military spending. We always got less than two thirds of what we asked for, even to these appeals for life saving assistance. With the exception of the Tsunami appeal and the Lebanon war appeal no emergency appeal was fully funded. Each year many places like Somalia or the Congo, where children died in the thousands for lack of funding, did not get more than 50 or 60 % of what our field workers said they needed to save the lives at risk.

Just as Iraq is the symbol of unilateral impotence in the new millennium, the positive change that has taken place in the worst war zone of our generation, the Democratic Republic of Congo (DRC), is the symbol of multilateral potency. During six terrible years of war, from 1998 to 2004 nearly four million Congolese died from malnutrition, preventable disease and violence according to the major mortality service of the International Rescue Service with partners. That is a loss of human life a great as the population of Norway, or five Rwandan genocides, or nearly 20 times the human toll in the Bosnia wars of the 1990s. Nowhere else have so many died from war during the last generation.

When I visited the DRC in 2003, a dozen or more armies were still fighting in Eastern Congo. The armed groups and militias consisted of hundreds of thousands of ruthless, undisciplined men from neighbouring states, from the main ethnic groups and from massive organised crime fuelled by the illegal exploitation of Congo’s vast natural resources. Among them there were some 30,000 child soldiers. In the crossfire of the many parallel armed conflicts was the defenceless civilian population.

When I visited again in the autumn of 2006, massive positive change was taking place. More than two million of the 3.5 million displaced had returned home. A series of militias had been disarmed. We met in conflict prone Katanga, the Kivus and in Ituri many others who were impatiently waiting for the small sums of money and support that is given by the World Bank and the UN for the demobilisation and reintegration of the men who for more than a decade specialised on living and praying by the gun and who now told us they wanted to join in a peaceful society as working men. My humanitarian colleagues had for the first time access to nearly all major communities in the huge conflict and disaster prone country. The mortality rates that recorded more than one thousand deaths each day during 1998 – 2004 was finally coming down in 2006 and 2007. What made things turn around in the Congo? After years of indecisiveness, neglect and penny-pinching lack of investment in United Nations operations, there was by 2004, finally a concerted effort from a united Security Council to provide a more robust peace keeping force, a generous and long-term push by the European Union to fund the enormous UN lead electoral process and there was more funding for our efforts to provide coordinate relief in all parts of the country. On the front-lines of this increasingly effective operation were the good efforts of dozens of Congolese and international non-governmental organisations, all the UN humanitarian agencies and a peace keeping force which received its soldiers primarily from the Asian and African
nations that have with little publicity helped pacify and secure increasing parts of these enormous law-less territories. The world is currently seeing the biggest and best network of like-minded inter-governmental, governmental and non-governmental organisations ever as channel of future investments in peace and development. Using highly specialised experts, big volume, local networks and manpower, continuous inbuilt quality control and improved coordination mechanisms, humanitarian agencies can feed, vaccinate and provide primary school for children for a couple of dollars a day even in the remotest crisis areas. Thereby the investment is, dollar by dollar, more cost-effective than anything I know in the private and public sector in any Northern or Western society.

The challenge for the Baltic Rim countries is very clear: take as a group a leadership role in global humanitarian and development assistance.

Jan Egeland
Director of the Norwegian Institute of International Affairs
Former UN Under-Secretary General for Humanitarian Affairs
Kesko - a retail specialist

By Matti Halmesmäki

Kesko is the leading provider of trading sector services and a highly valued listed company which provides products and services valued by consumers in the Nordic and Baltic countries, Russia and Belarus in close cooperation with retailer entrepreneurs and other partners. Kesko manages retail store chains, develops store concepts and business models, data management and logistics services. Kesko’s operations include the food, building and home improvement, car, department store, home and specialty goods, agricultural and machinery trade.

The Kesko Group's net sales in January-December 2007 were €9,534 million, which is 9.0% up on the previous year. Exports and foreign operations accounted for 22.8% of net sales. At the end of 2007, the number of the Kesko Group personnel was 25,900. Of these, 14,200 worked in Finland and 11,700 in other countries.

Customer satisfaction exceeding that of competitors
Kesko's strategic growth area is sales to consumer-customers. The targets are customer satisfaction that exceeds that of competitors and sales growth. Success in the consumer-customer trade requires clear customer and brand promises and delivering these promises on every visit to the store. Customer promises are delivered with high-quality and competitively priced products, a comprehensive store network and good service.

The objective is to increase the sales of all divisions faster than the market in Finland and to increase the proportion of international business. Kesko's strategic objectives include the combination of retailer entrepreneurship and efficient chain operations. K-retailers are responsible for customer service, local selections and delivering the customer promise in their stores.

Main divisions are expanding to high-growth markets
The emphasis of Kesko’s growth is above all on the food and building and home improvement trade. Growth is achieved with considerable store site investments and business acquisitions supporting the growth strategy. Outside Finland, growth is sought particularly from the Russian and Baltic markets.

Kesko Food is Kesko's biggest business division. It's net sales were €2,537 million in 2007, but Rautakesko is Kesko's largest international business unit. The sales outside Finland are about 64% of the whole sales.

Home building and improvement markets are becoming concentrated and international retail chains are establishing stores in the largest cities. The market is growing strongly in Russia and the Baltic countries, whereas growth in the established Nordic market is more moderate. The total retail market of this sector in Rautakesko's operating area is about €16 billion.

The Russian market in particular offers significant business potential in the building and home improvement trade. In addition to St. Petersburg area and Moscow, Rautakesko's objective is to open several new stores in other large Russian cities, too. Support for Rautakesko's growth is provided by investments in the joint enterprise resource planning system, centrally directed logistics network and by leveraging economies of scale in sourcing and purchasing.

Kesko Food's objective is to enter the Russian market. Possibilities in the Baltic markets are also being investigated. Expansion to the Baltic countries in the sports trade is being studied as well. Kesko will also strengthen its position in the Baltic machinery and furniture trade.

Development of electronic commerce and services
Electronic commerce is rapidly gaining ground in consumer-customer sales. Kesko's objective is to grow business and improve customer satisfaction through e-commerce and services. Kesko holds a strong position in online business in home and specialty goods with the NetAnttila and Kodin1.com concepts. There is plenty of scope for expansion in e-commerce in other product lines, too.

Best retailing competence and responsible operating practices
Developing the competence of personnel is a key factor in the K-Group's competitiveness. Emphasis areas in HR development include competence in retailing and international trading, customer and service competence and development of management skills.

The principles of sustainable development and responsible operating practices are highlighted in Kesko. Consumer-customers require that the trading sector bear responsibility for products' safety and healthiness, and also for the environmental and social impact of business operations.

Matti Halmesmäki
Kesko
President and CEO
The 2007 State of the Region Report*

By Hans Brask

At the 2007 Baltic Development Forum Summit (BDF) in Tallinn 4-6 November last year key decision makers and experts from and beyond the Baltic Sea Region representing business, politics, academia and media met to discuss and identify strategies taking the Region forward. One of the highlights was the release of the State of the Region Report, written by Principal Associate at Harvard Business School, Christian Ketels.

The 2007 State of the Region Report gives a very good overview and analysis of the economic situation in the Baltic Sea Region in general and in its 11 countries. The report states that last year has seen exceptionally strong performance by the economies in the Baltic Sea Region, mainly due to the raise in labour productivity and mobilization. The region’s FDI attraction has also improved significantly, while exports and patenting remain stable at high levels. The main conclusions of the reports are presented below.

Motivation for Regional Cooperation

First of all the Report provides a good overview of the incentives to strengthen regional cooperation. Why does cooperation with your neighbour matter? Why are certain regions more successful economically than others? It is worthwhile to repeat the basic argument at a moment where a lot of attention has been on the challenges and opportunities related to the European and global levels. Undoubtedly, the countries in the Baltic Sea Region can build further on their ability to optimise their common competitive potential. Neighbouring countries provide natural opportunities for economic interaction, natural markets, natural investment partners and sources of skilled employees, hence significant benefits for competitiveness and economic performance. However, most neighbourhood effects do not come automatically but have to be earned. The opportunities for the neighbourhood to generate benefits are high in the Baltic Sea Region but require political will and a strategy to overcome remaining barriers. Under the condition that the barriers can be overcome, the regional dynamics can become an important complement to the EU, pursuing deeper levels of integration and creating a platform to influence policy making in Brussels. At the same time, it is very positive that the EU has decided that time has come to elaborate a strategy for the Baltic Sea Region. It will also contribute to generating neighbourhood benefits.

Macroeconomic Performance

Evidentially, regional cooperation is affected by the macroeconomic climate in which it occurs. At the global level, the environment has been very benevolent in recent years. The most likely outcome now is a slowdown of the global economy not least due to financial market problems. The economy not least due to financial market problems. The most likely outcome now is a slowdown of the global economy not least due to financial market problems. The most likely outcome now is a slowdown of the global economy not least due to financial market problems. The most likely outcome now is a slowdown of the global economy not least due to financial market problems.

Prosperity growth has accelerated and is overall on a solid path, even if the high speed of the last year will be hard to sustain. The Region continues to benefit from a solid combination of high labour mobilization and solid productivity levels. Intermediate indicators of competitiveness, often a signal for things to come, send more mixed signals but are generally also at solid levels.

At the same time the economies in the Region are entering the later stages of the current business cycle. While there is risk of overheating, the most likely outcome is for an orderly slowdown of growth rates over the coming months and years.

Competitiveness in the Baltic Sea Region

The Baltic Sea Region continues to be among the most competitive economies in the world. Where changes occurred since last year, they tended to be positive, reflecting the benign economic climate that the Region is experiencing. The Region’s strengths continue to be its sophisticated companies, its asset base, its innovative capacity, and its equal rules for all in competition. Weaknesses exist in the burden that rules and regulations impose on the vitality of competition and in some aspects of the education system. The skill base remains strong for now but there are concerns whether it will remain competitive in a changing future environment. For this reason, the need to attract, develop and retain talents was a key topic at the BDF Summit in Tallinn.

The cluster portfolio of the Region is also solid, but a Region-wide strategy to develop it is required, in the face of increasing competition among clusters within Europe and globally.

From the perspective of the European Union’s Lisbon agenda, the Baltic Sea Region remains in a leading position, a ‘beacon for the rest of Europe’ as EU Commission President Barroso commented two years ago. The countries from the Region also get generally good reviews for the direction and implementation of their National Reform Programs. Regional cooperation could, however, become a more visible part of these programs.

Attractiveness of the Baltic Sea Region as a Market for Business

The company perspective of the State of the Region Report is based partly on a set of CEO interviews conducted for this Report. As a market, the Baltic Sea Region is not perceived as integrated, largely because the differences in regulatory regimes and the legacy market structures require companies to run businesses nationally. The Region is, however, becoming increasingly important as a higher management level to increase the efficiency of business models. The lack of market integration raises cost levels for companies. Further integration will reduce these costs and can attract more foreign companies and open the door for consolidation across the Region. This process has only begun; in the past, regional integration has supported the growth of existing business models but has not led to their recalibration.

The Baltic Sea Region provides a number of qualities that make it an attractive source of competitive advantages. Its small market size, however, leads foreign companies to stay outside instead of leveraging these opportunities. Those companies that have come are able to draw especially on the skill base of the Region. Companies from the Region have seen the particular nature of local markets and business environments shape their strategies on global markets. Competing on innovation, design, and a willingness to adjust business models flexibly to the particular needs of foreign markets, companies from the Region have been successful in a significant range of businesses across the world.

* The Report that is co-financed by Nordic Investment Bank, Nordic Council of Ministers and Baltic Development Forum can be downloaded free of charge at www.bdforum.org

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market opportunities in the Baltic countries, to some degree also in Poland and NW Russia, have invigorated the Region and given companies new opportunities to develop strategic advantages.

Efforts to upgrade competitiveness in the Baltic Sea Region work generally well; better than in many other parts of the world. But the current CBSS review of public sector institutions for Baltic Sea Region cooperation needs to be ambitious in its approach to register with the business community. Company leaders themselves will need to discuss whether they should create a new Baltic Sea Region voice of businesses as a counterpart to the existing public sector structures.

Without doubt, recent years have been a good year for the economies of the Region, a trend that is likely to carry on. The challenges are further away in the future, related to the Region’s position in the world economy and its demographic profile. The most immediate step to address these challenges is the creation of an effective institutional architecture that can devise and execute an action agenda for long-term competitiveness in the Baltic Sea Region. A platform for politicians, business, entrepreneurs and the academic world to meet is necessary in order to identify problem areas and opportunities for the Region. Baltic Development Forum will endeavour to play its role in this regard.

Hans Brask
Director
Baltic Development Forum, Denmark
Market-based investment into Russian power sector

By Timo Karttinen & Pirja Heiskanen

The on-going Russian power sector reform is one of the largest industrial reforms taking currently place in the world. It was initiated in response to the increasing need for investments in added capacity. Russian electricity demand declined after the collapse of Soviet Union but started to increase again in 2000. During the most recent years it has grown alongside high oil prices and the booming Russian economy. In 2006, electricity demand increased by over 4% in Russia compared to annual growth of about 1% in the Nordic countries. On the other hand, there have been few investments into generation capacity during the last decades, and the existing capacity is rather old. The strong growth in electricity demand, together with the ageing capacity, creates a need for both new investments and energy savings. It is estimated that Russia will need an additional 180 GW or so of electricity generation capacity by 2020, i.e. almost the equivalent of its existing capacity and twice the capacity in the Nordic market. The estimated capital needed for the investments is EUR 190 billion.

The main challenge in the Russian market is to secure sufficient electricity production capacity to ensure further economic growth. The challenge is not only to attract enough capital, but also simply to carry out these huge investment projects as scheduled. And while securing the future supply of electricity, the electricity prices for end-customers should remain competitive. As there is a need for new energy investments also globally and in the markets close to Russia, global competition for power plant equipment as well as for experienced project management has intensified. In many cases today, it is in fact the availability of equipment, engineering and management resources that is slowing new investments, not the capital required.

**Many similarities to the Nordic electricity market**

The main idea of the reform is to open the power sector to competition by unbundling the vertically integrated companies owned by Russian energy giant RAO UES and by setting up a marketplace for selling and buying power. The market economy was seen as the best mechanism to attract investments into generation capacity and to keep electricity prices competitive, due to tight competition between the generators. The overall model resulting from the Russian power industry reform is very similar to the Nordic power market successfully implemented for over 10 years now: The generation and sales of electricity will be privately-owned competitive businesses, and transmission and distribution will remain regulated. However, there are some differences in the Russian electricity market design in comparison to the Nordic one. For instance, in Russia there are separate markets for electrical energy and power capacity: In the energy market electrical energy is bought and sold with price covering the marginal production costs. Through the capacity market, customers buy capacity to cover their peak demand, and producers receive payment for their fixed costs and capital charges. Due to the large transmission network in Russia, a so-called nodal pricing model is utilised in the energy market. In this model, transmission losses and limitations are accurately reflected in local power prices. Starting at the beginning of 2008, at least 15% of energy is sold with liberalised prices. The capacity market and financial derivatives market will be launched during 2008. All in all, the speed of the Russian power market reform is impressive. In early 2008, the average market price for energy has been about 23 EUR/MWh in the European and Urals part of Russia. In addition, power plants receive a separate capacity payment that varies per power plant; the size of the payment is around 10 EUR/MWh.

**Investments require reliable price formation and stable regulation**

In the liberalised power market, investments are made based on anticipated future profits. Therefore, it is extremely important to have accurate signals for investment needs. When making investment decisions in the power sector, it is crucial that one can trust that the power price is and will be formed on the basis of supply and demand, and that it won’t be distorted by any regulatory mechanisms. Market-based price formation and a view of future price development is the single most important factor influencing the investment decisions. Liquid trade with electricity forwards offers a market view of future electricity price development. It is also important that market information, such as long-term forecast for demand and generation as well as transmission capacity, are publicly available so that all market actors are able to form their own view of the future capacity need and to plan new investments accordingly. In addition to average annual price, also the price profile within the year is important in determining what type of capacity is needed in the market. For example, frequent and high price peaks would make peak load capacity investments attractive, whereas big day-night price variations would give an incentive to build capacity that has flexibility in day-night production volumes.

It’s not only a question of investing in generation capacity: Investments into transmission network are also needed to ensure competition between different geographical areas. Large areas with no remarkable transmission bottlenecks and a diversified ownership structure increase competition between generators and guarantee the lowest possible prices.

Since an investment into generation capacity is a long-term commitment, it is important for the investor that the regulatory framework remains stable. In the EU, for example, the uncertainty of the detailed structure of the EU emissions trading scheme after the Kyoto period created uncertainty among investors; what type of production form would be economically viable? Similarly, sudden changes in taxation or subsidy mechanisms increase uncertainty about the competitiveness of different production forms. Stable and predictable regulation reduces investment risks and thus increases the willingness to invest. As discussed earlier, an undistorted, transparent and free price formation is needed to properly signal investment needs. Possible market distortions due to limited competition in areas with transmission bottlenecks should be taken care of by market monitoring.

In a market economy, investments are made when they are economically justified. Therefore, possible government steering should focus only on setting the stable boundary conditions, such as taxation, (minimal) subsidies, etc. Likewise, incentives for continuous efficiency improvements are needed to guarantee competitive prices. With the current huge investment need, also accelerated licensing procedures are of utmost importance. Government steering that is too detailed and inflexible and neglectful of market signals may lead to inefficiency or even a capacity deficit.

**A huge opportunity for foreign investors**

The Russian power market reform and the need for investments offer opportunities also for foreign investors. Fortum already owns a slightly over 25% stake in the power and heat generating company TGC-1, which operates in an
area spanning from St. Petersburg and Karelia to the Kola Peninsula. The further sale of RAO UES stakes and additional share emissions will provide added opportunities for investors. The foreign investors can bring both the capital to finance the needed investments and something even more important – namely their knowledge of and experience in the efficient operation of power plants in liberalized power markets and environmentally benign technology.

Timo Karttinen
Senior Vice President, Corporate Development, Fortum Corporation

Pirja Heiskanen
Vice President Russian Generation Business, Fortum Power and Heat
Energy and Transport into the Northern Dimension?: Russian Perspectives

By Tatiana Romanova

The Northern Dimension (ND), which got its second life in 2006, is currently striving to find its place in the maze of EU-Russian relations. In particular, the idea is to develop new partnerships alongside with the two existing (on environment and public health). Two sectors were identified for these partnerships – transport and energy. What is the Russian position on developing new partnerships within the ND?

The key aspect of the ND as a whole for contemporary Russia is the interrelation between it and the overall EU-Russia dialogue. This interrelation defines the place of the ND within the EU-Russian relations and at the same time, given the fact that the ND embraces only North-Western Russia, has to be consistent with the division of competences and responsibilities within.

The Political Declaration on the ND Policy of 2006 specified that the end goal is “to make the Northern Dimension policy a regional expression of the four EU–Russia common spaces with the full participation of Iceland and Norway”. This formula relieved some of the Russian concerns but at the same time made progress of the ND dependent on the success of the overall EU-Russian relations, particularly of the Roadmap for the Common Economic Space (CES).

Numerous factors prevent the CES from being a success. I would mention only two of them. Firstly, it is not obvious what a space is (whether it is a free trade area, an internal market or something else). Hence, the long-term goal of cooperation is quite amorphous. Secondly, the parties differ in how they see regulation of their economic relations. The EU insists on Russia approximating its legislation to the acquis communautaire. (The newest form of it is the so-called reciprocity principle.) Russia insists on legal convergence, i.e. designing common legislation together, either in the context of EU-Russian relations or within international organizations where both Moscow and Brussels are equal members. The ND, being linked to the overall EU-Russian relations became dependent on these conceptual differences on the CES.

Furthermore, numerous sector dialogues were created to further EU-Russian economic relations. They deal with energy, investments, IPR, transport, state procurement, environment, macroeconomics, competition, financial policy, telecommunication and information society, industrial policy, entrepreneurial activities, agriculture, regional cooperation. The content and progress in these dialogues also have to be taken into consideration when new initiatives are developed within the ND. The Conclusions of the meeting of Senior Officials that took place on 21 November 2007 is an example of cooperation between public and private parties. The ND is the interrelation between it and the overall EU-Russian relations because of their broad, strategic nature.

However, again, I would argue that a transport partnership in the ND might have a future if it concentrates on specific projects. This would be consistent with Russia’s vision. Several ideas were voiced by Moscow in this respect: the extension of the Barents link to Russia through the White Sea, the Republic of Komi and the Urals (Belkomur); high-speed rail link between St. Petersburg and Helsinki; construction of new border-crossing points to deal with the long key at the EU-Russian border. The main reason for the ND to play a part here is that it is the region of immediate contact and intensive economic interaction. Moreover, some problems have already been solved here, which can provide an example for EU-Russian relations as a whole.

To sum up, an energy partnership in the ND can be a trial ground for the implementation of the projects that have been agreed.

Furthermore, the region can contribute to the development of the transportation projects that were agreed by Moscow and Brussels in terms of practicalities, solving problems of cross-border formalities and setting a good example of cooperation between public and private parties.

Transport dialogue is a relatively new dimension of EU-Russian relations. Its terms of reference were agreed in September 2005. They presuppose harmonization of the development of transport infrastructure, enhancement of mutual understanding of legislation, compatibility of technical regulation, and development of harmonized EU-Russian position in international fora like IMO, ICAO or ILO. These issues can only be solved at the level of EU-Russian relations because of their broad, strategic nature.

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Managing a modern business law firm through values in the Baltic States

By Aku Sorainen

Typical current organisational structures

Typically law firms in the three Baltic States have been managed in a very conservative way, which was common also in the Western Europe some 15 to 20 years ago when much of the work was still litigation driven. Partners practicing law at the same firm have often been sharing costs rather than profit. In such environment a client is “owned” by a partner rather than the firm. The firms that share their profit between the partners are often led by a strong single leader, who is almost always also the founder. Typically salaries for associates are based on a proportion of the revenue they generate. Only a few law firms have offered systematic training (at the company’s cost) or career development for their personnel. Since the Baltic economies have grown rapidly, there has been a lot of work for everyone and there has been fairly little competition, including lateral hiring, between law firms.

Strengths of the above described management systems are a few: a high level of control over the clients and a fair amount of attention paid to clients because of highly motivated partners who keep contact with them. Partners have avoided taking business risk in the form of high fixed costs due to salaries of associates being tied to performance. Individual stars among partners and associates have been highly remunerated.

Yet the weaknesses are also visible: it has been difficult to develop the firm as a whole since the “stars” have been more interested in their personal practice. Also, assignments have not always ended on the desk of the best professional to handle the specific topic. This is due to the lack of “one-firm firm” culture and a high level of competition between professionals within the firm. Furthermore, it has been noted that such management systems are characterised by a fairly high turnover of personnel.

What is demanded from law firms in the near future?

The majority of the work among largest law firms has switched from litigation to consultation and project management, and clients have realised that most well known lawyers are not masters of all fields of law. The vast amount of legislation enforced and harmonized with EU directives during the past 10 years in the Baltic States, topped with substantial amount of EU case law, has made it clear to lawyers are not masters of all fields of law. The vast amount of attention paid to clients because of highly remunerated.

Yet the weaknesses are also visible: it has been difficult to develop the firm as a whole since the “stars” have been more interested in their personal practice. Also, assignments have not always ended on the desk of the best professional to handle the specific topic. This is due to the lack of “one-firm firm” culture and a high level of competition between professionals within the firm. Furthermore, it has been noted that such management systems are characterised by a fairly high turnover of personnel.

What is demanded from law firms in the near future?

The majority of the work among largest law firms has switched from litigation to consultation and project management, and clients have realised that most well known lawyers are not masters of all fields of law. The vast amount of legislation enforced and harmonized with EU directives during the past 10 years in the Baltic States, topped with substantial amount of EU case law, has made it clear to many that lawyers must specialise more than ever before. Furthermore, clients now demand better and faster service. Both the requirements mean that partners must delegate more than they have been used to. This will mean that clients will be less owned by a partner and more by the firm, while clients shall be served by teams of specialists rather than by one lawyer only.

The role of corporate values in a modern law firm

Organisational values must be clear and understood by all. This is no different in the Baltic States. It is sometimes claimed that employees lack long term career development vision. This is understandable due to huge transformation the three countries have undergone and fast development including fast increasing salaries. It is no wonder that many employees have opted for a slightly higher salary, if the salary was the only motivator to keep them in the first firm anyhow. Therefore, sharing values is important. If employees can agree on the corporate values and thus feel that they are doing the right thing in the right place and feel that there is progress, then they are less inclined to be easy targets for other employers. The set of values described underneath are values of Sorainen and described as one possible alternative:

The first value is quality (in people, processes, and work product). The best people simply want to work with the best people. As the organisation grows, a quality management system may become needed for the purpose of securing uniform approach and efficiency of work processes.

The second value is focus on the client. It may sound as a cliché, since everyone from restaurants to ticket offices and copying firms claims they focus on great client service. But how often is it really true and implemented throughout an organisation? Law firms cannot afford to focus less on clients than anyone else. It must be in the backbone for each employee in a law firm that their main task is to provide clients with great solutions and advice.

The third value is development. Systematic training of personnel is part of it. The training must include not only legal technical skills, but also relevant business and client industry related skills as well as negotiation, communication, sales and marketing skills. This may be a huge investment by the firm and the employer wants to see the investment being profitable, i.e. personnel using the newly acquired skills for the benefit of the firm and not for the benefit of a competitor. A way to encourage and direct the development is carrying out regular development discussions not only once a year, but more often. It seems that development discussions are already becoming a part of personnel strategy in most successful companies in the Baltic States.

The fourth value is teamwork and know-how sharing. Since specialisation is inevitable and clients shall be served by different specialists rather than individual all-round partners, the specialists must be able to work in teams. Not only are they required to share information about the client and his/her matter, but also they are required to share know-how regarding best practices and thus avoid “inventing the wheel twice”. Information used to mean power in the Soviet times, now keeping information to oneself is a serious sin.

The fifth value relates to ethics and respect. Some say that the new and immature business culture in the Baltic States leaves little room for business ethics. This is wrong. Ethics has become increasingly important and while the fight against corruption becomes increasingly visible and corruption is seen as non-acceptable behaviour, people feel comfortable in an organisation they vision as ethically behaving. The same goes to respect. It is not long ago that the management culture was very masculine and one leader driven. Today’s specialist teams are more self driven and the leader is much more a facilitator, supporter and a person leading by setting an (enthusiastic) example rather than one trying to control and lead by commanding.

The last value is business-mindedness. A successful business lawyer can barely be anything else. He/she must produce (cost efficient) solutions and advice of high added value. He/she must show initiative, be innovative, diligent, and ready to take responsibility.

The last value is business-mindedness. A successful business lawyer can barely be anything else. He/she must produce (cost efficient) solutions and advice of high added value. He/she must show initiative, be innovative, diligent, and ready to take responsibility.
Actually, any activity and any attitude of personnel in a successful modern law firm should be traceable back to the firm’s corporate values. As the French writer Paul Valéry wrote long time ago: “one who wants to do great things must pay great attention to details”.

Aku Sorainen
Managing Partner at Sorainen, Finland
State corporations – state property in de facto private hands

By Iwona Wiśniewska

In 2007 the Russian economy witnessed a rise and dynamic expansion of a new economic creation – the state corporation (“goskorporatsiya”). Corporations of this kind have specific legal structure, and are exempted from direct control of the majority of state institutions. The emergence of these structures is stimulated by the forthcoming presidential elections in Russia (2 March 2008). Officials close to the Kremlin are using their political influence to strengthen their economic position by creating and controlling state corporations, among other means. The rise of these structures leads to further strengthening of the state in the corporations, among other means. The rise of these economic positions is stimulated by the forthcoming presidential elections in Russia (2 March 2008). Officials close to the Kremlin are using their political influence to strengthen their influence have been extended while the state institutions’ control over the corporation has been reduced.

General principles of the corporation performance are defined in the act on the non-commercial units adopted in 1996, while detailed regulations can be found in the acts, that are a legal basis for each individual state corporation. Officially the state corporations are presented as a remedy for the problems of the Russian economy – among other things they were supposed to boost the economy’s modernization and strengthen its innovative character. Their appearance was supposed to contribute to the development of different sectors (nanotechnology, the municipal & housing sector and other). Some corporations have concrete tasks to perform, like the organization of Winter Olympics in Russia in 2014 (Olimpstroy).

The acts enable the state corporations to take over the state property entrusted to them. The heads of the corporations, who would have full authority over the property, will be entitled to – among other actions – establish subsidiary companies, issue IPOs and make investments overseas. Requirements towards the state corporations concerning accountancy are very lenient (as compared to the joint stock companies), the state corporations also enjoy greater freedom in making financial decisions. The profits generated by the corporations will not be transferred to the state budget and will be spent on the corporations’ “statutory outgoings”.

Even though the state corporations can carry out business activity as rightful subjects of the market, most of them do not come under the control of authorizes state agencies. State corporations are directly supervised only by the president of the Russian Federation who appoints and dismisses its directors (director general administers the corporation property).

A characteristic of a state corporation is also the amount of budget means transferred for its needs. According to the projects, in the upcoming years the corporations will receive over US $ 33 billion (RUR 830 billion), of which US $ 22 billion were already transferred in 2007 (they were taken from the Stabilization Fund and from the sale of Yukos assets).

Each corporation has its own specifics, they differ as far as their rights and authority are concerned. Rosnanotekh and Olimpstroy enjoy the greatest autonomy and greatest authority. These corporations have been exempt from the act on bankruptcy and are entitled to tax benefits.

The idea of introducing state corporations to the Russian economy on a greater scale is quite new. The first unit of this kind that enjoyed such broad autonomy (the Development Bank) was introduced in May 2007. In early 2008 already 6 state corporations existed: the fund for reform of the municipal & housing sector; Rosnanotekh responsible for the development of nanotechnologies; Olimpstroy – the organizer of the Winter Olympics in 2014; Rostekhnologii – involved in the modernization of the Russian industry; and Rosatom – responsible for the development of the nuclear sector (for more see Annex).

The emergence of most of the state corporations involved powerful lobbying in the Kremlin – part of the ruling elite opposed the idea of administering of the public property in this manner (this idea was criticized by the former Prime Minister Mikhail Fradkov and former minister of economic development German Gref). The aim of the lobbyists was not just to create a corporation, but to take control over it. Among those who succeed are the main initiators of Rosnanotekh (deputy head of the Russian Academy of Science Mikhail Kovalchuk and minister of education Andrey Fursenko). Both of them are close associates of President Putin and powerful members of the “St Petersburg group”, both belong to the board of directors of Rosnanotekh now. Equally successful was Sergey Chemezov, current director general of Rostekhnologii, co-founder and former head of Rosoboronexport (the state arms trader). Chemezov was formerly a KGB officer who met Putin while he served in Dresden.

Undoubtedly, some of the corporations stand a chance of fulfilling their tasks (like Olimpstroy). However, it is not very probable that they will transform Russian economy as a whole, modernize it and seriously reduce its dependency over the oil and gas sector. In fact, most of these structures can have a detrimental effect on the economy. The centralization of the decision-making process (concerning investments etc.) may reduce their efficiency and their ability to react to the real needs of the market.

The state corporations may further contribute to the nationalization of the Russian economy and its monopolization by powerful state structures. As a result, the role of the Kremlin in the economy will be even more strengthened and the competition on the market further reduced.

The emergence of state corporations opens another stage of acquiring control over assets by the ruling elite. Corporations participate in the process of re-distributing of the huge revenues from the energy resources sales. Thus, officials and private persons tightly connected to the Kremlin are getting control over public property – and whatever they do, the only one they report to is the Russian president.
## Existing corporations in Russia

<table>
<thead>
<tr>
<th>STATE CORPORATION</th>
<th>TASKS</th>
<th>DIRECTOR GENERAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rosnanotekh (the act adopted on 19 July 2007)</td>
<td>Support for the state policy in the sphere of nanotechnologies, innovation and implementation of prospective nanotechnology projects. The corporation budget totals US $ 8 billion.</td>
<td>Leonid Melamed, former manager in the energy monopoly RAO UES. However, the key person in Rosnanotekh will be Andrey Fursenko, the head of the supervisory board.</td>
</tr>
<tr>
<td>The fund for reform of the municipal &amp; housing sector (the act adopted on 21 July 2007).</td>
<td>Modernization and development of the municipal &amp; housing sector in Russia. The corporation budget totals US $ 10 billion.</td>
<td>Konstantin Tsitsin, deputy head of Gazprombank</td>
</tr>
<tr>
<td>Olimpstroy (the act adopted on 30 September 2007).</td>
<td>The organization of the Winter Olympics in Sochi in 2014. The corporation budget totals US $ 8 billion.</td>
<td>Semyon Vaynshtok, former head of the oil transporting monopoly Transneft. However, the political supervision over the project is carried out by President Putin.</td>
</tr>
<tr>
<td>Rostekhnologii (the act adopted on 24 November 2007).</td>
<td>Development of export-oriented industry based on new technologies. No information available on the amount of the investments planned.</td>
<td>Sergey Chemezov, former head of Rosoboronexport.</td>
</tr>
<tr>
<td>Rosatom (the act adopted on 3 December 2007).</td>
<td>Comprehensive administration of Russian nuclear sector and coordination of the state policy towards this sector. No information available on the amount of the investments planned.</td>
<td>Sergey Kiriyenko, former Prime Minister of Russia</td>
</tr>
</tbody>
</table>

**Iwona Wiśniewska**  
Senior Researcher  
Center for Eastern Studies, Poland
EU and Russia as neighbours and partners – the specific role of the Baltic Sea region

By Urpo Kivikari

All of Russia’s EU neighbours are Baltic Sea states. The Baltic Sea region is made up of eight EU countries and Russia. So, developments within this region have played a crucial role in laying the functional framework for EU-Russia relations.

Whereas in the early 1990s only two of the countries on the Baltic Sea rim, reunified Germany and Denmark, were members of the European Community, now eight states out of nine are in the EU and only Russia is outside. Sweden and Finland joined the Union in 1995; Estonia, Latvia, Lithuania and Poland in 2004.

Differences between Member States need no evidence, they are so apparent. Differences can be very useful, especially in view of the opportunities for international division of labour, although in general integration produces better results in a homogeneous environment. In politics, differences between Member States are a problem for the EU, which would like to have ‘one voice’ when presenting stands on various issues.

The neighbourly terms between Finland and Russia are characterised as normal and even good. Politicians like to define them as ‘problem-free’ – but many would not go so far as to use this expression.

The relations of Estonia, Latvia and Lithuania with Russia have not yet become normal. The experiences of years next to, and as part of, the Soviet Union were heavy for these countries, and the more recent experiences of Russia have not been positive, either. Russia has not been able to conduct a truthful discussion about the history of the Baltic states during the Soviet era. The new independence of these states reduced the Eastern superpower’s extensive presence by the Baltic Sea to a passage at the bottom of the Gulf of Finland and to the Kaliningrad area isolated from the rest of Russia. It seems to be difficult for Russia to accept that both the Baltic states, which are now members of the EU and NATO, and countries that joined the CIS break away from Moscow’s influence and become established as fully independent states.

Poland’s experiences of the Soviet Union during the Second World War and in the subsequent decades were a problematic starting point for relations between Poland and Russia, marked by both old and new sore points. For instance in November 2006, Poland’s dissatisfaction with the restrictions set by Russia on Polish meat imports postponed negotiations to put a new partnership agreement between the EU and Russia.

Germany is not Russia’s neighbour, but as Russia’s biggest trade partner, Germany has wanted to push aside the shadows of history. Mutual understanding between the two biggest countries in the Baltic Sea region – illustrated, for instance, by the plan to build a gas pipe under the Baltic Sea – is not to the liking of all outsiders. The economic area of the Baltic Sea is built on both the natural prerequisites for economic cooperation and good political relations between Germany and Russia. A functional Baltic Sea region would not be possible if these conditions were not met. All countries in the region should understand this fact.

In their relations with Russia, Sweden and Denmark need not carry the same burden of recent history as the other nations around the Baltic Sea; nor is Russia as important a trade partner for them as it is for others.

It is difficult for the EU to create a common policy on Russia, because the countries around the Baltic Sea alone have such different starting points in their relations with present-day Russia. In 1999, the EU approved the idea conceived by Finland concerning a Northern Dimension that is intended to affect, in particular, the Baltic Sea region. After enlargement of the EU in 2004, this has in practice meant the EU’s neighbouring policy in relations with Russia. In its original form, the Northern Dimension did not bring the expected results on a wide front. In 2006 the Northern Dimension was revised so that it is based on equal partnership among all participants, and this may give new impetus to the programme.

The EU and Russia also need mutual partnership on the coast of another inland sea. The accession of Romania and Bulgaria to the EU at the beginning of 2007 brought the EU to the Black Sea region. In the future, the importance of this region for the Union may even increase, since among the countries in the region, not only Turkey but also at least Ukraine and Georgia have expressed the wish for rapprochement with the Union. The EU and other parties concerned will have much to do in developing this region. For developing the ‘Southeastern Dimension’ of the Black Sea, the EU might receive useful help and lessons from the Baltic Sea region, which has experience of the development of a functional area in cooperation with Russia.

The Partnership and Co-operation Agreement (PCA) in force is the most comprehensive manifestation of the EU’s policy on Russia. Replacing this agreement with ‘strategic partnership’ that would extend both longer and deeper seems to be a goal that keeps escaping into the future in the same way as Russia’s long-prepared membership of the WTO. Maybe it has been reasoned in Brussels and Moscow that by naming the cooperation in words that are larger than life, it will sooner or later be possible to make the contents grow to the dimensions described by the words.

When assessing the prerequisites that the EU and Russia have for strategic partnership, the central question is what sort of country and partner Russia is. The fundamental issue is whether the social and economic systems of the parties can be seen to be so similar that breeding them would result in strategic partnership. Do the EU and Russia consider that they represent the same values? Finland and the Soviet recognising the differences between the two countries’ systems. Seen against the circumstances at the time, this type of ‘communiqué partnership’ worked well. Similar realism might also work between the EU and Russia until circumstances would enable strategic partnership that is genuinely built on shared values.

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Transit trade trough Estonia: problems and developments

By Alari Purju

The article describes recent developments in the transit trade of Estonia, evaluates its impact on economy and looks on some future development trends.

The first issue is how to measure the transit trade. The amount of transit flows of goods, services and tourists are measurable quite easily. On the other hand, to determine the size of value added created by the transit trade is a complicated task. The role of transit trade is even harder to define if the indirect impact of those activities is considered. The transport and storage services are accompanied by different financial, security and other services. In the framework of transit cluster, the re-export should also be included. Here, only directly to the transit trade services related activities are considered.

In the national accounts of statistical system, which is used to calculate the GDP, the transit trade is covered by the economic activity of transport, storage and communication. The GDP produced in this sector in Estonia was 21.7 billion kroons in 2007 or 12.1% of the total GDP. There have been made at least two research projects, which aim was to measure the GDP created through the transit trade. The measurement exercise performed by the group of researchers from the Tallinn Technical University and Statistical Office received a figure 5.7% of the total value added for the year 2000 using the production method.

In 2005, the Bank of Estonia found that the share of transit trade on the production side was 3.5% of the total value added and the consumption of the respective sector created 4.7% of the GDP in 2003. Those figures are quite close to each other. Here should be taken into account also that on the basis of other indicators it is possible to see that the growth of the transit trade was lower than the growth of the economy in 2000s which caused relative decrease of the transit trade as a share of the GDP. The railway and marine transportation have been dependent on transit trade which created 80% of the total volume of the former and 75-80% of the total volume of the latter sector in 2000s. The transit trade of goods from Russia through Estonia to Western Europe, of which oil and oil products created a major part, has been the most important item for Estonia. It is possible to conclude on the basis of these figures that the transit trade has been and still is a quite important activity for the Estonian economy and particularly for transportation sector but it is not critical for the economy as a whole.

The transit trade has been a politically sensitive issue due to the recent tensions between Estonia and Russia and claims that Estonia’s fast economic growth is first of all due to absorption of profits from the trade with Russia’s natural resources. Estonian relations with Russia have been especially under strain since the Estonian authorities removed a Soviet war memorial from the square in the center of the capital Tallinn to the cemetery in suburb of the city in April 2007. That move sparked riots among local Russian speakers drawing also protests from Russia.

A wide set of tools were applied by the Russian side against the companies involved in the transit trade. The strong political statements were made by the Russian authorities and the surrounding of the Estonian Embassy in Moscow by Putin’s circles close Youth Movement was tolerated by the Russian authorities during several weeks. The wide scale railway repair works were started east of Narva, the Estonian city on the border with Russia. Several companies preferred to redirect their products to the Sankt Petersburg port or to the other ports in the region. Boycotts of the Estonian food products were initiated by the activists in several Russian cities. The amount of products transported by Estonian Railway decreased during the months following April 2007 in comparison with the respective months a year earlier by 40% and did not recover up to end of 2007. The same happened to shipping from Estonian ports.

What is the price of the event for the Estonian economy? Considering the earlier estimates the amount of the transit trade and the figures on the size of decline of trade flows, the probable size of the impact on the annual basis could be equal to 1.5-2% of the GDP. However, also the other circumstances should be taken into account. The widening of Russian ports in Sankt Petersburg and surrounding area started already in 1990s and was intensified in 2000s. These ports have been already taking over some trade from the Baltic ports. That development would happen during the coming years anyway, the recent political events just speeded it up. The very modest increase of the Russian oil supply, the fast growth of incomes and domestic demand for the oil products is another factor which would decrease the exports and transit trade of oil products through the Baltic ports.

Another important outcome of the recent events is related to the impact on the restructuring of transit trade activities on Estonia. The transport of oil and oil products from Russia through Estonia to Western Europe has been the most important part of the transit trade for Estonia. At the same time, fast increase of incomes and demand for imported consumer goods in Russia, Ukraine and other countries in the region, creates big transit trade flows of those products. Serving that trade could be an important source of revenues. Service of containers transportation is an interesting new challenge for the Estonian ports and railway. An important step in the field was taken in January 2008 when the Port of Tallinn and Ningbo Port of China signed a cooperation agreement. That agreement foresees transportation of containers from China to Europe by regular shipping route for the markets around the Baltic Sea, including Russia. The next step will be the development of Industrial Park in the Muuga Port Free Zone. This project assumes investment not only by the Port of Tallinn to widen capacity of the container terminal, but also into other infrastructure objects like roads, border and customs services. The use of accumulated resources from the earlier transit business, public funds and the EU resources could be a good resource base for the future developments of transit trade. The high economic risk is accompanying that business also after restructuring. This risk has been balanced quite well by the high profit margins which were during good days of business for some operators up to 70% of the value of turnover.

Alari Purju

Professor

Estonian Business School, Estonia
SGH – Warsaw School of Economics and the Baltic Region

By Tomasz Dolegowski

SGH - Warsaw School of Economics, one of the most prestigious scientific and educational institutions in the field of economics and management in Poland has celebrated one year ago 100 years anniversary of teaching and research activity. Today SGH is active in building international ties and concentrates its foreign activity also on developing relations within the Baltic Sea Region, with the universities and academic centers in the Baltic Republics and Nordic Countries. Particularly important is here our participation in CEMS (Community of European Management Schools), BSRUN (Baltic Sea Region University Network) and Erasmus exchange programmes. Very interesting from this point of view is the idea of regional networks, like BSRUN, which covers e.a. Poland, Finland, Lithuania, Latvia, Estonia as well as some Russian and Belarusian scientific institutions.

There are several serious reasons for our interest in regional cooperation. One of them is historical. Poland and Lithuania some centuries ago have created common state, Rzeczpospolita (The Commonwealth of Poland and Lithuania). In some periods of our common history even the territory of Latvia, Belarus as well as some parts of Estonia and Ukraine have belonged to this specific political unit. This Commonwealth belongs now to the past and historians present very different opinions about this period of our common history, its advantages and disadvantages. The heritage and historical memory is here however still very important. As the example: Vilnius University is the part of the Polish and Lithuanian tradition... Also my family: Poles living in Warsaw, but with Vilnius roots is open for this heritage. In XIX and XX century (time of Russian domination and the lack of our national independence) many Polish young people have studied in Vilnius, Riga or Tartu. Also in the time of independence before the second world war countries like Latvia, Estonia and even Finland belonged to strategic partners of Poland - also in the field of science.

The second world war and the post-war period of Soviet domination was from this point of view very difficult, but the end of communism has created new opportunities. Problem was, that in the new period of freedom Poland and the Baltic Republics were much more interested in cooperation with the West than within the Region. Now, particularly after joining European Union, perception of the future-cooperation seems to be in my opinion much more optimistic.

There is one more motivation for our interest in regional cooperation development. In many countries, particularly in Lithuania (but also in Latvia and Belarus), lives quite big Polish community. SGH – Warsaw School of Economics is interested in contacts with that people as well as in supporting some intellectual initiatives of the scientists of Polish origin and meeting the needs and expectations of the representatives of young generation.

A group of students of the Polish origin as well as young people of other nationalities from the East (also from the Baltic Republics) studies at our university. Some of them are exchange ERASMUS students who learn here in English for one or two semesters, other however decide to study here for whole five years in Polish language - they are interested in obtaining our masters’ diploma.

In the past there were some attempts to establish even the Polish minority academic institution in Lithuania. It was not very easy and has created some controversies, but in 2007 the University of Bialystok has established its branch in Vilnius. We do not know how successful this project will be in the future, but SGH – Warsaw School of Economics is also ready to cooperate with them in some points.

Of course we do not want to reduce our contacts only to the Polish-language people. Last years we have observed increasing interest in students’ and professors’ exchange. SGH - Warsaw School of Economics hosts also and participates in many conferences, also on regional level. Our professors and students are satisfied with good relations with Vilnius Technical University, ISM University of Management and Economics in Lithuania, Mykolas Romeris University in Vilnius, University of Latvia in Riga, Stockholm School of Economics in Riga.

Some of our professors (including me) have offered the lectures at some academic centers, particularly at International Business School at Vilnius University and Estonian Business School in Tallinn. Very important is also our partnership with the above-mentioned Stockholm School of Economics in Riga – the affiliation of the famous Swedish institution in the Baltic Republics and one of the leading educational institutions in economics and management in the Region. Our cooperation in their bachelor thesis review process seems to be very important.

There are however still some mental, psychological, political and economic barriers for development of cooperation. Some of the barriers have been caused by ignorance, some by infrastructural bottlenecks (paradoxically we must remember about relatively poor transportation between Poland and the Baltic Republics). Our participation in Bologna Process creates new opportunities, but also challenges and problems. I do hope that in the near future Polish and Baltic States universities and business schools will have to cooperate with the scientific institutions in Finland and other countries of the Baltic Rim in creation of attractive joint degree programmes, similar to CEMS common diploma.

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Coastal management and regional cooperation in saving the Baltic Sea

By Samu Numminen

Coastal zones under pressure

Europe’s coastal areas are crowded. It is estimated that about one third of the continent’s population lives within fifty kilometres from the coast. In the whole world the percentage is a lot higher. Coasts are home for a variety of human activities, which of course puts a lot of stress on their natural environment. They are hubs for traffic and trade, as well as a source for food and energy. Coasts offer places for recreation and residence, and in many places they are also biodiversity hotspots that host a great variety of plant and animal species. With urban areas covering more and more of the coastal zones, we have to be careful not to suffocate the diversity that is a precondition for our own well-being.

What about the Baltic Sea, then? It is one of Europe’s regional seas, unique in its own ways with its shallow, brackish waters and organisms that have adapted to conditions that may well be considered to be somewhat extreme. Baltic Sea coasts are also under pressure from human activities, the sea itself being burdened by nutrients causing eutrophication and massive blooms of blue-green algae. The sea is also feeding itself with nutrients that are re-released from the sediment, a phenomenon that we have only recently begun to understand more. Loss of biodiversity is also a serious risk, as well as various human-induced hazardous substances in the ecosystem. Traffic at sea is expected to increase significantly in the future, which brings along for example the increased risk of oil spills.

Thinking globally

If we wish to protect our sea, we have to look at the big picture. A holistic perspective is needed, where the interactions between human activities and natural processes are considered. This is provided by Integrated Coastal Zone Management (ICZM). It is a dynamic, continuous and iterative process designed to promote sustainable development of coastal zones. It seeks over the long-term to balance the benefits from economic development and human uses of the coastal zone, the benefits from protecting, preserving and restoring coastal zones, the benefits from minimising the loss of human life and property, and the benefits from public access to and enjoyment of the coastal zone, all within the limits set by natural dynamics and carrying capacity.

At best, integrated management of the coast will increase the viability of the coastal zone. A well-known example is the east coast of Canada, where carrying out a thorough coastal management programme led to improvements in living standards, employment and attractiveness of the region to such an extent that the direct and indirect financial returns gained exceeded the investments that were put into the planning process. By restoring and maintaining natural habitats the coasts will also be better protected for example against erosion and flooding that can otherwise lead to economical losses as well as loss of human lives.

Commitment is needed for long-term activities

If some proper planning is all that is needed, why hasn’t it been done yet? There are certain prerequisites for successful ICZM. It is a long-term activity that needs long-term financing and to back this up, long-term commitment from decision makers. Successful implementation may take up to ten or twenty years, and the ICZM cycle needs to continue also after that. One of the most important needs for ICZM is the full participation of all relevant stakeholders. Information of the coast as well as the planning itself must be widely available. We also have to be able to work together and cooperate across national borders, because saving the coasts and the sea is most of all a common effort.

The European Union has noted the need for an integrated approach, and it has recommended that all EU countries should have a coastal strategy for this purpose. Deadline for these strategies was in early 2006, and it remains to be seen how the strategies will be implemented by member states in the future. Also on the European level, EUC – The Coastal Union, an association with members in 40 countries, has promoted coastal sustainable development in various ways for nearly twenty years. In the Baltic Sea the work of HELCOM has been important, the latest product being the Baltic Sea Action Plan which aims to restore the good ecological status of the sea by 2021. This aim is also in line with the coming EU Marine Strategy Directive. The Water Framework Directive, adopted in late 2000, has its aim at a good ecological status of rivers, lakes, groundwater and coastal waters by 2015. It is good to have clear goals, but we have to remember that directives won’t take care of themselves. We will have results only if we achieve the commitment of all levels of the society.

It all starts from the regional and local level

Apart from the big picture and major actors, there is also a role for us small people in helping to heal the Baltic Sea. We may feel powerless in front of big questions like climate change, but each of us can participate in one way or another. The impact of local and regional activities is shown in the local environment first, which is a good source of motivation for the people. In the Archipelago Sea area in Southwest Finland, the Pro Saaristomeri coastal forum has taken steps to make regional co-operation and participation easier. Forum activities, especially addressing coastal issues and planning river basin management on a sub-regional scale have been successful in many ways, the new-est achievement being the founding of the Fund for the Protection of the Archipelago Sea.

It has been said that the Baltic Sea needs its own Al Gore to really make things happen. It remains to be seen who, if anyone, will claim the title. Although a strong political leader is definitely needed, in the meanwhile we can all be the Al Gores of our own lives and start changing the way we take care of our environment. Climate change, for example, will not be tackled just by each of us remembering to turn off the lights when we leave the room, but it is certainly a good start. And we do have to start somewhere if we wish to enjoy the Baltic Sea and its coasts also in the future.

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Pro Saaristomeri Coastal Forum
Can competition protection in Poland become more effective?
by Wojtek Dorabialski

Poland’s entrepreneurial spirit has sprung up at the beginning of the transition, with millions of new enterprises taking up market niches. That initial sprawl was followed by an inevitable consolidation process. The toughening of competition brought about the dangers of unfair competition practices and anticompetitive mergers. Polish legislative bodies reacted very quickly to those threats by creating the Office of Competition and Consumer Protection (OCCP) as early as in the year 1990. Since then, Polish competition protection law and practice has been steadily evolving, drawing on the EU regulations and practice.

Competition protection agencies in transition countries face additional challenges, in comparison with their counterparts in developed countries. Most Eastern European economies are characterized by high growth rates, which facilitates cartelization (horizontal agreements). Many markets are abnormally concentrated – a legacy of the former state monopolies – which facilitates abusive unilateral conduct. Placed in this difficult environment, the agencies are also relatively weak, in terms of their budgets, number of personnel and accumulated experience. What is the impact of competition policy on Poland’s economy? How effective has CCPA been in pursuing competition policy goals?

Poland’s OCCP can serve as an example of the problems and weaknesses of competition protection agencies in the region. A steady increase in the OCCP’s budget allowed for a steady increase in the agency’s employment (see Table 1). Salary levels, however, did not keep up with those in the private sector. This resulted in high personnel turnover rates for the Office, which hindered the agency’s capabilities of accumulating experience and expertise.

Table 1. OCCP’s budget and employment*

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual budget (mln PLN)</th>
<th>Employment</th>
<th>Personnel turnover rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>21.1</td>
<td>259</td>
<td>14.7%</td>
</tr>
<tr>
<td>2005</td>
<td>25.4</td>
<td>273</td>
<td>19.0%</td>
</tr>
<tr>
<td>2006</td>
<td>25.6</td>
<td>282</td>
<td>18.4%</td>
</tr>
</tbody>
</table>

In addition, the law required that OCCP formally reviews all antitrust complaints submitted by entrepreneurs. Since the participants of anti-competitive agreements were not given incentives to defect, nearly all complaints submitted to the Office regarded unilateral conduct. This resulted in OCCP being overburdened with unilateral conduct cases, as can be seen in Table 2. Many of these cases regarded such non-spectacular, but locally monopolized markets, as cemetery services or waste dumping grounds.

Table 2. OCCP’s administrative output*

<table>
<thead>
<tr>
<th>Year</th>
<th>Unilateral conduct cases reviewed</th>
<th>Agreement cases reviewed (horizontal agreements)</th>
<th>Merger cases reviewed (blocked)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>126</td>
<td>26 (16)</td>
<td>199 (2)</td>
</tr>
<tr>
<td>2005</td>
<td>117</td>
<td>27 (16)</td>
<td>302 (0)</td>
</tr>
<tr>
<td>2006</td>
<td>170</td>
<td>32 (10)</td>
<td>251 (1)</td>
</tr>
</tbody>
</table>

Perhaps the biggest problem, that the Polish competition authority is facing, is the ineffectiveness of the penal system. In accordance with the EU standards, antitrust violations can be punished with a fine, up to 10% of firm’s revenues. A fine serve a dual purpose: it should nullify any gains from the violation and prevent future violations. However, as one can see in Tables 3 and 4, these purposes have not been served properly, due to long lags between the imposition and the collection of fines.

Table 3. Total fines imposed and collected by OCCP*

<table>
<thead>
<tr>
<th>Year</th>
<th>Total fines imposed (mln PLN)</th>
<th>Total fines collected (mln PLN)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>5.1</td>
<td>1.0</td>
</tr>
<tr>
<td>2003</td>
<td>11.3</td>
<td>(data not available)</td>
</tr>
<tr>
<td>2004</td>
<td>174.2</td>
<td>2.1</td>
</tr>
<tr>
<td>2005</td>
<td>38.0</td>
<td>2.0</td>
</tr>
<tr>
<td>2006</td>
<td>339.0</td>
<td>10.2</td>
</tr>
</tbody>
</table>

Table 4. OCCP’s fine collection efficiency in 2006*

<table>
<thead>
<tr>
<th>Fines imposed (mln PLN)</th>
<th>Fines collected, total</th>
<th>No lag</th>
<th>1-year lag</th>
<th>2-year lag</th>
<th>&gt; 2-years</th>
</tr>
</thead>
<tbody>
<tr>
<td>339.0</td>
<td>10.2</td>
<td>1.7</td>
<td>4.7</td>
<td>1.2</td>
<td>2.6</td>
</tr>
</tbody>
</table>

*Source: OCCP annual reports.

We should note here, that the problem of lagged fine collection stems mostly from the inefficiency of Poland’s judicial system. The lengthy appeals process gives lawbreakers an opportunity to postpone the payments, even in cases of obvious violations. In less obvious cases, the courts often escape from judging the case on the merits, by focusing on procedural issues. The latter is understandable, since the courts are just as underfinanced and understaffed as the government sector. Somewhat paradoxically, the firms who actually pay the fines imposed by the OCCP timely, turn out to be mostly small businesses and first-time offenders, who find it too costly to appeal their case. This situation favors large companies, which face the largest fines, but can afford to enter the appeals process.

Is there a hope for a more effective competition policy in Poland? Yes. Almost a year ago the Polish competition law has been changed, and the OCCP was given full discretion on whether to review an antitrust complaint or not. In addition, the newly established leniency program, gives the participants of anti-competitive agreements some incentives to defect. This will allow the Office to refocus, and allocate more effort to multilateral violations (agreements) and only the biggest unilateral violations. Giving more focus to selected cases will result in better quality of administrative output, which should limit the possibilities of challenging the OCCP’s decisions in court on procedural grounds.

In the face of low fine collection rates, the OCCP should consider toughening its penal policy. Of course, higher fines will not speed up the collection process. They will, however, additionally hurt large offenders, through the bad publicity associated with the results of antitrust proceedings. Companies will immediately notice the negative effects of their anticompetitive practices, if not on their balance sheets, then on their public relations. By drawing the interest of the media, higher fines will also help to pursue the educational and preventive goals of competition policy.

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*Any opinions expressed in this column represent personal views of the author, and do not necessarily reflect the views of the OCCP.
Future of the EU-Russia relations

By Kari Liuhto

The European Commission suggests that the Russian investment stock in the EU amounts to some € 10 billion. Russia’s President Putin stated during the EU-Russia summit in Portugal that the Russian investments in the EU total less that € 3 billion. I doubt the accuracy of both the aforementioned figures, when I keep in mind that the United Nations reports that Russia’s total outward foreign direct investment (FDI) stock, by the end of 2006, was over € 100 billion and the EU is one of the major destinations of the Russian FDI.

The question here is not statistical but rather political, since Russia seems to imply that the EU restricts her investments in the Single Market, which is not the case. All the foreign privately run companies are openly welcomed to the EU regardless of their country of origin as long as they do not create a monopoly inside the European market, they cannot be regarded as tools of any country’s foreign policy and they obey the rules.

Instead of being afraid that the EU starts to exercise protectionism in order to slow down the expansion of foreign state-controlled investments in the Single Market, I am more concerned that the Russian investment environment turns more restrictive towards foreign firms. I am not only concerned about the possible Law on Strategic Industries or Mineral Resource Act, but I am even more worried about the future development of so-called National Champions Policy, which accumulates unpredictability in the Russian investment environment, because foreign investors cannot predict what are the ultimate measures the Russian State uses when it creates these domestic champions. The non-transparent National Champions Policy is more damaging to the Russian investment climate than even their restrictive legislation is.

I would like to underline that one cannot improve competitiveness without intensive competition, and therefore, a National Champion Policy fostering monopolisation and legislation restricting foreign competition does not help Russia become more competitive. The World Economic Forum placed Russia in the 58th position among 131 countries analysed in the global competitiveness study. For instance, Chile, Thailand, Tunisia, India, Mexico, and Indonesia rank better than Russia.

Foreign investments are not only the cheapest way to obtain capital, modern technology and advanced management techniques, but the foreign enterprises per se are valuable since their business contacts build additional bridges between the EU and Russia, and hence, support European integration continent-wide. Due to differing opinions at the political level, all the additional actors are needed in keeping the dialogue constructive.

In order to avoid reciprocity of investment restrictions, one should create an independent expert team of policymakers, businessmen and researchers to analyse how to create a free and predictable investment environment in the EU-Russia context. The EU-Russia Industrialists’ Roundtable accompanied with leading policy-makers and researchers could be a convenient way to form an objective research team, which could biannually produce a report on the EU-Russia investment climate and the main barriers hindering its further development.

In addition to problems related to investments, transit of conventional goods gives us unnecessary headache. We have, each moment around the clock, several kilometres of truck lines, if we take all the customs points between the EU and Russia into account. Technical solutions, such as electronic customs declaration, are available, if there is enough political will to solve this issue.

Energy transit is an even more burning issue than conventional transit. The Baltic Sea has already become the most important oil export channel of Russia, and the amount of oil shipments is to increase sharply in the near future. At the moment, the oil shipments via the terminals around the Gulf of Finland total to some 140 million tonnes, and they are estimated to go over 200 million tonnes in the next decade. In order to avoid a looming oil accident in the Baltic Sea, no single-hull tanker should be allowed to enter this sea. Hopefully, one should not first have to experience an oil hazard before this decision will be taken. One can only guess the dramatic consequences of such an accident to the shallow Baltic Sea and the negative impact of the oil spill on the EU-Russia relations. Here one should not forget that over 6 million Russians, living in St. Petersburg and the Leningrad region surrounding it, would be directly affected by the increasingly probable oil accident in the Gulf of Finland.

In addition to oil deliveries, the Baltic Sea may become a major export route of natural gas from Russia to the EU. The plans to build the natural gas pipe, Nord Stream, on the seabed of the Baltic Sea have heated the discussion for some time. In order to create a genuinely sustainable solution for such a strategic energy project, which more than doubles the gas deliveries from Russia to Germany, I propose that the project would involve as many EU countries as possible. In other words, I propose that the Nord Stream plan would be abandoned and instead a pipe via the Baltic States and Poland to Germany be constructed, or alternatively, the second leg of Yamal-Europe via Belarus and Poland to Germany would be erected. The re-direction of the pipe would be a fundamental gesture of goodwill from the Russian side, and this gesture would definitely support the continent-wide integration in Europe.

Even if the relations of the Baltic States and Poland with Russia are not at their best at the moment, the Baltic States and Poland are members of the EU, and hence, they should be regarded as reliable energy transit countries. Moreover, the land-based pipeline is less risky operationally, environmentally more friendly, and obviously financially less expensive.

Should the Nord Stream pipe be realised, its costs will definitely go over € 5 billion, the sum indicated earlier by the Nord Stream organisation. Here one should mention that the preliminary budget of the South Stream, the 900 km-pipeline project underneath the Black Sea, is € 10 billion. With the similar cost structure, the planned budget of the 1200 km-long Nord Stream would be more than € 13 billion. As differing opinions on the real cost level exist, I propose that an independent organisation would calculate the costs of building a comparable land-based pipeline connection to Germany.

In this context, I want to stress that the Baltic States and Poland should not charge extra transit fees, since the use of the Nord Stream pipeline does not cause any extra administrative transit cost to its owners. The current ownership structure is as follows: Russian Gazprom 51%, German E.ON 20%, German BASF 20%, and 9% Dutch Gasunie. Including three companies from two EU countries in such a strategic project do not really turn this pipeline “a EU project”.

The following five facts may help to analyse the strategic significance of this project for the whole EU: (1) Germany accounts for 20% of the EU economy, (2) natural gas forms already at the moment nearly 25% of Germany’s primary...
energy consumption, (3) Germany is already now the EU’s largest importer of the Russian gas with annual imports amounting to some 35 billion cubic meters, (4) the total capacity of the Nord Stream pipe would be 55 billion cubic meters, and (5) Germany’s gas dependency on Russia would jump from today’s 42% to approximately 65%, if the Nord Stream pipe would operate at the moment.

One may ask whether the EU’s largest economy becomes too dependent on gas deliveries from Russia, and what might be the consequences of such overdependence to other EU members and their relations with Russia. Furthermore, one may wonder the position of Ukraine and Belarus vis-à-vis Russia if the Nord Stream and the South Stream will be implemented, since Ukraine represents currently some 80% of Russia’s gas transit to the west. The respective share of Belarus is approximately 15%. The non-payment of the Russian gas and other transit-related problems by Belarus and Ukraine motivate Russia to speed up the building of both the Nord Stream and the South Stream.

To end, it is essential for all the EU countries neighbouring Russia that there is a common policy within the Union towards Russia. Bilateral relations may aid common policy but they should never challenge it. I dare to argue so, even if the trade relations between Finland and Russia are more intensive than those of any other EU member state. Although Finland has also had several painful historic moments with our eastern neighbour and even some differing opinions nowadays, one should always try to search for constructive ways to go forward instead of searching for differences in opinions, systems or even values. The EU and Russia are different enough to learn from each other but similar enough to collaborate with each other. The Finnish pragmatic approach on how to conduct relations with our eastern neighbour might also be useful to some other neighbours of Russia and to the EU’s Common Policy towards Russia in general.

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The full version of the article has agreed to be published in the journal “Russia in Global Affairs”. To obtain the full version visit http://eng.globalaffairs.ru/