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## The Baltic Sea Region – a Swedish perspective

By Per Westerberg

The Baltic Sea Region has historically been characterised by both trade and conflict. Until 1917 Russia played an important role in trade relations within the region. During the last few decades the region has again experienced a dynamic development in cross-border cooperation. The independence of Estonia, Latvia and Lithuania, the re-unification of Germany, the political transition of Poland and the emergence of the Russian Federation opened a wealth of possibilities that had so far been blocked. The decisive element was, and remains, democratisation, respect for human rights and the rule of law in the new or transformed states. Their decision to base their economies on market principles was another very important element for trade, investment, and other economic cooperation. We believe, and certainly hope, that these trends will persist in the general development of the entire Baltic Sea Region.

It was natural that the first field for concrete cooperation was the Baltic Sea itself. For many years all states in the region had contributed to polluting it – sewage from industries and dwellings had been released into rivers or directly into the sea, excess fertilizers had been leaking out into the sea and ships had been dumping waste in it. In the early 1990s we were able to see the effects with our own eyes. The depletion of fish stocks confirmed that something had to be done if we were to avoid serious consequences.

The revised Helsinki Convention, or HELCOM, was adopted in 1992 and marked a new era. HELCOM was the first convention ever to take on all sources of pollution around an entire sea. It covers the whole of the Baltic Sea area. An action plan was established to eliminate the 132 "hot spots" that were identified. Since then, concerted action has been taken, including on co-financing. More than 50 of the "hot spots" have been deleted altogether from the list, and HELCOM has been successful in reducing discharges and emissions of a number of hazardous substances. A Baltic Sea Action Plan was adopted in 2007, listing additional measures to restore a good environmental status of the Baltic Sea by 2021.

This illustrates how much we can achieve if we focus our attention and create mechanisms for coordinated action both between the states around the Baltic Sea, and with the many other stakeholders concerned.

It is not only important but also a natural development that cooperation has been successively broadened over the years, and now covers a large number of fields. One early example of this is the Task Force on Organised Crime, which was established in 1996, resulting in joint efforts to combat trafficking in human beings. Similarly, cooperation on combating contagious diseases has continued, and has also developed into discussions about healthy life-styles. We have started to connect energy networks in the region, and to promote energy efficiency. We are also cooperating on improving land transport within the region and to the south, and are currently discussing how to design transport facilities

in the north in view of the possible use of the Northeast Passage.

Examples of projects and plans are manifold. So are, nowadays, the number of actors, including states, provinces, municipalities, companies, NGOs and educational institutions. Our experience from long-standing Nordic cooperation is that this is, basically, positive. Close and frequent contacts at all levels will provide both ideas and popular support for more in-depth cooperation.

But, of course, the multitude of initiatives and actors mean that coordination is crucial. Existing structures, such as the Nordic Council of Ministers, and later the Council of Baltic Sea States, have been instrumental in this. The Nordic Council established contacts and initiated the Baltic Sea Parliamentary Conference, at which national and regional parliaments now meet regularly to monitor cooperation in the region. The EU Strategy for the Baltic Sea Region, adopted under the Swedish Presidency of the EU in 2009, was a qualitatively new step. It is not merely another organisation, but rather a framework for common aims and priorities which should guide all actors in the region. The Northern Dimension of the EU, in which Iceland, Norway and Russia participate on an equal basis with the EU, is also an important instrument for coordination.

Cooperation in the Baltic Sea Region can develop further. The better we understand each others' situation, and the more we share the same values, the better the opportunities. There are problems and issues which can only be addressed jointly. However, we should also see the opportunities for an advanced and dynamic world-class region. After all, our resources put together are considerable: raw materials, science, knowledge and modern technology in almost all important fields, and almost 100 million inhabitants who are generally well educated. To realise this potential, our cooperation should be open, but it is not necessary for everyone to participate in every field or every project, as long as it fits into the larger regional perspective. We should promote "creative clusters", where cross-border contacts will lead to innovation in a broad sense – socially, culturally as well as in services and industry. Adaptability and creativity are key words for tomorrow's successful societies. It is evident the Baltic Sea Region has the capacity to continue the development of a vibrant region.

Per Westerberg

Speaker

Swedish Parliament

Sweden



## Croatia – becoming the 28<sup>th</sup> member state of the European Union

By Zoran Milanovic

The Republic of Croatia, a country of nearly 4.5 million inhabitants, situated at the crossroads of three European regions – Central Europe, South East Europe, and the Mediterranean, currently is approaching the finishing line of its European Union accession path and is set to become the 28th Member State on 1 July 2013. Even though Croatia's road towards the EU was not easy, with the degree of difficulty in some areas surpassing initial expectations, the combination of strong belief and hard work of Croatia and its peoples brought us where we stand today.

From this point we can look back with pride onto the two decades behind us, and with optimism to the decade ahead. The mere comparison of Croatia at the moment of gaining independence in 1991 and Croatia of today speaks volumes of the remarkable and profound changes our state and society have undergone. What needs to be put into the foreground is the unquestionable benefit these changes have brought to the everyday life of our citizens.

It was with great enthusiasm and ambition that Croatia had embarked on this journey. However, Croatia's accession negotiation process made it evident that the needed reforms could not be effectively addressed in just a few months' time. It was a highly complex and challenging process, where the conditions for EU membership became more rigorous over time. I would even say that Croatia faced the most demanding accession negotiations yet. Nevertheless, defining measurable benchmarks and concrete targets, sensitive to the specific regional or national context, has helped us to effectively meet the various EU conditions. Croatia's substantial progress and its preparedness for EU membership has also been recognized by our European partners, who engaged in the process of ratification, which we foresee to be completed by all 27 Member States in time for our accession on 1 July 2013.

Today's time is a challenging one too and we must not lose focus, first and foremost, on surpassing the challenges our economies, and societies, are facing. Before the economic crisis, our growth rates stood at about 5-6%. Today, it is a different set of rules, numbers and results. One thing is sure: all are significantly less than in the past. High unemployment rates, decreasing European investment flows, declining remittances, and a troubled banking sector, have taken much of the luster from the EU. On the other side, with the future of the euro – and indeed of the Union – under serious discussion, it is up to us to find the rationale to remain loyal to the founding principles upon which the Union has been built. It is exactly this context that makes the Croatian willingness to join the EU even more significant as it is based on a thoroughly examined and rational decision, not on emotional idealism. The result of the EU referendum in Croatia in January 2011, at which 66% voted for Croatia's accession to the EU, further strengthened our resolve.

I am convinced that Croatia's membership in the EU opens a new window of opportunity for us, as well as the community we are about to join. We are fully aware that the EU is currently searching for answers to many questions, such as the response to the financial crisis, security threats, climate change or migrations, to name just a few. And we are also aware that through this prism, the continuation of EU enlargement is not always seen as a popular thing. In light of accentuating the positive effects that the accession negotiations have produced, Croatia has learned the value of proactive participation. For this purpose, we have set up a Council for Transition Processes that is to act as a center of excellence, with the primary aim to transfer Croatia's knowledge and experience from EU and NATO accession processes to countries in the region.

I am certain that Croatia as a new Member State will represent an added value to the EU in several ways. Croatia's cultural heritage and contemporary achievements in arts, science, sports and other areas form a part of our common European legacy. Its largely well-preserved environment is a valuable addition to Europe's natural resources and biodiversity fund. As a desired European tourist destination, Croatia will undoubtedly contribute to Europe's competitiveness in the world of tourism.

But if you asked me what our biggest asset was, I wouldn't have to think twice. Being a country with a Central European orientation, a Mediterranean spirit and a continental heart, Croatia has the privilege to be the only country in Europe that lies on the shores of both the Danube and the Adriatic Sea. With a specific understanding of its neighbourhood and extensive regional cooperation, Croatia fits perfectly into the mosaic of Europe's unity in diversity. Through its active membership in various regional associations Croatia contributes to regional development in line with the goals of the EU's cohesion policy.

Croatia will continue to exercise its responsibility for the region by sharing its experiences, by listening to the needs of the individual countries and by acting as a strong voice of the European future of all countries in this part of Europe. We sincerely hope, and believe, that our success will encourage our neighbors in the region to follow on our path and serve as a powerful reminder that determination to rise to the challenge will ensure tangible results.

Zoran Milanovic

Prime Minister

*The Republic of Croatia*



## Mutual trust and reciprocity – a key to success in the Baltic Sea Region

By Maria Lohela

The Baltic Sea has always been important for Finland and especially for Southwest Finland. It has provided our country with great opportunities for living and an efficient trade route. Still today, the Baltic Sea region is a very important area for our country. It has both challenges and opportunities that each of the region's states have to respond to in co-operation. Fostering of fundamental values of international relations and international law, trust, reciprocity and feeling of obligation (*pacta sunt servanda*), will be necessary in order to fully benefit from international co-operation of the region.

The Baltic Sea Region is Finland's home ground. What happens in the region directly affects Finland, too.

Therefore, Finland is committed to implementing the EU Strategy for the Baltic Sea Region. It is in the best interests of our country to further goals related to sustainable environmental policy, thriving regional economy, development of transportation services and the safety of the region.

The Baltic Sea is highly vulnerable due to its geographical and physical characteristics, and it is in need of special protection. Finland's own measures mainly affect its coastal waters, whereas international co-operation should aim to protect the open sea. Consequently, joint national and international measures are needed.

The Baltic Sea region consists of states of different backgrounds. In addition to the EU member states, Iceland, Norway, and Russia take part in the organized co-operation of the region. Russia's involvement is especially important in order to protect the sea efficiently and to fully benefit from the economic co-operation. Thus, the European Union is not a sufficient political arena to respond to the challenges of the region. Eventually, central concepts of international relations and international law, mutual trust, reciprocity and feeling of obligation, determine the outcome of the co-operation in the Baltic Sea region.

Reciprocity requires a mutual understanding about which actions are to be expected from those involved and how a co-operation agreement will be enforced. It also requires that the parties know perfectly what actions each counterpart of the agreement has taken. If monitoring of the compliance of the partners becomes difficult, there is a risk that reciprocity becomes irregular and disproportionate to potential violations.

The state of the sea is a common tragedy in the Baltic Sea region. In order to respond to our common challenge, a co-ordinated action is needed. Reciprocity should be fostered in the international relations of the Baltic Sea region's states both internally and externally.

Firstly, mutual trust should be strengthened between the Baltic Sea states by clearly determining what are the rights and responsibilities of each Baltic Sea country. They should

be in a right balance in order to secure an efficient co-operation. The co-operation model is not functional nor sustainable if it allows any countries to act as free riders in the region's common environmental problems. A right balance of responsibilities and obligations for each state would make the co-operation more legitimate and fair – and most importantly – more efficient.

Secondly, a fair balance should prevail between the interests of the Baltic Sea states and states from other regions. The Baltic Sea states have to improve the competitiveness of their economies. The competitiveness of the Baltic Sea region states is a complex equation and the countries have to take into account a global perspective while developing their economies.

The European Parliament approved new sulphur directive in September 2012. The new directive lowers the sulphur content of fuel used in the shipping industry by 2015 from its present one per cent to 0.1 per cent in the so-called Sulphur Emission Control Areas, the Baltic Sea, the North Sea, and the English Channel. The directive has been estimated to cost, depending on the source, from 500 million to 1 billion euros a year.

Meanwhile, the ships in the Mediterranean Sea will be allowed to use fuels with 3.5 per cent sulphur content until 2020. Protection of the nature is important, but actions made in the Baltic Sea region have to be proportional to those made elsewhere. The Baltic Sea region states are entitled to look after their interests globally.

Environmental protection of the Baltic Sea is crucial for our well-being, and the well-being of the future generations. Consequently, a joint action is needed in order to make cooperation fair and efficient. International law and monitoring institutions of the Baltic Sea region can have a remarkable role in the regional cooperation. The existing institutions of the Baltic Sea region should have a more significant role in determining what is a legitimate share of obligations for each country and determining whether their actions are serving the purpose or not. Only mutual trust, reciprocity of actions and feeling of obligation can deliver successful results in the Baltic Sea region.

*Maria Lohela*

*Member (The Finns Party)*

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## Towards a more responsible Baltic Fisheries Policy

By Katja Taimela

Salmon is an important fish for the Finns. Its health effects form a key part of a balanced diet. The vast majority of fresh salmon currently comes from Norway. In Finland, 70 % of the fish consumed is imported from abroad. The share of salmon within the Finnish professional fishery catch is minor; the salmon catch in 2010 was only 0.2%. Thus, the commercial value of the salmon catch accounted for about 3% of the total fishery.

However, for the tourism in Northern Finland, salmon is highly significant. The river Tornio is the largest salmon-fishing river in the whole of Europe, and tourism is the main business in the area of Tornio river valley. Tourism has also a significant business potential for growth. In the Tornio area, the main tourist attractions are the old fishing culture of the location, as well as sport fishing, traditional fishing and recreational fishing. Healthy and viable salmon populations are important for commercial, cultural, and recreational activities. The populations can be ensured only by the Baltic countries in a responsible and long-term co-operation.

In Finland, the coastal fishery has been reduced, and currently, a large part of the domestically caught salmon is farmed fish. Wild salmon stocks have during the recent decades weakened significantly. At this moment, an intense process to amend the situation is taking place. The concrete change within the political approach to Finland's fishery policy has already happened. Prime Minister Jyrki Katainen's government program includes a strong commitment to protect wild salmon stocks. When defining the quotas for 2013, the Finnish Parliament settled for the first time a major decrease in the fishery quotas. In addition, the Government approved a fish passage strategy where the message is clear: natural fish stocks are to be revived.

The Ministry of Agriculture and Forestry set up in December last year a working group whose main objective is to find a consensus on a national strategy for the salmon. The working group will examine the Baltic salmon and sea trout fishery and salmon and sea trout stocks as well as other issues regarding the management of their natural life cycle. Results from the working group are expected as early as this spring. It is important, that the forthcoming Salmon Strategy includes scientifically estimated quantified targets for brood fish rising to rivers, the achievement of which guarantees the long-term vitality of wild salmon stocks. Furthermore, the scientific evaluation methods need to be developed in order for them to be more widely accepted as the basis for the fisheries policy.

The decline in salmon stock contributes to the eutrophication of the Baltic Sea. When the ecosystem is significantly weakened by one species, the effects appear at all levels. Salmon reduction has led to the smaller fish populations have grown which the salmon feeds on. These small fish in turn feed on zooplankton, which is consequently reduced. Zooplankton consumes phytoplankton, the amount of which will therefore grow and rampant the sea.

For the recovery of wild salmon stocks, the Baltic salmon fisheries policy has a very important role. Naturally, when

fishing at sea, it cannot be determined which stocks are being fished. As a result, all available stocks are being caught from. Whereas, when fishing at a river one can choose to fish only at those rivers where the stock populations are healthy, and not at those where the stock populations are not as strong. Thus, stock recovery problems can thus be solved by either stopping the joint position of fishing in the main basin and the Gulf of Bothnia, or by setting such low catch quotas, that it also ensures the most vulnerable salmon populations to recover. Migratory fish of the joint position of fishing is the key. If fishing continues as it is and the river-specified protection measures have no effect, the spawning fish do not get to return to their home rivers from their migrations at sea.

In the recent years Sweden has begun to actively revive its salmon stocks. It has banned the much discussed long line fishing that has been debated upon in Finland as well. In principle, the oceans are open and nobody owns any wild fish until it's caught. Therefore, the salmon that a Finnish fisherman had to miss due to the quotas might end up, say, to be caught by a Polish fisherman. Baltic fishery policy is therefore a common interest for all of the Baltic Sea countries. None of the Baltic countries can take care of the salmon stocks alone. It requires extensive cooperation within the EU's fishing policy, uniform regulations and adequate supervision.

The WWF estimates, that half of the fish imported to the EU is illegally-caught. Illegal fishery has far-reaching impacts on for instance the deprivation of the poor countries as it kills their own fishing industry. Nature is being harmed through aggressive fishing methods. Fishermen in poor African countries have been robbed of their source of livelihood by illegal fishery and they have been subjected to a cheap labor force. Therefore, the EU's Common Fisheries Policy is closely linked to the world's trade and environmental policies and human rights issues as well.

The EU's Common Fisheries Policy is designed to ensure that the fishing will become biologically, economically and socially more sustainable. Currently, the implementation of the objectives is not at a satisfactory level within the EU's internal seas and, in particular, on the imported fish. The most important means to achieve the set objectives for the EU's internal waters are the catch and effort limits. As a rule, these elements must be based on the use of fish stocks in the multi-annual management plans and comply with the scientific recommendations.

*Katja Taimela*

*Member*

*Parliament of Finland*

*Finland*



## Maintaining a sound all-win relationship between China-Finland in the future

By Xing Huang

The year of 2012 has witnessed major changes in political arena throughout the world as a number of states selected their new leaders, that include Russia, Germany, France, USA and Korea etc. Furthermore the Finnish President Sauli Niinisto assumed his office early last year while later in the year China elected the new leadership by the 18th National Congress of the Communist Party of China. New leadership in the two country's political life not only bring up fresh impetus, but also provide new opportunities and potentials for bilateral relationship between China and Finland.

It is widely recognized that the relationship between China and Finland has been sound and healthy, which is characterized by comprehensiveness, mutual benefit and friendliness. Particularly in the last 20 years, "booming" should be the right word to symbolize the development of cooperation in almost every field. Contacts of people both in high and root level become increasingly extensive, which in turn greatly deepen mutual trust. As major component part of the relationship, bilateral trade volume in 2011 exceeded over 10,000 times of that in 1950. Nowadays Finland has become China's second largest trading partner, technology exporter and third largest source of investment among Nordic countries. And China is Finland's largest trading partner outside EU and one of the most important source of investment. China and Finland have offered a lot to each other but there still exist enormous potentials. Our differences in social institutions, cultural traditions and level of development are outweighed by the similar ideas we share on economic and social development as well as the common interests in international affairs. Finland is one of the first Western Countries who established diplomatic relations and signed a bilateral trade agreement with China. Now, we are delighted to see peoples' enthusiasm to acquaint each other is rising and interest in each other's culture enhancing. Confucius Institute of Helsinki University and Finland Research Center of Beijing Foreign Studies University have both just celebrated their 5th birthdays. Over 30 pairs of cities have established sisterhood relations between China and Finland.

To review the path of the past 35 year when China made spectacular achievements, the most important experience is self-reliance. Yet, there are still other key factors such as adherence of opening up policy which stimulates development to a large extent. We absorbed capital, advanced technology and experience from other countries including Finland, which significantly contributed to "China speed". It is foreseen that China will continue to carry out the opening up strategy. To maintain sustainable development of the relationship with Finland is one of our priorities. To this aim, a few principles which served us well in the past should be adhered further.

Mutual benefit, a key for sustainable cooperation. In the background of globalization, countries have become further interdependent to each other, which requires players to set and pursue an all-win target. Fortunately, the Chinese and Finnish economies have long been complementary, and both countries targeted green tech and low-carbon economy as priorities among others of development. Bilateral cooperation in technology innovation, environmental protection, clean

energy, modern agriculture has demonstrated as great potentials, while the mutual direct investment should be given an even greater backup by both sides. On the whole economic cooperation certainly serves as backbone in the relationship.

Engagement of people, a fundamental for solid relationship. An old Chinese saying goes: amity between people holds the key to sound relationship among states. Personnel contacts not only serve as a bridge for better understanding in our generation, but act as a relay-race baton to pass our friendship generation by generation. Friendship between China and Finland dates back when new China was founded several decades ago. We always base our relationship on mutual respect, equality and non-interference in each other's internal affairs.

Harmony and diversity, a principle for peace. The ancient master in philosophy and education, Confucius once said that people should coexist in harmony while maintaining their characteristics. Only based on mutual respect and concede differences, can prolonged relationship be preserved. We deeply believe that countries all have certain experiences that can lend to and borrow from others.

Favorable environment, a basic factor for attraction of business. Today, China and Finland are both faced with the challenge to promote national economy and to raise people's living standard, in which process pragmatic cooperation between the two sides can have a great part to play. Therefore favorable environment must be created and effective measures be taken to facilitate business conduct. Simplification for application of visa and working permits, especially for business people, favorable economic and financial policies as well as national treatment for foreign enterprises are among the most effective and pragmatic measures at our disposal.

The world today is undergoing profound and complex changes. Peace and development remain the underlying trends at present era. Yet the world is still far from being peaceful. To effectively tackle global issues needs cooperation of all players in the world. China attaches great importance to bilateral relations with EU as well as with its member states including Finland. These two kinds of bilateral relationship are not contradictory but complementary to each other. Neither of them should be weakened. Sound development of both fits the core interests of the Chinese, the Finns and other Europeans. We hope and believe that the friendly and cooperative China-Finland relationship could set up a good example for China-EU relationship and vice versa. China is ready to endeavor for a even brighter future for its relations with Finland and EU thus to contribute further to promotion of the noble cause of peace, development and harmony of the whole world.

Xing Huang

Ambassador

*Embassy of the People's Republic of China in Finland*

# Latvian defence planning in transforming security environment – political perspective 2011–2013

By Veiko Spolitis

Security of the Baltic States is a topic often discussed in different forums around the Baltic Sea. The Baltic States became members of the NATO in 2004 after Poland in 1999, and today there are strategic debates in both Finland and Sweden about rationale to join the greatest Western Defence Alliance. This article will try to outline rationale behind the Latvian government declaration today. Thus, the article will first outline a major regional development that has made Latvia to continuously opt for embedded integration of the Baltic States. Second, the article will shed light on major defence policy documents. And finally, the article will pinpoint major challenges for the balanced and peaceful domestic development in Latvia, which is a prerequisite for the ongoing and peaceful coexistence in the Baltic Sea area.

The regional security environment after the new Russian defence doctrine was accepted is becoming sensitive. The Baltic States are aware of the increasing number of the over flights by the Russian Air Force, the same as other NATO allies bordering Russian Federation. The fact that countries have exercises is absolutely normal, however for the last two occasions Russia and Belarus have staged joint military exercise "Zapad" while simulating breakthrough out to the Baltic Sea. Such military activity fostered NATO to elaborate contingency plans, and during the upcoming summer the NATO will have the largest military exercise in the Baltic Sea region since disappearance of the bipolar world order. Renewed military activity of the Russian military has only fostered the coordination of the Baltic States exercises with the NATO partner countries within the region. The government declaration and operational program asserts that fostered integration among the Baltic States and increased cooperation with the Scandinavian countries is among medium term goals of this government. Already established regional institutions – Baltnet, Baltron, and BaltDefCo – serve their purpose of not duplicating tasks and churning out well trained staff officers instructed in multi – cultural environment. The integration with the Baltic States is thus embedded; the cooperation with the Scandinavian countries follows the footsteps of NORDEFCO and it is the task of lawmakers to provide priority to the questions of security and defence.

Among primary tasks of the present government are outlined those capabilities that are essential for keeping territorial defence system sustainable. Second, the Latvian defence structure had to be brought in line with the promise Latvia gave to the NATO partners. To achieve the targeted goal the Ministry of Defence prepared the State Defence Concept (SDC) that outlines political guidelines for developing the long term development plan for the National Defence Forces. SDC was passed in the parliament unanimously. The gradual increase of the military spending will set the budget increase by 0.1 percentage points y-o-y

basis to the target level of 2% from GDP by 2020. It would allow developing the basic capabilities of defence forces in order to provide territorial defence, and also to make expeditionary deployments sustainable with support and transport capabilities fully developed. The ongoing administrative transformations made the cyber security department CERT to move from the Ministry of Transportation under roof of the Ministry of Defence. Such decision was well rehearsed, because the Defence Forces had paid attention to the formerly unconventional security threats turning hot in neighbouring Estonia, and increasing cyber security capabilities is one of the new priorities for the Latvian Ministry of Defence. The SDC document underlined the principle of quality over quantity, and outlined the need for transforming the home guards into the functioning defence force reserve system. Operationally fit Defence Forces will be able to successfully plan participation in a variety of cooperative networks that Latvian membership in the three major international organizations requires - the EU Battle groups, the UN peacekeeping missions, and NATO operations. The planning documents at this stage do not involve notions about the pooling and sharing among the three Baltic States explicitly. The challenge of synchronization between three capitals for the sake of joint procurements is perhaps the greatest at the moment, because defence forces have developed at different speed and the domestic political considerations bear heavily on smooth policy planning process. Therefore, to achieve increased synchronization of the military planning process the three ministers of defence in their last meeting in Gulbene agreed to assign Latvia to develop a plan for establishment of the Joint Headquarters. Such bold moves would come perhaps more often if the political cycles would be synchronized between the Baltic States as well. For this happening political system must professionalize. The too anachronistic media environment and segregated schooling system does not allow reaching hearts and souls of the Latvian non-citizen population fully. Ridding the corruption, embedding the rule of law and solving the previously mentioned non-citizen dilemma are three major domestic challenges of the Latvian domestic security policy – and key for the balanced development of the Baltic Sea region.

Veiko Spolitis

Parliamentary secretary

The Latvian Ministry of Defence

Latvia

## Finland and Sweden – military allies? Never and yet for all times

By Hannu Miettunen

The year 2013 started with a discussion of the common defence between Finland and Sweden. The idea keeps popping up like a cork every now and then although all the debaters know it is futile. The union can only materialize within a larger alliance i.e. NATO.

In principal the idea is quite natural. All of the Nordic countries have values and societies similar enough to form even a common state. The major obstacle for common defense is the human nature: selfishness or the instinct of survival, if you will.

The founding father of modern Finland, J.W. Snellman put it bluntly already in 1863: "Nations sacrifice themselves for others only in the daydreams of schoolboys." He was proven right the next year when Prussia attacked Denmark. Sweden, that at the time controlled Norway, did not lift a finger. The episode was a fatal blow to the idea of Scandinavism. Denmark became a timid poodle of the unified Germany for almost a century. Sweden turned inwards.

In World War I, both countries managed to stay out of the conflict. So did the newly independent kingdom of Norway, and, for quite some time, even the autonomous Grand Duchy of Finland. Russians did not trust the Finns enough to draft conscripts to the Imperial army. Violence entered our shores only after independence in the form of Civil War.

The success of the neutrality in 1914-1918 made it an obvious choice for all of the Nordic countries in the 1920's and 1930's. The only one that could retain the status through the World War II was Sweden, and even that required some awkward concessions.

One could say that the 1864 was re-experienced in the autumn of 1939 and the spring of 1940. When Finland was attacked by Russia, both Denmark and Norway declared themselves neutral. In Sweden, the Military would have wanted to send troops but the Government decided otherwise. Sweden gave Finland substantial material aid though. Volunteers poured in from all three countries.

The tables turned quickly in the spring of 1940. Germany invaded both Denmark and Norway and held them until the end of the war. This time it was Finland and Sweden who looked the other way. Neither could help either the Baltic States that were annexed by the Soviet Union. In order to survive both Finland and Sweden had to fraternize with Nazi-Germany until it was weak enough not to pose a serious threat. That is something Norway and Denmark have never forgotten or fully understood.

The Cold War split the Nordic countries once again. The memory of the Occupation drove Norway and Denmark into NATO. Finland became a reluctant ally of the Soviet Union. Sweden was balancing in the middle. Had it chosen to join NATO, the leash of Finland would have been much shorter. The neutrality in the late 1940's was probably more significant a service Sweden did for Finland than any assistance in the Winter War. In practice, Sweden was an ally of the West.

There is also another well-known secret. In certain areas Finland and Sweden have had common defence for almost a century. In the Gulf of Bothnia both countries have their soft

bellies exposed in the coastline that stretches for over thousand kilometres. The fortifications have always been scarce. Nowadays the military installations are historical relics. In the Finnish side of the Gulf even the garrisons have all been abolished. The only way to defend the area is to close the straits on both sides of the Aland Islands. There is however, one obstacle: the demilitarization of the isles.

Ironically enough, Aland was demilitarized in 1856 in order to protect Sweden and her capital from the threat of Russia. The fortifications had been demolished a year earlier by the Anglo-French troops in the Crimean War.

After Finland became independent the status quo was preserved mainly because there was a dispute between Finland and Sweden over the ownership of the islands. The idea of a war between these countries was absurd even back then, but it might not have been so obvious in Geneva in the headquarters of the League of Nations.

In practice, the demilitarization has been a curse. The islands have been occupied in every military conflict in the Baltic. In 1918 alone there were five different military contingents there in a row, most of them disarming the previous ones! Both Finland and Sweden have always been ready to send their troops in when necessary. The demilitarization has just made it a bit more complicated.

In the 1920's Finland spent astronomical sums for building two monumental battleships, monitors Ilmarinen and Väinämöinen. Their main task was to bring fire-power to the waters of Aland. In normal circumstances the job would have been done with coastal artillery. The money and the steel would have been in much better use in submachine guns. Neither of the ships had much use in World War II. Ilmarinen hit a mine and sunk. 271 lives were lost.

In the late 1930's Finland and Sweden had been planning to fortify the Aland Islands together. This was prevented by the diplomatic pressure from Soviet Union.

We don't know what kind of secret plans and unofficial treaties these countries had during the Cold War or have now, but it would be a big surprise if there were none. Finland and Sweden may or may not be joined through a common membership in NATO one day, but one thing is sure: they both have to secure Aland. The only ones that have never realized this are the Alanders. Pacifism is at its best during peacetime.

Hannu Miettunen

Head

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*Turun Sanomat, 3rd largest Daily newspaper in Finland*

Finland

# Mecklenburg-Vorpommern and its relations with the countries of the Baltic Sea Region

By Erwin Sellering

International links of the state of Mecklenburg-Vorpommern have traditionally focused on the region around the Baltic Sea. They are founded on historical and cultural ties, our state's geographical location and its socio-economic development. The objectives pursued by Mecklenburg-Vorpommern's activities in the Baltic Sea Region are closely linked to those givens. Before all, these include strengthening and consolidating the role of Mecklenburg-Vorpommern as a rising and attractive region, developing sustainable links of partnership with all neighbours in the region around the Baltic Sea, an active participation in efforts to protect the Baltic Sea and promoting competitiveness. Mecklenburg-Vorpommern has recognised this outstanding relevance of cross-border cooperation in the Baltic Sea Region early and enshrined it as an objective of our federal state in Article 11 of its constitution.

It is with this in mind that our state shows its commitment by working in a number of multilateral bodies, such as the Council of Baltic Sea States, the Baltic Sea States Sub-Regional Cooperation as well as the Conference of Peripheral Maritime Regions (CPMR). To this one has to add multi-faceted bilateral relations, in particular with Poland, the countries of Scandinavia and the North, the Baltic states and Russia. As early as more than ten years ago, Mecklenburg-Vorpommern laid the groundwork for this type of working together by building partnerships. By now, these regional partnerships have come to form major links for and driving forces behind cooperation around the Baltic Sea.

To me, these regional networks and cross-border structures have come to form a major foundation, on the basis of which our state may tap into new growth potential in an atmosphere of intense world-wide competition, promote innovation and create a high quality of life. Over the past few years, the Baltic Sea region has developed into one of the most economically stable regions, generating a total of one-third of Europe's economic output. Also and as a maritime region, Mecklenburg-Vorpommern is closely intertwined with the Baltic Sea region's economic structures and trade flows. One third of all exports of our federal state are to the Baltic Sea region. Poland, Sweden, Denmark, Finland and Russia are amongst the major recipients.

The Region around the Baltic is an interesting partner with a potential for growth, particularly for our small and medium-sized companies. It is in this spirit that we strive to build the closest and most efficient network of relations possible with our neighbours in the Baltic Sea region, thus also contributing towards a self-sustaining network of economic actors.

The successful structural economic change our state underwent over the past twenty years also results from its clear orientation towards cooperation in the region around the Baltic.

It is particularly in the fields of ports and logistics, tourism and health management that Mecklenburg-Vorpommern has built close contacts and networks with the regions around the Baltic. Under the EU Strategy for the Baltic Sea Region,

Mecklenburg-Vorpommern took on the work of a coordinator for tourism. And it is this very cooperation with our partnering regions that is underpinned by appropriate specific projects. The Sassnitz-Ust Luga ferry line links us to the Leningrad region, the ScanBalt Life Science network means active work with south-west Finland and amongst other projects, we developed a joint telemedical venture with our Polish neighbours of the West Pomeranian voivodship.

We should link into these and generate new impetus. For instance, I think of the field of renewable energy. By today, renewable energy, mainly wind power, generates 66 per cent of Mecklenburg-Vorpommern's requirements. To guarantee our needs for the future, I think it would be right to develop a joint concept for wind energy from the countries around the Baltic. I can also see exchanges among the grouping of bioenergy villages. For this we agreed with our partners from south-east Finland to advance a joint project.

It is not only economic cooperation but especially cultural exchange and meetings of people in the Baltic region, which are a central objective of Mecklenburg-Vorpommern. A major role in this is played by cooperation with Poland, especially by partnerships with the Western Pomeranian and Pomeranian voivodships. Together with our Polish neighbours we want to render our contribution to the economic, cultural and regional development of the border area we share and of the Baltic Sea region.

The involvement of Russia in this regional cooperation offers important added value to which Mecklenburg-Vorpommern contributes actively by way of its partnership with the Leningrad area. It is our objective to further widen such good cooperation as we already have in the field of ports and logistics, and to open up new fields such as health management or an exchange of experts and managerial staff. This was also the target of the visit by a party of entrepreneurs both to Finland and to the Leningrad area in October 2012 led by me.

Over and above, the countries of Denmark and Sweden are major partners of Mecklenburg-Vorpommern in the Baltic Sea region. Here, the focus of economic cooperation is on the fields of transport, tourism, health management and trade. It is our intention to further strengthen relations and to open up new fields of cooperation. This is because the closer this cooperation in the Baltic Sea area, the more dynamic will be the economic and cultural development of this region in its entirety.

*Erwin Sellering*

*Prime Minister*

*Mecklenburg-Vorpommern*

*Germany*



## Cooperation of the Republic of Karelia with Finland at the present stage of development

By Alexander Khudilainen

The Republic of Karelia has a common 800-kilometer long border with Finland, therefore the volume and content of interaction with Finnish regions has a direct impact on its socio-economic situation. The Karelian-Finnish cooperation started already in the previous century. From the history of the Soviet-Finnish relations we can underline such a unique example of cooperation as construction in 1974-1984 of the Mining and Processing Combine in Kostomuksha, and the city itself.

Along the transition of Russia to the market economy and liberalization of foreign economic activities, the Russian-Finnish intergovernmental Agreement on Cooperation of Border Regions (1992) laid foundation of the Karelian-Finnish cross-border cooperation in its modern understanding. After that it has developed also within the framework of joint cooperation programmes of Russia and the EU, bilateral cooperation with the regions of Eastern and Northern Finland and established in 2000 the Euroregion "Karelia". Interaction of Karelia and Finland develops in the business sphere, in the fields of culture, higher and secondary education, social and healthcare, ecology and tourism, sport and transport, within twin-cities relations and on the level of people-to-people diplomacy. The results of this cooperation are reflected in establishing of hi-tech enterprises with participation of the Finnish capital, such as "Elektrokos", "AEK", and wood-processing plant "Setles" etc.

At the same time, the traditionally formed model based on raw materials export became by 2008 ineffective and, in general, exhausted itself. Due to the growth of duties on export of unprocessed wood and crisis developments in the world economy, the decrease of the trade volumes began. In spite of the recovery of the foreign trade turnover in general by the year 2011, the trade turnover with Finland continued to decrease.

Under these circumstances, considering, among others, participation of Russia in the WTO, we defined as a priority the recovery of the foreign trade volume with Finland on a principally new level. In order to achieve that, the Government of the Republic of Karelia developed a new investment policy, directed at granting conditions of most-favored nation treatment to investors, it assists to the modernization of frontier and customs infrastructure and transport routes, also intensifies contacts on all levels.

During the last years, a considerable growth of passenger traffic has been noted on the Karelian part of the Russian-Finnish border. Russia's entering the WTO in the future will increase cargo and passenger flows. Therefore the Government of the Republic of Karelia promotes the ideas of construction of a new international automobile border crossing station "Syuvyaoro-Parikkala", reconstruction of railway border crossing stations "Vyartsilya-Niirala" and "Lyuttya-Vartius" (considering the container and passenger transportation in the future). Reconstruction of border automobile roads is being done. A respective agreement on joint actions together with the OJSC "Russian Railways" has been gained.

Thanks to the efforts of the Government of the Republic of Karelia, "VR Group", OJSC "Russian Railways" and Regional Council of the Northern Karelia, at the end of 2012 was arranged a test trip of a passenger train between

Petrozavodsk and Joensuu. As a follow up to this event, the issues connected to establishment of a regular connection on this route are being worked out. We are also interested in development of international passenger air traffic. A few versions of renewing flights between Petrozavodsk and Helsinki are under consideration.

The Government of Karelia has developed the new concept of the investment policy, which implies establishing of conditions of most-favored nation treatment to investors, including foreign investors. These measures are reflected in the regional law "On the State Support of Investment Activities", which grants new considerable preferences and privileges.

During the last six months the mentioned new approaches of the Government of the Republic of Karelia have been discussed during meetings with regional authorities of the Northern and Eastern Finland, members of the Government, Deputies of the Parliament and the President of Finland. Our mutual interest to strengthen and develop border contacts was supported also by the Summit of the Advisory Commission of the Eastern Finland.

The work on intensifying foreign economic ties is also done in the sphere of business. The Presentation of Economic Potential of the Republic of Karelia in September 2012 and Business Mission of Small and Medium Enterprises in October 2012 in Helsinki caused a great interest by the Finnish side. At the Forum of the Eastern Finland in October 2012 was signed the Agreement on Cooperation between the Chamber of Commerce and Industry of the Republic of Karelia, Central Chamber of Commerce of Finland and Chambers of Commerce of South Savo, Kuopio and Northern Karelia. In November 2012 the Business Mission of Finnish entrepreneurs visited Karelia. Undoubtedly, such events give an additional impulse to development of our cooperation. The number of business proposals from Finnish companies has grown.

It is clear that we cannot change the situation at once, especially when we talk about large-scale infrastructure projects, such as construction, reconstruction of border crossing stations and border roads, which require major budget expenses. The Government of Karelia has support from the Federal Authorities on the mentioned initiatives, which was expressed during the meetings with the President of Russia Vladimir Putin. At the same time, assistance from the Finnish partners is also important for us. We hope that by the 100-th Anniversary of establishment of the Republic of Karelia in 2020 we will gain positive results from implementation of those basic projects of cross-border cooperation.

Alexander Khudilainen

Head

*The Republic of Karelia*

*Russia*



## Northern growth corridor – an opportunity for Southwest Finland

By Janne Virtanen

On one hand the Baltic Sea separates Finland from the EU's key market areas, but on the other hand it connects Finland to them. Developing land-sea-land transport chains is important to improve the smooth flow and competitiveness of Finnish foreign trade transports. It is important for Finland that the EU's key market areas can be reached cost-efficiently. Finland's remote location, long distances to main markets, small population, severe climate conditions and great dependency on foreign trade carried by sea set challenges to the development of traffic infrastructure and logistical system. These special conditions require special attention.

The Baltic Sea is a sensitive ecosystem. On the other hand, the Baltic Sea plays an important role in the traffic system of the region, and it still has unused potential for transports. Developing the transport system in the Baltic Sea region puts, however, the environmental aspects in a particularly important position. The growing transport volume presents challenges to the safety of seaborne traffic. Innovations of an intelligent traffic system, such as systems for automatic monitoring of vessels for improved maritime safety, provide a wide range of means for enhancing safety.

The EU's border states, such as Finland, have common interests in developing connections to third countries. In Finland's case the connections to Russia play a key role. In the Baltic Sea region the east–west traffic corridors in particular need to be developed further. The Central Europe–Scandinavia–Stockholm–Southwest Finland–Russia–Asia traffic corridor is an excellent example of a smooth, reliable and competitive transport chain, whose existing connections need to be improved and usage enhanced. This region-structural idea is supported by the previously determined European-wide transport networks, TEN-T and their priority projects, such as the Nordic Triangle and the Motorway of the Baltic Sea.

The severe, exceptional weather conditions due to the northern location and special requirements for arranging traffic connections emphasise the need for a sufficiently dense traffic network. It secures the service level of the network, allows for flexible and alternative transport routes, and optimisation of costs according to the transport needs. Flexibility and optimization mean energy-efficiency and are worth striving for in terms of climate policy.

While developing the regional structure of Southwest Finland, the position of the area in the Baltic Sea region as part of Europe is taken into account. This is affected most by the traffic corridors that pass through the province. An internationally important connection between the EU and Russia goes via Southwest Finland. The regional structure responds to the challenges generated by globalisation. Regions and urban areas have to specialise and network, which leads to an increase in the importance of development zones. The business world needs quick international and national connections. In passenger and goods transports the key question is which urban regions and areas will be accessible by high-speed trains, motorways and good flight

connections. Transport systems and telecommunication connections have great importance to the competitiveness and development of areas.

Finland's logistical functioning has done very well on the whole in international comparisons. Although the importance of managing logistics and supply chain for the competitiveness of companies operating in Finland has continuously increased, the biggest challenges directed at the operation of companies come from other sources than logistics. From the point of view of Finland's logistical competitiveness, the most important items of development in Finland's foreign trade are ports, border crossing points, and the main roads leading to them. Finland's competitiveness and functioning of society lean largely on functioning travel and transport chains. The international connections via Southwest Finland are vital to the export industry of the province, but also to the foreign trade of all of Finland. The success of Southwest Finland in logistics is made possible by the increasing supply of logistics services, the Trans-Siberian rail, a bridgehead position toward Scandinavia and the west, uncongested logistics infrastructure, general cost level, availability and permanence of labour, and varied business structure.

The connection between Finland and St Petersburg is a growth corridor for the European internal market, where the number of consumers may be as much as 20 million depending on the method of calculation. The buying power and mobility of consumers are rapidly increasing. The economic, cultural and societal connection between St Petersburg, Helsinki, Turku and Stockholm is a power that maintains the development of the whole of Northern Europe. It is also the most important direction of Finland's economic development. The northern development corridor is a priority project among the future projects of the Finnish transport system, to which the Finnish government as well as cities and provinces along the corridor have committed themselves. The corridor strengthens Finland's national competitiveness and generates conditions for economic growth by developing a transport corridor between the EU and Russia which will attract international players and new business. The northern growth corridor is an opportunity for Southwest Finland, too!

*Janne Virtanen*

*Acting Director  
Regional Promotion*

*Regional Council of  
Southwest Finland*

*Finland*



## Is Russian economy overheated?

By Sergei Guriev

The end of 2012 brought back a debate from early 2008. At that point, Russian economy was growing at 8 per cent per year, and the ministers of economy and of finance engage in the debate on whether Russian economy was overheated. This debate had very tangible policy implications – in particular, whether Russian government and Central Bank had to sterilize oil revenues and capital inflows or encourage spending (and raise its own spending).

The situation is different now – the capital inflows are gone, there is now a net capital outflow (4% GDP in 2011 and 3% GDP in 2012). Also, there is no debate about further increase in government spending – the government understands that it is already spending too much (the government budget is now balanced at \$110/barrel oil price – what a contrast with 2007's breakeven level of \$37/barrel!). However, there is now a new instrument. Unlike the pre-crisis years when the monetary policy was conducted through the currency exchange market, now the Central Bank has an array of interest rate tools that have a direct impact on money supply. Therefore the issue of overheating has immediate implications for the interest rates set by the Central Bank.

So, is Russian economy overheated? On the one hand, the growth is much slower than it used to be before the crisis. In 1998-2008, Russian economy grew at 7 per cent per annum. In 2009, Russian GDP fell by 8 per cent and in 2010-11 it grew at 4 per cent reaching pre-crisis levels at the end of 2011 – beginning of 2012. Now, the growth slowed down to 3.5% (the data for the year of 2012) or even lower 2-2.5% (in the second half of 2012). Does this mean that Russian economy is under the trend?

Judging by the fact that the Central Bank raised interest rates in September 2012 and kept them high despite the obvious signs of slowdown in the fourth quarter of 2012, the Central Bank believes that Russian economy is overheated. Why can this be the case? There are quite a few observations that are consistent with this view. Unemployment rate is at all-time low at 5.3% (below the levels reached in the summer of 2008 when the oil prices peaked at \$137/barrel). Inflation is above the announced target (6.6% in 2012 instead of 6%). Russians do not spend or invest the income that they generate in Russia – instead, there is a substantial net capital outflow.

How can one make sense of these two seeming contradictory views? There is a simple explanation – based on the fact that the investment climate in Russia is poor (and worse than it used to be before 2008). At the current level of investment climate, the potential growth rate is not 7 per cent but more like 2-3 per cent per year. Therefore 3 per cent may well be an overheating and the Central Bank may be right

prioritizing disinflation policies. Can Russia grow faster? President Putin set a target of 6 per cent per year and Prime Minister Medvedev announced 5 per cent per year. These targets are certainly possible – Russia's per capita GDP is still reasonably low to allow a fast catch-up growth. When Korea was at a similar level 15 years ago, its economy grew at 6 per cent per year. There is however an important difference: the quality of institutions in Korea – even 15 years ago – was much better than in Russia today. Therefore, if Russia reforms its bureaucracy and judiciary system, fights corruption, protects property rights and competition, it may well follow the same path. In this case 5-6 per cent per year will certainly be possible. If this does not happen, then the slower growth of 2-3 per cent may be the potential GDP growth.

What does this analysis imply for the monetary policy. The Central Bank should fight inflation – and at least make sure that inflation is within announced targets. In the meanwhile, faster growth can be achieved through the structural reforms (rather than macroeconomic policy). All these reforms – including drastic reform of business regulation and massive privatization – are included in Vladimir Putin's 2012 electoral promises. If all these promises (which have been now formalized in his Decrees and his government Action Plan) are fulfilled then the potential GDP growth will certain be different.

So far, there has been no substantial progress in improving Russian investment climate. Russia's positions in international rankings have not improved substantially. Most importantly, investors have voted with their feet. Despite balanced budget and low leverage in Russia (Russian sovereign debt is below 10 per cent of GDP) and huge fiscal problems and high leverage in Europe and the US, capital flows from Russia to the West. The opportunity to improve investment climate, reverse capital outflow and raise the long-term growth rate of Russian economy should not be missed in 2013.

Sergei Guriev

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## Nordic-Baltic financial zone needs a well-functioning banking union

By Pia-Noora Kauppi

The Nordic-Baltic financial zone is continuously becoming more and more integrated and has weathered the financial crisis well. The structural dynamism of the Nordic-Baltic area is unrivalled in Europe. It might well be the most competitive EU region in the coming years. For the Nordic-Baltic financial industry, development of a full-fledged banking union is a key issue. The Finnish financial industry supports single banking supervision and the Single European Rulebook but considers the joint liabilities possibly included in the union very problematic.

Last spring, the Commission presented its vision on deepening the Economic and Monetary Union. A central part in this was the establishment of a banking union. Main political decisions on the matter were made in the EU Council in June and December.

The Finnish financial industry has naturally been following these developments with great interest. We have presented five prerequisites that must be met so that the banking union can function well and promote stability of the euro area financial system. These prerequisites concern the setting up of a single rulebook, a uniform "toolkit" for crisis management, an independent supervisor with strong prerogatives, the harmonization of the financial health of banks and deposit guarantee schemes, as well as the accentuation of the crisis situation responsibilities of the shareholders, creditors and taxpayers of a bank's home country.

We certainly need more cooperation in the form of a banking union, but it has to be planned and executed right. In our opinion, the banking union requires a single rulebook and uniform tools for potential crises. "Banking union" typically refers to a structure that consists of supranational bank supervision, a common deposit guarantee scheme, and joint financing of crisis management measures. The latter can be complexes formed by national funds, or fully supranational arrangements. While single European banking supervision is justified, the union's possible joint liability elements are highly problematic for the Nordic-Baltic banking sector which – despite the challenges it has seen lately – has still largely remained well-capitalized with well-managed balance sheets.

Uniform rules are an essential prerequisite for a well-functioning banking union. Banking union should not compromise the integrity of the internal market, which is the most precious asset the EU has for the financial industry. Bank supervision in the union must be based on a single rulebook that applies to everyone. This is the only way a European bank supervisor can operate efficiently and even-handedly. A single rulebook also helps to guarantee a level playing field for all banks.

It is of utmost importance that the European banking supervisor will be fully independent from the monetary policy decision-making of the ECB. The ECB's monetary policy duties should be kept strictly separate from its supervisory duties. The same applies to the authority responsible for crisis management, when it is established.

In addition to the single rulebook, a single crisis management mechanism is needed for the recovery, restructuring or controlled shutdown of ailing banks. Such banks must be treated in the same way in all countries.

Crisis situations in particular require strong independence from the authorities: the large banks of large member states must be treated equal to the banks of small countries. It must be possible to shut down any ailing bank, if necessary. From the point of view of fair competition, the new supervisor should have the authority to supervise all banks operating in the EU area, not just euro area banks.

The most difficult issue in the whole banking union debate is the concept of joint liability. In addition to single banking supervision, there are plans to include elements of joint liability in the union. These include financing for crisis management and possibly a single deposit guarantee scheme. Such joint liabilities are always highly problematic, because they involve moral hazards. They are

particularly problematic at present as there are significant differences in the financial health of individual countries' banks and deposit guarantee schemes.

Before joint liability can be established, the banking sectors and deposit guarantee schemes of all countries should be set on the same line. We cannot behave as if we were starting from tabula rasa. The owners and home countries of the banks should be responsible in capitalizing their banking sector, taking also care of the funding of the deposit guarantee systems and resolution schemes. In many Member States, the banking system must undergo fundamental structural reforms before they can enter under the umbrella of joint liability.

Even if all banks and deposit guarantee schemes are set on the same line when the union is established, we must prepare for the possibility that, regardless of single banking supervision, an individual country or bank may seek to abuse joint liability elements for its own benefit. To decrease moral hazards, it is of primary importance that the liabilities of bank owners and creditors are explicitly specified in crisis management regulations, and that these regulations are also uniformly applied in all situations.

The union must also operate on the basis that if the total liabilities of a failing bank's owners and creditors are insufficient to cover the expenses of crisis management, they must primarily be paid from the deposit guarantee and crisis management funds of the bank's home country and, if necessary, with input from the country's taxpayers. Joint liabilities must only be considered as the very last resort.

Establishing a European banking union is a long-term project. The union must be prepared carefully, and its impact on banks and economies must be thoroughly assessed. It is therefore clear that the banking union is not a solution to the present crisis – its effects cannot be expected in the near future, perhaps not until the next decade.

When the Financial Services Action Plan was implemented during 1999–2004, the EU had a clear vision: to create the most competitive, integrated financial market in the world. There were naturally shortcomings such as reliance on a patchwork of national supervisors. It is important that these defects are now corrected. However, the post-crisis agenda is heavily based on the safety of financial markets, which sometimes leads to over-regulation. There should be nothing wrong with competitive markets that serve the real economy.

We need more crisis-resilient markets, and regulation should foster that. However, we should not become a museum in the world economy. This can only be avoided by balancing safety and efficiency.

The Nordic-Baltic financial institutions and industry associations are already working closely together. Yet, Nordic countries cannot pursue an efficiency-driven agenda by themselves without allies. In this respect we look to countries like the UK, Ireland and the Netherlands. We might not always agree, but in broad terms our interests often meet, and regardless of our differences, we should strive for a common voice.

Pia-Noora Kauppi

Managing Director

Federation of Finnish  
Financial Services

Finland



## Internal devaluation can work

By Leszek Balcerowicz and Aleksander Łaszek

In the euro-zone, as in other hard peg areas, nominal devaluation vis-à-vis other members is not possible. Therefore, in case of competitiveness and current account problems, the internal devaluation i.e. reducing the growth of wages and prices relative to that other countries. This has been widely known before the creation of the EMU. Nevertheless there has been recently a lot of heated debate on the difficulties and costs of internal devaluation and a lot of related advocacy that the most affected countries of the euro area should just abandon euro and devalue. The empirical part of this discussion usually focuses on the PIIGS (Portugal, Ireland, Italy, Greece and Spain), and especially on the most difficult case among them – that of Greece. Much less attention is being paid to the variation of performance in this group, e.g. the fact that Ireland and Portugal have been doing much better than Greece. Almost completely neglected is the experience of Bulgaria, Estonia, Latvia and Lithuania (the BELL) even though it sheds a lot of light on the contested issue of internal devaluation.

During the period 2003-2007 BELL countries experienced enormous inflow of foreign capital, exceeding 100% of their GDP which fuelled credit booms, asset bubbles, inflation and eroded competitiveness. Housing prices more than doubled during this period. The boom went bust in 2008, when the inflow of capital first slowed down and then reversed. The risk premia skyrocketed with governmental 10Y bond yields raising from less than 5% in 2007 to more than 7% in least affected Bulgaria and even above 14% in case of Latvia. Faced with such a dramatic situation the BELL governments have introduced without much delay tough stabilization programmes, reducing general government deficit, on average, by 4.5% GDP in 3 years, between 2009 and 2012 (the largest adjustment of 8% GDP was in Latvia, the smallest of less than 1% GDP in Estonia). It was achieved despite lower general government revenue (average decline of 1.5% GDP) due to significant reduction of expenditures of 6% GDP on average (ranging from 7.6% GDP in Latvia to 4.3% GDP in Estonia). On the other hand in case of PIIGS the expenditure reduction during the same period was twice smaller (3% GDP on average, ranging from 6% GDP in Ireland to 1% in Italy). Simultaneously general government revenues in PIIGS countries rose by about 2% GDP (it ranged from -0.5% GDP in Ireland to 5.6% in Greece). As one can see, fiscal consolidation in the BELL was largely expenditure-based while in PIIGS raising revenue played much more significant role.

An important reason for this radical approach in BELL has been the desire to preserve euro-based currency board at the unchanged parity, widely shared across the political spectrum and by the population. Therefore, the BELL opted for internal devaluation, i.e. the only way available also for the members of the EMU. Another reason for this tough approach was that they could not have counted on the massive support from the ECB or rather that they did not believe that any bail-out in itself could have solved their problems.

After the burst of credit bubble in 2009 the BELL suffered a deep recession with GDP falls ranging from -5% (Bulgaria) to nearly -18% (Latvia). However, already in 2010 growth resumed (with the exception of Latvia, which followed one year later), accelerating in 2011 when all BELL countries benefited from a strong recovery. According to the latest IMF

forecasts Bulgarian and Lithuanian GDP will exceed their precrisis, peak levels in 2014. Estonia will achieve the same result in 2015 and Latvia in 2016. This should be compared with PIIGS countries – IMF forecasts that, with exception of Ireland, in 2017 their GDP will still be lower than before the crisis. The initial drop in import and subsequent growth of export, both contributing to GDP growth, indicates rebalancing of the BELL economies. The current account in all 4 countries followed similar pattern, moving from deficits ranging between 25% GDP (Latvia) and 15% GDP (Lithuania) to surpluses and then remained close to zero. Those facts coupled with the data indicating 20%-30% declines in ULC in manufacturing, which can be taken as a proxy of the tradeable sector, show that internal devaluation has been introduced and that it has worked.

Also, the radical adjustment programme has brought down the yields on the BELL governments bond even below precrisis levels (in November BELL yields ranged from 3.22% in case of Bulgaria to 4.11% in case of Lithuania). This shows that proper policies in response to the crisis are capable of producing not only longer-term effects (e.g. growth of employment or of productivity) but also shorter-term confidence effects in the financial markets. The official bail-outs cannot substitute for the latter benefit, certainly not in a longer run.

The BELL countries tell the story of an enormous boom that went bust. Latvia experienced the biggest boom and as a consequence also the biggest bust. In Bulgaria the boom started later and from lower level of GDP thus eroding competitiveness of the country to a lesser extent, before bursting. The main point is that due to prompt and radical fiscal, consolidation and other structural reforms all BELL countries are on the growth path again and have quickly regained normal access to capital markets. That is in strong contrast to most PIIGS where policy of muddling through keeps them in stagnation or recession. The Irish policy response of frontloaded adjustment was similar to policies followed by BELL and currently Ireland is the best performing country among PIIGS. Therefore, Ireland should be moved from the PIIGS to the BELL group.

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## Academic capacity building on trade for development in Belarus and Russia – contribution of the UNCTAD Virtual Institute

By Vlasta Macku

In the past two decades, countries of the Commonwealth of Independent States, including those in the Baltic rim, underwent a significant economic transformation, moving from centrally planned to market systems, opening their economies, and joining international economic institutions, such as the World Trade Organization (WTO). During this period, the world became more globalized, offering these countries new trading opportunities, but also exposing them to increased competition in international markets.

Aiming to integrate into the world economy in a manner coherent with their economic development objectives, these countries are now faced with numerous challenges. One of these relates to the capacity of governments and society at large to leverage trade as an engine for development.

The development of trade-related capacities in a country depends on the quality of its tertiary educational system. University graduates well versed in international economic and legal issues will be better prepared to analyse their countries' economic potential, defend their trade interests in international negotiating fora, and design appropriate national policies, laws and regulations. Universities can also provide valuable research inputs into government policy decisions.

Recognizing this pivotal role, the United Nations Conference on Trade and Development (UNCTAD), a UN organization assisting developing and transition country governments to formulate economic policies supportive of sustainable development, created, in 2004, a programme for cooperation with academia, the UNCTAD Virtual Institute (Vi).

With support from donors like the governments of Finland, Spain, Japan, Norway, Canada and Germany, the Vi works with 79 academic institutions in 41 countries to enhance the capacity of its developing and transition country members to teach and research international economic and legal issues. The ultimate objective is to help them make their work useful for the formulation of national economic policies. As the needs and priorities of countries vary, so do the forms of Vi support to individual universities. In the Baltic rim, for example, Vi efforts were successfully deployed in Belarus and the Russian Federation (St. Petersburg).

The Belarus State Economic University (BSEU) joined the Vi in 2007. Its immediate priorities were to increase its international exposure, and strengthen the professional capacities of its staff. The medium-term objective was to develop a Master's programme in international economics and to foster the university's cooperation with the government.

In 2008, the St. Petersburg State University (SPSU) became a Vi member, followed by St. Petersburg State University of Economics and Finance in 2010, and the North-West Institute in 2012. SPSU had already been running an English-language Master's programme on the international trading system, but wished to further enhance it by adding up-to-date teaching materials, developing new courses, and offering its students international learning opportunities, a wish shared by the other two Russian universities. The need for qualified experts in this area further increased with the progress of WTO accession negotiations and Russia's WTO membership in 2012.

The Vi offered its Belarusian and Russian members tailored assistance in support of their objectives. It provided professional development for their staff by facilitating the participation of a

BSEU lecturer in UNCTAD's training on investment and granting a Vi fellowship to an SPSU colleague. Staff from both countries also participated in UNCTAD's courses on key international economic issues and in Vi online courses on international economic law, and on trade and poverty.

To support their teaching, all universities received bi-annual shipments of UNCTAD publications and Vi teaching materials for their libraries, and were provided access to the Vi online library of research reports, presentations and multimedia teaching resources. The Vi also assisted BSEU and SPSU in the adaptation of its teaching materials on regional integration, investment, and competitiveness, to the context of their countries, and provided advice on the design of the new BSEU Master's programme. Russian faculty and students benefitted from annual teaching programmes at Geneva-based international institutions through Vi study tours, and videoconference lectures on topical international trade and investment issues by UNCTAD experts.

The Vi also used its networking capacity to include BSEU in a capacity-building project led by its German member, the University of Applied Sciences (HTW) Berlin. As part of the project, BSEU received curricular advice and teaching materials used in HTW's Master's programme, and its staff were granted fellowships in Berlin. In 2009, SPSU was the only academic institution from a transition country selected for the WTO Chairs Programme which provides financial support for teaching, research and outreach activities.

Finally, the Vi assisted BSEU in strengthening links with national policymakers by facilitating its participation in the preparation of the UNCTAD Investment Policy Review for Belarus. Their involvement brought BSEU staff an invitation from their government to contribute to the revision of the Investment Code of Belarus and the evaluation of the country's investment climate.

With Vi and HTW support, BSEU launched its English-language Master's programme in International Economics and Trade Policy in November 2012. SPSU's Master's programme is currently at its 10th intake; the university is also frequently solicited by regional government authorities and the business sector for advice and training on WTO issues. Faced with the rapid evolution of the world economy, it is crucial for universities to keep abreast of the most recent developments and update their teaching and research on a continuous basis. The long-term partnership between the Vi and the universities in Belarus and Russia, based on mutual trust and commitment, provides a substantial contribution to this challenging endeavour.

Vlasta Macku

Chief

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United Nations Conference  
on Trade and Development



# The Council of the Baltic Sea States in the era of regional strategies, networks and projects

By Jan Lundin

The Council of the Baltic Sea States has been blessed with constant improvements in living standards and connectivity in the region ever since its inception 21 years ago by the then two sole EU Members in the region Germany and Denmark. Today, all Member States but three have chosen to join the EU. A third of the GDP of the European Union is produced here, and some 12 percent of the cargo traffic of the world is carried by the Baltic Sea. By most global comparisons, we are doing well.

The challenge for the organization is to adapt to the new circumstances so as to remain relevant. There are plenty of challenges left to address through regional cooperation; one is the remaining large gap in living standards between the "West" and the "East" of the region. Simultaneously, freedom of movement can certainly be improved further. Arguably, we have yet to regain the degree of regional interaction pervasive in our region 100 years ago, before two world wars set us back in a horrifying way.

The yearly CBSS Ministerials or Baltic Sea Summits make it clear to the world that there is a sense of family in the region, and that the countries concerned want to work together. The truly multilateral character of the CBSS enables all Member States to have a say, and to understand each other better when cooperation is pursued. This serves our neighbourhood well.

Another asset are the more than 20 regional cooperation networks of varying kinds associated with the Council. A one million euro large Project Support Facility (PSF) was launched last spring in support of project development endorsed/pursued by such networks. Amongst these are networks as old as the CBSS itself such as e.g. the Expert Group on Radiation and Nuclear Security. One of my personal favourites is the Monitoring Group on Cultural Heritage. The most recent addition is P3CN, a time limited network of civil servants working on public-private partnership (PPP) issues. Financial support for PPPs is available through the so-called Pilot Financial Initiative (PFI), a financing framework established at the Baltic Sea Stralsund Summit in May, providing a credit line to PPPs and "sustainable" SMEs in North West Russia.

The Task Force against Trafficking in Human Beings TF-THB is an excellent example of the CBSS becoming a more project oriented organisation, as instructed by the Riga Summit in 2008. The TF-THB staff at the CBSS Secretariat in Stockholm has produced a training and literature for consular staff in the region on how to handle trafficking victims. Similar work is pursued by the units on Sustainable Development /Baltic 21, and Children's issues (Children at Risk – CAR). The Units are all supported by stakeholder networks in the region.

New impetus to regional cooperation is occasionally given through high-level initiatives and generous financing focusing on specific areas. In recent years, the EU Strategy for the Baltic Sea Region (EU SBSR) stands out, being the

first macroregional strategy for the region, and a test case for the EU. The strategy has improved transparency in regional cooperation, and the CBSS is together with e.g. Helcom and the Northern Dimension one of several platforms on which EU SBSR cooperation can occur, with participation also by non-EU BSR countries. The CBSS Secretariat has central coordinating responsibilities in civil security cooperation on land, sustainable development and the modernization partnership for the South Eastern Baltic Area (SEBA), a recent cooperation effort focusing on Kaliningrad and surrounding countries/regions.

These and other areas simultaneously harbour a cooperation potential also within the framework of the recently enacted Russian Strategy for Socio-Economic Development of the North-West Federal District until 2020, and the Baltic Sea States Summit in Stralsund in May last year tasked the CBSS to explore this. In the environmental sphere, the Baltic Sea Action Summit (the next one to be organised in spring in CBSS format by the Russian Chair-in-Office in St. Petersburg) and NGOs such as the Baltic Sea 2020 are good examples.

Whenever transparency improves, the risk for duplication and overlap diminishes. One must also take care not to mistake similar activities within different constituencies as duplication. For instance, within the field of Maritime Policy, there are several regional groups active, but they organize varying stakeholders, and thus complement each other. The CBSS Expert Group on Maritime Policy gathers civil servants to discuss issues such as e.g. compliance with new strict emissions requirements for maritime traffic ("clean shipping"), and interacts with other stakeholders on this. It also prepared and executed the recent (5 Dec) CBSS Transport Ministerial in Moscow.

Communication is of course crucial to the CBSS. Anyone visiting [www.cbss.org](http://www.cbss.org) will now find that the homepage offers not only news and basic info, but also access to social media on the internet. It is today possible to interact with the Secretariat through some 70 internet platforms. For former employees of our organisation, an alumni network has been created. An electronic newsletter, *Balticness Light*, has replaced the printed *Balticness*. Feel free to be my friend on Facebook! <http://www.facebook.com/cbssdg>.

Jan Lundin

Director General

CBSS International  
Secretariat



## The Baltic Sea region and the Pan-European Institute

By Kari Liuhto

The Baltic Sea region (BSR) has been in the core of the research activity of the Pan-European Institute (the PEI), since the foundation of the institute in 1987. The PEI has produced numerous research reports related to the region. Recently, the institute has published reports concerning energy infrastructure and innovation activity in the BSR, which are freely downloadable at the following site. <http://www.utu.fi/en/units/tse/units/PEI/reports/Pages/2012.aspx>

In addition to academic research, the PEI has also conducted contract research on the Baltic Sea region, for instance, for the Prime Minister's Office of Finland, the European Parliament, and the European Commission. The latest report funded by the European Commission deals with the competitiveness of the maritime cluster in the Baltic Sea region. <http://www.utu.fi/fi/yksikot/tse/yksikot/PEI/tutkimus/Documents/SmartComp%20Research%20Report%201,%20December%202012.pdf>

At the moment, the Pan-European Institute actively participates in the building of the Baltic Sea databank, called Domus Baltica. <http://www.centrumbalticum.org/en> We wish that by the end of this year the databank has received its place among the leading BSR databanks. Should you wish that your report, article, or presentation related to the Baltic Sea region will be included in the databank, please send it to Ms. Helena Erkkilä ([Helena.Erkkila@centrumbalticum.org](mailto:Helena.Erkkila@centrumbalticum.org)).

At the end of October (24.10.2013), the Pan-European Institute together with the Centrum Balticum, Finland's national BSR think tank, organises for the first time national BSR Research Forum targeted to Finnish researchers interested in the region at the Forum Marinum. [www.forum-marinum.fi/en/](http://www.forum-marinum.fi/en/)

Prior to the BSR Research Forum, the Centrum Balticum organises national BSR Policy Forum dedicated to Russia due to Russia's presidency at the Council of Baltic Sea States. The BSR Policy Forum will be held in May (23-24.5.2013), and it will gather over 200 Finland's leading experts specialising in the BSR at the Turku School of Economics. The programme of the event can be found at the website of the Centrum Balticum. <http://www.centrumbalticum.org/en>

The Baltic Rim Economies (BRE) review is one of the flagships of the PEI. Since the beginning of the review in 2004, over 1000 experts have written an article related to the Baltic Sea region. In the future, some of the BRE writings will end in the new information service called newsWave, giving even more visibility to the ideas expressed in the BRE review. In addition to interesting columns dealing with the Baltic Sea region, we will produce a special issue on the Arctic region, which will be published in March.

The Pan-European Institute puts a lot of emphasis on the distribution of the Baltic Rim Economies (BRE) review. Currently, the review spreads into tens of thousands of readers in over 80 countries. We are extremely grateful that

the City of Turku, the Turku Chamber of Commerce and the Centrum Balticum continues collaboration in producing the BRE review, which probably is the world's largest virtual discussion forum on the Baltic Sea region affairs. We warmly welcome our two new strategic partners in the BRE collaboration, namely the Baltic Development Forum and the John Nurminen Foundation.

In the autumn, the Pan-European Institute continues producing the special courses related to the BSR, and moreover, the PEI arranges the Studia Generalia devoted to the Baltic Sea region. We also plan to organise some joint events with the Royal Society of Arts – Baltic Sea Region. <http://rsabalticsearegion.org/>

The University of Turku, the Regional Council of Southwest Finland, and the City of Turku are deeply committed to developing their Baltic Sea activities, and hence, I am convinced that Turku will strengthen its status as the Baltic Sea Hub of Finland. The status will be reinforced this year by the festivities of the 60-year-anniversary of the friendship city cooperation between Turku and St. Petersburg. And there is a lot more to come...

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*Finland*

## Energy efficiency in Russia – experiences from Kaliningrad region

By Hans Brask

According to the International Energy Agency (World Energy Outlook 2012), Russia is the world's fourth-largest energy user. According to various studies it has a technical and social potential to decrease its energy consumption by 45%. What a potential!

The Russian Government has taken legal initiatives in order to improve energy efficiency (EE) and energy savings (ES) on all levels of the society. With the Federal Law nr.261 (2009), the objective is to achieve 3% energy efficiency improvement each year and to reduce energy consumption by 15% in 5 years. How can this huge Russian potential be released – what needs to be done? The answer is of course very complex and a satisfactory answer cannot easily be made but maybe Kaliningrad could become a role model.

Baltic Development Forum has gained some insight into the issues through working closely with Russian partners on both municipal, regional (oblast) and district level (Northwest District of Russia) within the project Energy Efficiency and Renewable Energy Solutions in Kaliningrad Oblast (RENSOL [www.rensol.eu](http://www.rensol.eu)), which is a partly EU-financed project in Kaliningrad, within the Northern Dimension Environmental Partnership. The perspective is regional and de-central and valuable lessons have already been learned from this cooperation.

The dialogue is open, frank and lively. However, often it turns out to be mainly a dialogue between our Russian partners themselves. There seems to be a big need and demand for consulting, coordinating and discussing these matters between different authorities and other actors in Russia.

The first lesson learned is that there is a need to facilitate better vertical coordination procedures where all relevant local stakeholders are involved and/or consulted. Decision-makers on district and federal levels should also be invited as far as it is possible, not least to obtain political support and awareness of the initiatives.

It is very complex to ripe all the benefits from EE and ES in any society. It requires that all parts of society are mobilised. It includes public information, education and behavioural change of energy consumers, companies and households, and it demands a wider participatory approach. It cannot only be centrally planned.

The second and related lesson is that the Russian society seems to be much better equipped to introduce big-tech solutions, as opposed to small-tech solutions, in the energy sector. This is also reflected when EE and ES policies are made. "Big-tech" represents in this regard the big power producers close to the decision-makers at a federal level where the solutions tend to focus on new and efficient power plants and interconnections. In the case of Kaliningrad, the solution to the challenges of the oblast seems to be the construction of a new Baltic Nuclear Power Plant (BNPP).

There is a strong tradition that national politicians work closely in partnerships with universities and energy planners in finding large scale technological solutions without greater involvement of local authorities or the general public for that matter. According to this tradition, national energy planning is for centrally placed decision-makers, experts and engineers and not for economists, market analysts and local politicians.

Contrary to this tradition, small-tech solutions require the role of active consumers responding to price signal and incentives when investing in energy-efficient appliances, equipments and buildings. In the Kaliningrad case, it requires the involvement of the municipalities, representatives of flat-owners, tenants, businesses and NGOs. From working in Kaliningrad one gets the impression that municipalities as well as NGOs, local organisations, non-commercial partnerships, energy saving unions and other non-state initiatives have started to come out and that this new voice is gradually being more and more listened to.

Ideally big-tech and small-tech solutions should interact and be mutual supportive but often they seem to stand in the way of each other. The big-tech solutions often remove incentives to change behaviour because energy prices stay very low. An additional

element is that energy prices are often seen as part of the country's social policy.

What is a very positive experience from Kaliningrad is that the will among most actors to introduce EE and ES measures in order to improve the environment and prevent climate changes. The issue is taken seriously, and there is also an interest to invite neighbours from the Baltic Sea Region into a closer cooperation in the field. The regional authorities and the municipalities want to learn, not least from Nordic municipalities and cities. We have also witnessed that Kaliningrad's EU neighbours are willing to provide the information and knowledge they possess on best available practices and technologies.

The district administration in St. Petersburg pays a lot of attention on Kaliningrad region because this region and its municipalities have come relatively far in its energy planning and in various EE and ES initiatives. There is a real chance that Kaliningrad can become a role model in the Northwest district of Russia and an example for others to follow. It makes it even more interesting for foreign partners to come to Kaliningrad. This vision for Kaliningrad needs to be supported by all the EU countries in the Baltic Sea Region.

A further lesson that has been learned is the need to overcome the obstacles imposed on the entire EE and ES sector by the lack of clear market incentives and the challenges linked to the need to develop adequate financing mechanisms and tools. The lack of information on available financing solutions is one of the main barriers for EE investments in Russia. As part of the RENSOL project, we will identify existing global EE financing practices with a special focus on the Baltic Sea Region experience. The main goal is to propose "up-front payment sensitive EE financing solutions" aligned with the specific legal and economic characteristics of Kaliningrad Oblast and North-West Russia, but no magic formula does exist.

Energy efficiency ought to be a booming business sector in Russia. A lot of money can be saved and used for other economic and social purposes. In the Russian case, it is even more interesting because what is saved can be earned through higher energy export revenues. Russian EE initiatives should attract economic interest of companies and business partners on a global base, especially the neighbouring companies in the Baltic Sea Region with some of the most energy efficient countries and some of the best clean-tech industries in the world.

This leads to the final of lessons learned so far: The need to involve the private sector more in the EE and ES projects. Russian decision-makers on all levels should be more aware of the different energy solutions available, not least the solutions in the small-tech area. It can be a complex and sensitive matter to involve the private sector in projects in a country that is trying to reduce the level of corruption and mismanagement of public funds.

Still, the Russian society will benefit considerably from having access to the latest technologies, products and project skills developed in the private sector. Perhaps public-private partnerships do not work in Russia yet, but at least there are obvious opportunities to improve the public-private dialogue. It is possible our RENSOL project cooperation has shown in Kaliningrad.

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## FinlandCare – health from Finland

By Eero Toivainen

Well-known Russian pediatrician, Professor Leonid Roshal, executive director of Moscow Clinical and Research Institute of Emergency Children's Surgery and Trauma said in FinlandCare seminar held in Moscow November 22nd 2012 that Russia spends 3-4% of its GDP on health care. He compared this situation with that in Finland, where 8-9% of the GDP goes to health care. In absolute terms the state of Russia spends about 4 times less money on health care per person than Finland. This means the demand for medical treatments abroad will not disappear from Russia in the short term.

FinlandCare program promotes Russian health tourism to Finland and supports the internationalization of Finnish private healthcare and wellbeing service providers. The program brings together the most distinguished Finnish healthcare and wellbeing service providers to offer services of uppermost quality. It offers a vast variety of medical treatments and procedures that meets even the highest demands. With highly skilled doctors and medical staff and cutting-edge technology at our disposal, the variety and quality of care are truly world class.

Every year tens of thousands Russians travel abroad for medical treatments and the trend is expected to grow. According to Finpro survey, price and reputation of a clinic or a doctor are the main facts that determine the Russian customers' choice. The other very important factors are high quality of health services and the availability of specific treatment and healthcare technologies that are not available in Russia, and Russian-speaking staff. Russian customers' geographical preferences are not among the main decision-making factors.

However majority of medical tourists from the Russian Federation choose treatment in Israel, Germany is on the second place. Among the areas gaining popularity among Russian medical tourists during last years are countries such as Turkey, Singapore and France. Swiss doctors are traditionally in demand among Russian middle class representatives. Sociologists also noticed growing interest in Eastern European countries, as their governments and the private sector are actively promoting their opportunities in health tourism.

FinlandCare started on 2010, when the Ministry of Employment and the Economy (TEM) appointed a working group to prepare a strategy promoting the internationalisation and export of nursing and care services. In pursuing the objectives of the Ministry's strategic welfare project, preparatory work was aimed at the internationalisation of enterprises within the social and health care sector, while strengthening the prerequisites for exporting the related services.

Suggestions by the working group include continuing the strategic development of the welfare sector and welfare entrepreneurship, and promoting the sector's prerequisites for internationalisation. A proposal was made for the establishment of an internationalisation network, with a long-term focus on strengthening the prerequisites for the internationalisation of businesses and exports in the sector. It is proposed that, within the Ministry of Employment and the Economy's administrative sector, resources reserved for promoting internationalisation be focused on the welfare sector. In addition, the working group proposes the creation of an operating model for developing the prerequisites of the productisation and commercialisation of service concepts, research competence and expertise in the social and health care sector. As further work, it is suggested that an operating model be investigated for coordinating services

and cooperation between service providers, in connection with clients arriving for medical procedures from abroad. FinlandCare has partly influenced that new firms have been founded specifically to offer operator services as proposed by the working group.

The aim of FinlandCare, the internationalization network, is that the Russian client service and website makes it easier for Russians to find out more about the services and come over for the treatments. FinlandCare.ru website offers information about Finnish healthcare and wellbeing services and a Russian speaking healthcare professional connects the interested Russian customers and Finnish private service providers.

Over 20 Finnish private healthcare and wellbeing companies participates FinlandCare program. They are selling and marketing their services in Russia and developing their business in the Russian market. Treatments include for example in following specialties: cardiology, oncology, internal medicine, hematology, gastroenterology, rheumatology, pediatrics, psychiatry (incl. psychotherapy and psychological testing), ophthalmology, neurosurgery, surgery, heart surgery for children, oral and maxillofacial surgery, vascular surgery and orthopedics.

FinlandCare is a unique program uniting Finnish healthcare and wellness service providers under the common FinlandCare brand. FinlandCare has been developed as a joint effort between the Finnish government and leading Finnish healthcare and wellness service providers.

Our aim is to offer the best possible overall experience for anyone seeking healthcare or wellness services in Finland.

We promise our customers the following core benefits:

### *Top quality offering*

Finland excels in many areas of healthcare and wellness. Our aim is to offer our customers a wide selection of the very best services on our common platform. Regardless of our customers' needs, we can offer high quality, internationally competitive services.

### *Convenience*

Coming to Finland is in its simplicity and convenience an experience of its own. FinlandCare takes that experience even further, making sure that distractions and hassle are replaced by peace of mind and focus.

### *Safety, security and reliability*

Finland is one of the safest places on earth. The unique combination of a reliable and safe system with the sincerity and integrity of our professionals creates an overall experience, which is very hard to find anywhere else.

Eero Toivainen

Senior Consultant

Finpro, Life Sciences

Finland



## Gazprom on the antitrust ropes

By Alan Riley

The launch of the European Commission's investigation into Gazprom on September 4th is extremely serious for the company. The EU investigation is no small bureaucratic inquiry which can be swept under the carpet. This antitrust investigation is being undertaken by the Commission's DG Competition, the US Marine Corp of the European Union. As Microsoft knows to its cost they do not give up and they do not tend to lose cases. In fact DG Comp have not lost an abuse of dominance case before the EU's European Court of Justice since the competition rules came into force across the continent in January 1958.

DG Comp does not launch investigations unless it has already obtained a substantial amount of evidence. That evidence in all likelihood was picked up in its raids of Gazprom's premises in the Czech Republic and Germany in September 2011, and from complainants and its own extensive market monitoring operations. Furthermore, once an investigation is launched more complainants usually come into the Commission with more evidence further extending and expanding the inquiry.

Gazprom's leadership have a lot to worry about. The initial focus of the investigation is in respect of three key issues. Firstly, hindering the free flow of gas by dividing markets. This is most likely a reference to destination clauses restricting resale of gas. Any such 'no resale' clauses in gas supply contracts have the effect of splitting up the single market and are per se illegal. Secondly, the Commission baldly says that 'Gazprom may have prevented the diversification of the supply of gas'. This is in large part a reference to steps that may have been taken to deny third party suppliers of non-Gazprom controlled gas access to pipelines. It could also be a reference to attempts to frustrate the building of other gas facilities including LNG stations and alternative pipelines.

The great problem for Gazprom is that the abuse of dominant provision contained in Article 102 of the Treaty on the Functioning of the European Union is much broader in its effect than its US equivalent, the monopolization provision contained in Section 2 of the Sherman Act. Article 102 imposes a 'special responsibility' on dominant companies to respect competition. This special responsibility obligation becomes much more onerous when a business is super dominant. Given that in most of the CEE and Baltic States where the investigation is focused Gazprom has market shares of upward of 50% of total gas consumption, and in some states as high as 100%, these obligations can become extremely onerous.

Many CEE and Baltic States governments may question whether Gazprom has ever taken its antitrust 'special responsibility' seriously. The Lithuanian government for instance alleges a range of threats made against it due to its desire to fully liberalise its gas market. It is clearly observable at least, that Lithuania pays some of the highest gas prices in Europe, which may or may not be connected with the liberalizing decision of the government.

However, the most threatening element of the Commission's initial statement on the investigation to Gazprom is the third focus of the inquiry into the link between oil and gas prices. The linkage of gas prices to oil is vigorously defended by Russian energy officials. They fear that given the liquidity of modern gas markets due to the shale gas boom and the upsurge in LNG production any major break in the link will threaten Gazprom revenues.

Unfortunately it is difficult to justify that linkage in the modern European economy. In the 1960s when oil fired power stations were common across Europe it was not unreasonable to tie long term supply contracts for gas to the oil price. Due to the 1970s oil crises and environmental regulations over the following four decades Europe no longer uses oil to generate power. According to the IEA only 3% of power is generated from oil, whereas gas is overwhelming deployed for power generation.

The antitrust question here is whether it constitutes an abuse of dominance for a dominant firm to seek to impose a method of imposing price which has little relevance to the market in which it operates? Gazprom can legitimately argue that the law on exploitative pricing is limited. However, the Commission is also likely to take account of the lack of justification for the oil link combined with the fact that when prices were very low in the late 1990s and early 2000s, it sought to escape the link.

Undermining the oil price link would clearly undermine Gazprom's current business model. There may still be worse to follow. DG Comp in the CEE and Baltic States can only go back to 1st May 2004 to investigate anti-competitive behaviour under EU law, as that is the date of accession to the EU of those states. However, under the Europe Agreements all those states agreed from approximately 1994 onwards to enact EU equivalent antitrust provisions into their national law. One major additional danger for Gazprom is that the National Competition Authorities of the CEE and Baltic States may launch a combined parallel investigation into their operations from 1994-2004. This could significantly widen the scale of the investigation and the extent of the liability of the company.

There is also the prospect that private antitrust litigation firms also move into the CEE and Baltic States to encourage energy intensive users, energy companies and consumers to follow on Commission and national investigations with civil damages claims. Such claims would be able to run under EU and national law back as far as 1994 with interest from the date of damage.

The initial statement by Gazprom that it is registered outside the EU and is a 'strategic organization administered by the government' will cut no ice in Brussels. As long as Gazprom trades within the EU and sells gas there it is a subject of EU law.

Gazprom needs to move fast to recognize the real threat to its business from the DG Comp investigation. Its best approach would be to seek a private antitrust settlement. Gazprom could offer remedies to address the Commission's concerns; offer compensation and introduce reforms to its practices. Robust defence may be heroic, but it will ultimately prove futile. Ask Bill Gates.

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## Liberalisation of the Estonian gas market

By Taavi Veskimägi

In 2009, the European Parliament and the Council approved Directive 2009/73/EC with the main purpose to create efficient competition in the gas sector, to establish access to natural gas for all markets as well as increase the security of supply for consumers.

As one of the main measures in the development of gas markets, the requirement of ownership unbundling of the system operator was established. According to the preamble of the Directive, "without effective separation of networks from activities of production and supply (effective unbundling), there is a risk of discrimination not only in the operation of the network but also in the incentives for vertically integrated undertakings to invest adequately in their networks".

The Government of the Republic of Estonia supported the proposal of the European Commission on the implementation of ownership unbundling upon the development of the directive. It was indicated in the explanatory memorandum to the decision of the Government of the Republic of 01.11.2007 – "The Position of Estonia on the Third Energy Package of the European Union". However, it was considered necessary to apply for an exception, as the global gas sector seemed entirely different at that time. It seemed unpromising to develop a competition-based gas market in Estonia with just one gas supplier and a single supply chain.

Within the last three years, important developments have taken place in the gas market:

- Rapid development of the non-conventional gas sources (incl. the shale gas);
- New possibilities in liquefied gas transportation;
- Increased attractiveness of gas use due to its low CO<sub>2</sub> emission;
- Changes in gas pricing models;
- Significantly greater liquidity and dynamics in the global gas market;
- Problems with the development of gas fields in the Russian Federation (Stockman and Yamal developments) and the increasing demand in the Northwest Russia leading to additional capacities of Nord Stream;
- Implementation of BEMIP infrastructure projects.

Based on the aforementioned changes, the Government of the Republic of Estonia prescribed in its action programme 2011–2015 the ownership unbundling of the system operator in order to increase the security of supply and bring competition to Estonian gas market and therefore enable Estonian consumers to benefit from the spot and oil price linked arbitrage (currently, Gazprom's maximum price in Estonia about €40/MWh vs. the spot price based price in Tallinn about €30/MWh (Ramboll survey "Pre-Feasibility Study for an LNG Terminal in Tallinn)).

In order to prepare the action package necessary for the liberalisation of the gas market, the Government of the Republic, with the decision of a government meeting of 4 November 2010, obligated Elering AS to develop gas market related competence.

Based on the mandate, at the beginning of 2011 Elering ordered a report from Pöyry Management Consulting in purpose to analyze the possibilities and effects of fully

opening the Estonian natural gas market for competition and how this would affect Estonian gas consumers. The bottom line of the report was that in order to open the natural gas market, Estonia has to carry out a whole package of activities, including:

- Creating new natural gas supply chains by establishing a liquefied gas terminal and a Lithuania-Poland gas link;
- Linking the small gas market of Estonia to the larger common market of the Baltic States and Finland which operates under the same set of market rules;
- Introducing new market models which would enable to develop a competitive gas market and provide Estonian consumers with more advantageously priced natural gas.

The report also pointed out that the existing gas monopoly in Estonia would not be interested in such developments in the gas market, as the opening of the market and the entry of new gas suppliers into the market would impair their business. According to the report, the establishment of an independent system operator is the main precondition in terms of taking the next steps in the development of the gas market.

The Natural Gas Act Amendment Act prescribes an obligation to carry out ownership unbundling of the gas network by no later than 1 January 2015 (the amendments entered into force on 08.07.2012). AS Eesti Gaas is obligated to sell the natural gas transmission network to a company that would not, directly or indirectly, be related to the production or sale of natural gas.

Simultaneously with the unbundling of ownership of the transmission network, a number of other measures related to the development of a functional gas market have been taken up.

1. Establishing a regional gas market for the Baltic States and Finland, which shall involve the following elements
  - Consolidating markets – developing a joint harmonised market regime, including:
    - Introduction of the entry-exit model;
    - Equitable rates;
    - Free movement of gas from one state to another;
  - Establishing a regional gas exchange;
  - Establishing a gas release programme;
  - Ensuring third party access (TPA) to the infrastructure by legislation;
  - De facto opening of the market and informing consumers – it is planned to create a working group for the analysis of gas trade opportunities;
2. Establishing a cross-border infrastructure. (Ensures the precondition that in terms of security of supply the 100% N-1 criterion would be met. The state shall ensure the compliance with N-1=100% by 3

December 2014, currently compliance with the criterion is 59.2%)

- BalticConnector (Estonia-Finland gas pipe) – connects the markets and thereby supports competition and increases the security of supply;
- GIPL (Lithuania-Poland gas pipe) – enables limited access to the Polish LNG terminal and the liquid gas market of Western Europe.
- Development of a regional LNG terminal in Estonia.

### 3. Creation of opportunities to use gas

- 2012–2013 the “Energy Sector Development Plan” shall be updated in the process of which the potential for gas use in the Estonian energy portfolio shall be determined. The most important factors include the possibilities/need for balancing wind energy, increase in natural gas use in the district heating, potential for using natural gas instead of oil shale for power generation post 2023 when the lifetime of oil shale blocks expires.
- Bunkering of ships (SECA requirements as of 2015)
- Several measures that create the basis for the increase of gas use in sea and road transport (studies for promoting the biogas sector carried out within the framework of the SPIN-Project in the Baltic Sea Region regarding Estonia as well as the whole Baltic region, meetings in regard to the project).

- Elering has started to carry out a survey on the potential for using liquefied gas instead of shale oil in district heating power stations and the chemical industry.

None of the aforementioned decisions can be made unless there is certainty that the gas market shall be free and effective in terms of competition. The planning and carrying out of these measures in cooperation with Finland, Latvia and Lithuania shall be, as in the development of the regional electricity market and activation of the Nord Pool Spot electricity exchange in Estonia, the obligation of the gas system operator.

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*Elering is an independent electricity system operator in Estonia who owns and operates 110–330 kV power lines and crossborder connections. Elering manages the Estonian electricity system in real time, ensuring the functioning of the transmission network as well as the balance between production and consumption.*

## Russian geostrategy in the energy sphere in the Baltic Sea region

By Irina V. Zeleneva

At the beginning of the 21st century Russia more actively integrates into world market of energy resources, taking an active part in all command centres of world energy security. Global character of energy problems, its politicization and Russia's increasing role on the world energy arena raised energy issue to be one of the major elements, which Russian foreign politics at the moment lies upon.

Selected countries of the Baltic region, which are the object of study in this article, Latvia, Lithuania and Estonia, all have a similar geographical location and historical past. Baltic Sea countries share a common history, and there were conflicts in which common interests often prevailed despite disagreements. One of the best examples of such confrontational type was a Swedish company Nobel Industries. Nobel Industries (Company "Branobel" in Russia) played a decisive role in the development of the Baku oil fields, as well as in the history of the Russian oil industry. Before World War I the company continued to implement a large-scale commercial activities in Russia, despite the fact that at that time, Russia was the main military threat to Sweden. This and other facts are examples that the Baltic Sea has often served as a unifying rather than divisive factor in the region's history, how it should be today.

At the beginning of 21st century, the configuration of the global energy market has begun to change due to a wide variety of both political and economic reasons. The formation of a European common gas market in the world of fierce competition among world exporters for short-term and long-term contracts, the growth of energy consumption in China, Japan, India, the growth of trade in liquefied natural gas "shale revolution" are the most important.

Russian energy policy nowadays is based on the fact that Latvia, Lithuania, Estonia and partly Poland are mostly focused on importing energy resources. For a long time during the Soviet period, Russia had a monopoly on the supply of natural gas to the Baltic states, but at that time the RSFSR was a friendly republic. Now Russia is politically perceived as an external threat to the energy security of these countries. Global political risks and the changes in the international security sphere forced the region to look for ways to stabilize energy supplies.

Russian nuclear energy policy is built upon the challenges it is presented with. In 2009 the EU shut down the Ignalina Nuclear Power Plant in Lithuania because of the environmental risks. Lithuania, Latvia, Estonia and Poland made a decision to build the Visaginas NPP, using Japanese technology (although Poland in 2011 withdrew from the project). Poland and Estonia had since declared their intention to build their own nuclear power plant.

A so-called "third energy package", adopted in 2009, became a challenge and a threat to Russia's energy policy towards the countries of the European Union. The ideas of the "third energy package of the EU" are based on two principles. The first one, «Unbundling», states that the entity should not simultaneously produce energy resources and organize their delivery to the EU. The second principle, «TPA - third-party-access», claims that in addition to the provider

and consumer of gas (as two parties of the process), third parties also may use the infrastructure of transportation, pipelines. Without a doubt, these principles are a threat to the energy security of Russia, and, above all, "Gazprom", which, firstly, in most cases, provides transportation of gas to Europe, and, secondly, feels threatened by the emergence of new investment in infrastructure.

Russian "Gazprom" and other energy companies with state participation seek to maintain a stable relationship with the traditional consumers of Russian energy. But at this point and in this region they realize what is known as "geopolitical" approach, defending national interests, for economic prosperity largely depends on exports. Is it possible to change their ways and to go from a geopolitical approach to geostrategic (integrative) one for the region - that is the question. This will depend on whether the Baltic countries are willing to transform from "the last bastion of the West" to "the bridge between East and West." Signs of geostrategic (integrative) approach can be found in the energy policy of Russia in regards to Poland.

In our opinion and according to the geostrategical approach, for a successful energy policy in the region Russia has to balance its own interests with those of the Western European countries, consumers of Russian resources. Perhaps, it would be a wise long term strategy to accept the "third energy package" in the future. At the same time in Europe, not all Western experts agree with the necessity for urgent liberalization of the energy market. The root of their doubts lies in realizing that in this case, Russia may tighten the gas supplies, the alternative to which would be extremely difficult to find. And that will adversely affect the Baltics. The best option for Russia would be the soonest commissioning of the Baltic NPP and participation in the project "The Baltic Energy Ring," which would unite together all countries around the Baltic Sea.

Energy Policy of Russia in the Baltic Sea should be determined by the following three "I" notions: involvement, integration and innovation. We consider them to be not three different approaches, but three components of Russian geostrategy at present, including the energy dialogue between Russia and the EU.

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## Gas – the last frontier in the bilateral relations between the Baltic States and Russia

By Agnia Grigas

Gas is poised to be the main flashpoint in relations between the Baltic states and Moscow in 2013. The ongoing international arbitration between Vilnius and Gazprom as well as the EC's investigation into the latter's monopolistic practices demonstrates that the ongoing gas tensions have transcended the political realm. The 100 percent dependency on Russia's gas remains the last and most potent vestige of Soviet imperialism and now collides with Baltic and EU's efforts at diversification. The main agenda in the Baltic gas sector for 2013 and upcoming years is centred on 1) gas sector unbundling; 2) gas pricing negotiations and 3) diversification efforts via liquefied natural gas (LNG).

EU's 'unbundling' policies call for a separation of the ownership of transmission and distribution of gas from supply. Because Baltic gas dependence on Russia is made more acute by the fact that Russian gas is imported solely via Soviet-era Gazprom-owned pipelines, unbundling is central to any effort to mitigate Baltic gas infrastructural predicament. In the Baltic states, where Gazprom holds significant shares of Baltic gas companies Eesti Gaas (37 percent), Latvijas Gaze (34 percent), Lietuvos Dujos (37 percent), 'unbundling' means potentially splitting up these companies into two separate operations.

Lithuania had taken the lead in its pursuit of 'unbundling' with a law calling for the transmission networks of Lietuvos Dujos to be shifted to the Lithuanian state. Gazprom, Lietuvos Dujos, and even Vladimir Putin have tried to change Vilnius' stance towards unbundling by indirect threats of higher gas prices, international arbitration and media assaults. In mid-2012, Vilnius and Gazprom reached partial agreement at UNCITRAL, but Gazprom reserved its arbitration rights. The newly elected centre-left Lithuanian government is likely to move slower on unbundling and seek compromise with Gazprom, leaving Estonia to carry the torch in 2013. After initially seeking exemption, Tallinn also passed legislation in 2012 calling on Eesti Gaas to sell its pipeline unit by 2015. In contrast to its neighbours, Latvia continues to seek exemption from 'unbundling' until 2014. Riga favours less stringent policies that let Latvijas Gaze retain ownership of transmission operations by making them legally independent stock companies.

In recent years, the Baltic elite have complained that Russia uniquely discriminates against them in gas pricing in comparison to neighbouring states and EU members. In 2012, following an official complaint by Lithuania, the EC launched a formal antitrust investigation against Gazprom's activities and unfair pricing in the Baltics and Central Europe. The investigation could put pressure on Gazprom to alter its pricing model from oil-linked to hub-based prices – a change Gazprom has historically strongly resisted. However, if the investigation fails to deliver results, the Baltic states will be further disadvantaged as Europe moves towards hub-based prices because as 'gas islands', they will not have access to European gas markets. Meanwhile, Vilnius in 2012, filed a claim against Gazprom for \$1.9 billion in alleged overpayment for gas. Even though the new Lithuanian government is likely to seek a compromise agreement, lower gas prices are unlikely for any of the Baltic states without a stronger negotiation position which can only be achieved by diversification of gas sources or links with European gas markets.

To-date the Baltic states have made little progress towards gas diversification other than supporting EC's Baltic Energy Market Interconnection Plan (BEMIP), which includes a number of gas projects such as a land-based LNG terminal, a floating LNG terminal, 'LitPol Link' gas pipeline with Poland, and LNG storage in Lithuania among others. However, none of these projects have moved past the planning to the execution stage due to costs, institutional weakness, and vested interests in the gas sector. The LNG terminal has been delayed because of disagreement of participating states over its location. Warsaw has dragged its feet on the 'LitPol Link' but the appointment of an ethnic Pole as the Lithuanian Minister of Energy is hoped to help the project.

Despite these hindrances, LNG has gained traction in all three states resulting in competing plans: a floating low-cost terminal in Lithuania and a land-based terminal to meet needs of the whole region in one of the Baltic states. In 2012 the Lithuanian parliament approved plans for the floating terminal, but it is unlikely to be implemented by the deadline of 2014 with the new government still to take a position on the project. Latvia and Estonia have emerged as the most likely contenders for a land-based terminal, and an independent study led by the EC seemingly concluded that Estonia would be the best location for a regional terminal providing Finland joined the project. The completion of such a floating or land-based terminal would significantly alter the region's gas security, especially if the terminal remains in the ownership of the state or Western investors. The possibility of having alternative sources of gas could strengthen the Baltic bargaining position vis-à-vis Gazprom regarding gas prices and increase gas security.

While 2013 is unlikely to bring diversification of gas for the Baltic states, progress with 'unbundling' and a reassessment of gas pricing is in the cards, which will certainly raise tensions with Moscow. The tensions are likely to spill over into domestic politics since relations with Russia remain highly divisive. Still, Estonia with its centre-right is most likely to keep a steady course on diversification, while inconsistency is likely both from Latvia's centre-right government which is under constant pressure from powerful opposition and the new Lithuanian government which will reassess and challenge the energy diversification projects of the previous government.

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## A game of power – the Baltic States and energy security

By Reinis Āboltiņš

The Baltic States face a number of challenges for their energy sector with energy security as the overall umbrella for the debate. Despite the fact that Estonia, Latvia and Lithuania have different energy portfolios with their up and down-sides, energy security is going to remain the overall headline issue for the three countries over the coming ten years at least.

In the 21st century energy security has more to do with laws, regulations, turbines and wires than with armed forces protecting cables and pipelines although the latter option cannot be entirely dismissed as unimportant. There are a number of issues that can definitely be associated with energy security and they are all relevant for the Baltic States. Four issues are of a very tangible character – energy efficiency, generating capacity, share of renewables in energy production, and transmission system including regional interconnections. Policy and legislative framework is the fifth issue and in a way both reflects and sets the mode of thinking about energy security.

Availability of energy is a key factor that keeps any modern economy running. If resources are scarce the there is need to spare resources and it can be done through consuming energy efficiently. Each of the Baltic states separately and all together have enormous potential for improving energy efficiency in public and private sector, in state institutions, households and businesses, every day and industrial processes. With average household annual heat consumption of over 200 kWh per m<sup>2</sup> this sector alone could spare a wealth of energy every year if consumption would be cut to half. The recently adopted EU energy efficiency directive will hopefully become only an extra factor motivating Latvians along with Lithuanians and Estonians to invest in energy efficiency.

One can always think of increasing power production capacity to tackle existing or growing demand. After the closure of Ignalina NPP Lithuania is struggling with a growing share of imported electricity. Latvia is trying to solve its problems by installing modern gas-fired power plants consuming 100% Russian gas. Both Lithuania and Latvia face the choice between deploying generating capacities of large or small scale and this is directly linked to going towards spending more on imported gas as opposed to own sources while Estonia is comfortably sitting on its domestic oil shale and thinking of how any existing or future emission trading system might influence its power production.

Another way of thinking of energy security is through an increase in use of domestic renewable resources in power generation. International Energy Agency and the European Commission urge states to grow the share of renewable resources in electricity production thus aiming both at cutting the overall European GHG emissions and improving energy security through a greener and distributed energy production. The Baltic States have a good potential for using biomass with other renewables – biogas, wind, hydro and other –

adding to the portfolio depending on specific conditions in particular geographic area.

No wires, no power – it is a simple fact of life. Therefore maintaining and renewing power transmission systems will always remain an essential part of energy security. The Baltic States do not experience particular problems with power transmission between themselves; however, they still effectively represent an energy island in the EU context: there are few power lines and also gas pipelines linking them with other EU countries, but current infrastructure is far from satisfactory. EU-backed Baltic Electricity Market Interconnection Plan will be part of the solution with making the Baltic States connected with Scandinavian countries and Poland. Intra-regional interconnections need to be strengthened to tackle bottlenecks and avail enough capacity to ensure effective participation in Nord Pool electricity market that all three countries will be part of very soon. Ability to accommodate renewable power sources is essential to this end. Domestic networks await investment in power lines and transformers to ensure security of supply and quality of electricity with the latter factor being important for effective and synchronous operation within the high-voltage transmission system across Europe.

Last, but not least, the beginnings of energy security stem from the way we think about it, the way we think about power. In this context it is important to see the ambivalence of the notion of power and to be able to think about power as electricity as well as power as the ability to influence the way things go. The policy and legislative framework leading towards a greater energy security has to stem from such an approach. The technological and technical solutions should go hand in hand with a clear and long-term vision of how various elements of the energy system interact to provide the best result in terms of decreasing technical, economic and political vulnerability of the Baltic States together and each one separately.

Estonia and Lithuania have their long-term energy strategies adopted several years ago and Latvia is on its way to elaborating and adopting a new energy strategy that would set targets for 2030. All of the above issues need to be covered through a complex and integrated approach; this is the only way to win the game of power.

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## Gas and oil reserves in Russian Arctic seas remain out of reach to all but two state-run giants

By Mikhail Krutikhin

It was a pathetic effort. 'Liberals' in the cabinet of Dmitry Medvedev, led by Deputy Prime Minister Arkady Dvorkovich, announced they would make a vital decision by the end of 2012 on the way Russia's continental shelf could be developed. They didn't.

The idea was to make a loophole in the draconian mineral legislation initiated by Vladimir Putin in 2008. The current laws on subsoil and on foreign investment allow offshore projects to go ahead only if they are at least 50% controlled by the Russian state; and the license holder must have at least five years of experience in operations on the Russian continental shelf. It leaves only Gazprom and Rosneft on the list of eligible players. The two giants are obtaining offshore licenses without any tenders or auctions.

To make the situation even worse for international companies, Gazprom is already 50% owned by the state and therefore cannot offer any real partnership rights (shares in posted reserves or production volumes) to possible companions. Rosneft, about 75% owned by the state, can offer just 33.3%, and has signed a few such agreements with ExxonMobil, Eni and Statoil. The foreign companies have agreed to assume 100% of geological risks and financing at the exploration stage.

The model impedes the development of Russia's Arctic reserves of course, and Putin instructed the government last summer to find a way to accelerate the work.

The Ministry of Natural Resources suggested a solution: a more lenient approach in a draft program for developing oil and gas reserves on the continental shelf. The draft document, if the cabinet adopted it, could allow exploration companies to get access to offshore blocks and sell the geophysical and geological data to potential developers. It could also permit private companies to acquire the blocks that Rosneft and Gazprom are unwilling to explore and develop (and pay an extra tax for this privilege). And it could allow private businesses to form consortia with the state-controlled duo for obtaining licenses.

The proposals did not go so far as trying to alter the discriminatory laws of 2008, but the liberal attitude of cabinet ministers has provoked an angry reaction of the monopolies, even though the authors of the draft admitted it would take at least three years before the amended rules become effective.

Rosneft President Igor Sechin and Gazprom Chairman Alexey Miller sent a complaint to the president and prime minister in September saying that the government was not acting quickly enough to issue them the remaining offshore licenses—and Putin angrily ordered Medvedev to heed the wishes of the state-run companies. Rosnedra, the governmental agency that issues the licenses, made a weak attempt to argue that Rosneft was not prepared to perform the necessary volume of exploration and Gazprom had not submitted any specific applications for licenses, but it made no effect.

In late November Rosneft refused to endorse the governmental draft of the program for developing the continental shelf and insisted that a liberal approach to

licensing would affect the company's financial status and the size of its future revenues to the state coffers.

Cabinet ministers, other relevant government officials and representatives of oil and gas companies convened several times before the end of 2012 but could not come to terms. It appears to be a blind alley. Too much depends on the will of the Russian president, and Putin keeps sending mixed signals to his subordinates. He criticizes the government for failing to accelerate the work on the Arctic shelf but then bashes the same government for delays in issuing all licenses to the two monopolies.

The proposals of the 'liberals' are unlikely to get implemented any time soon. Whatever government theoreticians say about the need to continue privatization and encourage foreign investments, the trend definitely points toward further monopolization of the energy industry and expanding the footprint of the two giants. It does not bode well for the industry and for the Russian economy as a whole because Rosneft may follow in the steps of Gazprom and initiate politicized, costly, and often redundant, projects on presidential orders. The exaggerated budgets of 'friendly' contractors, kickbacks and other losses would be covered by the federal budget (aka taxpayers). For private businesses and foreign companies, the only opportunity is becoming service providers or technology and equipment suppliers to Gazprom and Rosneft, if they want to work in the Russian Arctic seas at all.

The national leadership is evidently convinced that the current prices of oil will remain high enough to continue this practice, and the domestic price of gas can be raised annually to compensate Gazprom's losses from stagnating export.

As to the Arctic offshore projects, most of them are either non-commercial or doomed to remain on paper. Here is one, cynical, explanation for the procrastination. The price tag on such ventures as Shtokman is so high that it leaves no room for an extra budget of making government officials and their cronies in the contractor business happier.

The payback on technically cumbersome Arctic oil and gas development in this country can be reached not sooner than 25 or 30 years after the onset of exploration, and the timeframe is unacceptable to those Russian officials who are accustomed to making a quick profit immediately and disregarding long-term strategic projects.

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## Nord Stream pipeline – an energy dialogue or deadlock?

By Maria L. Lagutina

Late 2012 was seen as a landmark by the Russian energy company Gazprom, which has carried out one of its grand projects – the Nord Stream pipeline. Its second branch-line, which links Russia and Germany via the bottom of the Baltic Sea, went into exploitation. In November 2011 gas transport to Europe started out within a first branch-line. According to experts' estimates, up to 55 blnm<sup>3</sup> of natural gas can be delivered annually for 50 years after completion of the second branch-line. Currently, Gazprom management team is actively viewing an opportunity of making a sideline to the Kaliningrad region. The board of directors is also negotiating with the UK over its alignment to Nord Stream. However, since 2011 euphoria regarding recent success has been marred by the EU "belligerent actions" in respect of Gazprom's activity in the European market.

Back in 2005, Nord Stream venture was designed by its founders as a new prospective constituent in the Russia-EU energy partnership. The principal idea of Nord Stream venture lays with providing the parties with energy security and building up sustainable strategic partnership, known as the Energy Dialogue, which began in 2000. At that time, the goal of Nord Stream was:

- to deliver gas directly from Russia to Europe, bypassing the territories of the transit countries for the first time in history;
- to supply European consumers with gas as much as reliably for years to come;
- to make for development of Common European energy area.

At that moment, it was quite obvious that both Russia and the EU needed stable gas supply and independence of economic issues from political ones. Energy "interdependence" of Russia and the EU was also evident: the former needed a new market for its gas, and the latter was interested in uninterrupted gas supplies. Thus, energy security became a common concern for both Russia and the EU. Implementation of Nord Stream venture was to diminish dependence of energy supplies to European consumers from transport related risks through states with unstable political regimes (the Ukraine, Belarus, etc.) and strengthen Gazprom's positions in the EU. In other words, development of Nord Stream venture was to herald a new stage of Russian-European energy cooperation. Nevertheless, unfortunately, by the early 2013 the result has been the opposite. Since 2009 Russia's gas market share has been shrinking in the EU. Nowadays Russia is waging a full-scale war with Europe instead of transit issues with its neighbours in the recent past.

Throughout all stages of discussing Nord Stream venture, its start-up and up to nowadays the project has been seriously opposed by several EU members (e.g. Poland, Estonia, Latvia, Lithuania, etc.). Their stance can be boiled down to the following points:

- Nord Stream is an unreasonably expensive venture;
- Construction of the gas pipeline has been doing unrecoverable harm to the environment of the Baltic region;

- There is a high risk of Europe's dependence on Russian gas in the future;
- Politisation of Nord Stream – Russia will take advantage of this venture as a tool of political pressure on Europeans.

The latter argument sounded in rhetoric of opponents of Nord Stream particular thorny. These discrepancies resulted in the crisis of the Energy Dialogue between Russia and the EU. If to sum up the outcomes of this initiative, one argument is clear: no substantial progress has been achieved in evolution of the Energy dialogue for the 13 years. There has been neither a successful project, nor an actualized initiative. The Energy dialogue between Russia and the EU failed. The main reason for that setback – Russia and the EU are engaged in their own energy dialogues on different languages. Even a notion the "energy security" is construed by both parties in different ways. For the majority of the EU member states the "energy security" implies energy independence, first and foremost, from Russia, whereas for the latter the "energy security" stands for independence from unstable transit countries.

Under these circumstances, unfortunately, hopes for Nord Stream venture appear to be not so magnificent, as it was back in 2005. Having been devised as a platform for effective multilateral cooperation between Russia and the EU, as a new milestone, a breakthrough in Russian-European energy relations, currently Nord Stream is operating exclusively on a bilateral basis with the separate European countries. Apart from that, Nord Stream–2013 is operating in a completely different environment from what it was in 2005. In particular, since 2009 the so-called "shale revolution" has been the reason for decrease of Russia's gas market share in the EU, as tremendous shale gas fields have been discovered in many regions. Qatari cheaper liquefied natural gas (LNG) is also regarded by the Europeans as an alternative for Russian resource.

All things considered, having started a struggle over increase of Gazprom's share in the European market, Russia achieved the opposite outcome. Moscow had put an end to gas warfare with neighbouring transit states, but turned out to be bogged down in a standoff with European consumers. The energy dialogue between Russia and the EU has reached a dead-lock.

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## Interpretations of energy security in the Baltic Sea region

By Tomas Malmlöf

Energy cooperation is a prioritized issue on the common agenda for all countries surrounding the Baltic Sea. Yet – with some notable exceptions – in spite of the geographic proximity around a shared inland sea, high-level engagement combined with ambitious political intentions, it has been difficult to reach a consensus on energy issues, let alone build a comprehensive regional energy infrastructure and institutional framework. Energy policies are national by default, and different economies as well as different use of and access to energy imply that the Baltic Sea rim states do not necessarily share the same energy policy objectives. A central watershed preventing deeper regional energy integration is the prevailing diverging perceptions of energy security.

In Russia, energy security is about reliable supply to comply with domestic needs – especially electricity – but also about demand from abroad for Russian oil, coal and gas. Energy is Russia's only competitive commodity of importance, and export generates significant state revenues and also serves as some kind of pay-back assurance for earlier and continuing investments in Russian oil and gas pipeline systems. Besides being an important trade policy instrument, the Russian energy strategy until 2030 also underlines its significance for Russian foreign policy. Not the least during Mr Vladimir Putin's two earlier presidential terms, it was obvious that, to a large extent, Russian energy exports replaced or supplemented other Russian instruments of influence or power projection on the regional scene.

As for the other rim countries – all members of the European Union – a common denominator is the EU approach to energy security, focusing on security of supply, competitiveness and climate change. This part of the Baltic Sea region might be further divided into two sub-regions, with a major fault line between Denmark, Sweden, Finland and Germany on one side and Estonia, Latvia, Lithuania and Poland on the other.

Countries in the western sub-region usually enjoy high energy efficiency, comparatively well-developed energy markets and diversified sources of energy and energy providers. Focus is on competitiveness and climate change. Market mechanisms and emission targets are perceived as the main instruments to take on most energy security issues. Norway also belongs here due to the extensive Nordic energy cooperation, of which the common electricity market is one of the more notable examples. In its unique twin role as a major oil and gas producer and as a strong global advocate of climate change mitigation, Norway also shares the same understandings and perceptions of energy security as the adjacent older EU member states in the Baltic Sea region.

In the eastern sub-region, Estonian, Latvian and Lithuanian views on energy security are highly coloured by the asymmetric Russo-Baltic energy interdependence and the three countries' sometimes very complicated political relationship with Russia. Much less dependent on Russian energy carriers than the other two states, the Estonian approach has yet tilted towards a pan-European perspective, advocating less dependence on Russian energy carriers among all EU member states. At the other end of the scale, in post-Ignalinian Lithuania, leading political circles opposing

Russian influence interpret energy independence from Russia as a matter of long-term state survival – no matter the costs. Poland is not as exposed to supply shocks as the Baltic states, as it has large reserves of hard coal and lignite. It buys most of its oil and gas from Russia, which has a proven track-record as a reliable supplier. Nonetheless, Polish energy security is still communicated in terms of 'geopolitical vulnerability', and Poland's energy agenda is coloured by profound distrust of Russia. Poland is also one of the main architects behind EU energy policies related to security of supply. Thus, energy security in the Baltic Sea region encompasses several challenges related to supply and demand as well as environmental impact and market efficiency. Different understandings of the intrinsic urgency of these challenges guide the nine countries towards different policies and strategic initiatives. Nuclear energy is an illustrative example: Germany plans to close its remaining nuclear power plants in 2022 for environmental reasons, while Lithuania plans to build the Visaginas plant for reasons of national security. In Finland a fifth reactor is under construction and a third plant is planned in order to improve self-sufficiency of electricity and prevent Finnish emission of greenhouse gases from rising. In the Kaliningrad region Russia is building the Baltic nuclear power plant specifically for export of electricity to surrounding countries. Polish nuclear plans are motivated by difficulties to live up to EU plans to limit emissions from coal generators without becoming more dependent on Russian gas.

It is probably a long way to go before we will see a comprehensive and coordinated energy strategy covering all parts of the Baltic Sea region. Energy policies will remain national, because this is what the main national actors want. However, as long as energy policies remain securitized in certain countries instead of being transferred from the national security agenda to 'normal' politics, in some cases cooperation will remain excessively constrained.

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*Note: The views expressed in this article are the personal opinions of Tomas Malmlöf. They may not reflect the views of the Swedish Defence Research Agency nor Swedish Government policy.*

## Russian electricity market reform – deregulation or re-regulation?

By Satu Viljainen, Olga Gore and Mari Makkonen

Russia has been reforming its electricity supply sector for ten years. The reform has been perhaps the most ambitious reform in the world because of the enormous size of the market, both geographically and in terms of electricity usage. The electricity industry reform is also one of the largest and most complex restructuring efforts of the post-Soviet era.

The electricity industry reform has meant vertical and horizontal unbundling of the former state-owned monopoly company RAO UES, privatization of generation assets (excluding nuclear and hydro power), and opening of the electricity generation sector to competition. However, the Russian electricity market is still characterized by horizontal integration of electricity generating companies as well as vertical integration of electricity generating companies and fuel companies.

Russia started restructuring its power sector with a very small electricity generation reserve. The lack of investments in electricity generation over the past couple of decades had led into deficits in some regions, and there was a severe need to upgrade the generation fleet. Attracting private investment was one of the primary goals of the electricity market reform.

Deregulation of the electricity market changed the flow patterns and revealed structural bottlenecks in the electricity transmission networks in Russia. For instance, the congested network between the capacity surplus in Siberia and the deficit in the European part of Russia has meant that full use is not made of the electricity of the power plants in Siberia. In other words, some of the cheap hydro power is currently "locked" in Siberia.

To cover the demand for electricity, so called base load and peak load power plants are needed. In Russia, nuclear power plants are always base load plants, and the hydro power plants are mostly "run of river" base load plants, operating passively and generating electricity in accordance with river flow. The base load nuclear and hydro plants are not run against the market price; instead they accept whatever price is formed in the market. Nuclear and hydro power plants together compose one third of total generation in Russia. Combined heat and power plants (CHPs) constitute another third of total generation. During the heating season, CHP plants operate as base load power plants responding to the need for heat. The thermal power plants that produce only electricity constitute the remaining third of total generation in Russia. Only these power plants are run against the market price.

The Russian electricity market consists of the electric energy market and the capacity market. Electricity generators receive payments for the electricity they produce and for being available to produce. The capacity payments obtained on the basis of availability constitute a large share of generators' revenues. New generation investments are mainly incentivized through capacity payments. The government has adopted a strong role in promoting new investments in the electricity generation sector by signing contracts with generators and guaranteeing returns on investments for 10–20 years ahead.

At the start of 2011, electricity end-users' in the Russian market have experienced price increases of 30–40%. Further pressure on the end-users' electricity prices are expected as the most intense period of the generators' investment programs is reached in 2016–2020.

A fully liberalized electricity market in Russia was to be achieved by 2011 (excluding the household sector, which will remain regulated at least until 2014). At present, new investment has been attracted but competition in the market is poor. For instance, the agreements between the generators' and the government, to some extent, close the market from new entrants. This conflicts with the idea of free competition, which assumes easy market entrance with equal conditions for all market actors.

When assessing the state of the Russian electricity market, three characteristics stand out: 1) the heavily congested electricity transmission network leads to deviations from the market-based merit order of generation; 2) the concentrated ownership structure of electricity generation assets does not support competition; and 3) the need to attract extensive new investments in electricity generation has led to strong government involvement in the sector. Thus far, price increases have been allowed but with some reluctance and hesitation.

In the nearest future, the pressure to increase electricity prices will grow as extensive new investments in electricity generation start to materialize. This will be the real test for the Russian electricity market liberalization—are the markets allowed to work freely without intense price regulation? The answer to this question will eventually determine whether the Russian electricity market reform should be addressed as deregulation or re-regulation.

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# The Baltic Sea ports – resonance of trends in the container shipping

By Eero Vanaale

The present short article aims to provide a very brief overview of main trends taking place in global container shipping and assess impact that may have for the ports in the Baltic Sea region and the main argument is placed on the impact of cascading and size increase in regional trades.

## General industry dynamics

Since early 1980-s global seaborne trade grew on average at around 3% per annum exceeding 8.2 billion tonnes or 18% of the total in 2011.

Historically, the container shipping industry was driven by the need to operate the biggest ships in each trade in order to provide the scale and realise the lowest slot costs. Accompanied by technological advances and booming trade of the first decade, the orderbooks for new container ships have been open wide. Currently post-panamax container ships represent over 80% of the sector's orderbook and over two thirds of that are ships of over 10,000 teu capacity. Virtually all major carriers have vessels of 12-18 thousand teu already in service or on order.

However, large orders of new fleet created substantial oversupply on the global market. After recovering of the crisis' shock in 2010, the leading carriers have been engaged in a true battle for market share for most of 2011. This battle, accompanied by slow and uncertain world economy, devastated freight rates and pushed the industry into "the red" for a second time in history despite a decent growth in trade of just below 7% globally.

In 2012, all carriers engaged in a series of rate increases aiming to offset the collapse of the past year and bring the industry back into profit. A task extremely challenging in the conditions of slow or no trade growth and substantial fleet oversupply. It is important to note that the sector average EBITDA for container terminal operators is historically strong and has shown strong resilience in recent years, while the carriers face unprecedented volatility in earnings and were largely "in red" in 2009 and 2011. 2012 provided mixed messages with loss-making quarters followed by very strong results in the next period.

## Increasing vessel size

New, larger vessels come into service replacing the existing fleets. These ULCV's<sup>1</sup> need to be deployed effectively creating what is known as cascading: vessels of over 10,000 teu capacity replace those of 6.5-8 thousand teu, which in turn replace those of 4-5 thousand teu, which themselves come into service on markets previously served by ships of 2-4 thousand teu capacity.

Importantly, the ordering of new fleet is effectively in batches of ten, thus suggesting unchanged round voyage times, speeds and time spent at ports. Or in other words, carriers expect the port operators to increase their handling efficiency and make necessary upgrades by default.

The Baltic region is no exception and the average vessel size is clearly increasing here. Albeit draft limitations and foremost the ice-class requirements are the main obstacles for further growth in size of ships that can serve the market. The mild winter of 2011-2012 however, allowed non-ice class ships (on Baltic trades visibly larger than classed ones) to service the northern ports such as St. Petersburg and

Rauma in late November. Thus, the terminal operators must be ready to accommodate such calls quickly and efficiently.

For the purposes of the current argument May of 2011 and July 2012 were randomly picked up to analyse the change in the average container vessel size. Of the three ports selected, Gdansk saw the sharpest increase, due to its deep-sea service with vessels growing over 37% (in gross tonnage equivalent) on average. But also other ports such as Rauma and St Petersburg where the average size increased by 21% and 15% respectively on average.

## Baltic container market

Historically, Eastern Europe produced the highest average growth rate globally at 20% CAGR in 2000-2011, outpacing other emerging container markets such as Africa or Mid-East. However it is also the smallest global market by throughput, which makes it extremely sensitive to any fluctuations in trade: as was clearly demonstrated by extremely volatile V-shaped growth dynamics in 2009-2010.

Baltic region experienced strong recovery in 2010 followed by almost exceptional growth in 2011, braking previous throughput records in almost all ports from Gdansk all the way up to Rauma. As of the first half of this year, smaller ports continue the growth rally, but not the larger ones such as St Petersburg or HaminaKotka for the notable exception of Gdansk which seems to be on the way to brake 1m teu level in 2012.

## Russia's market influence

Analysing container market in the Baltic Sea is not complete without mentioning Russia. St Petersburg is Russia's as well as the Baltic's largest container port. In 2011 it handled 2.36 million teu, which is effectively 51% of all Russian ports total throughput<sup>2</sup> and roughly about 30% of the Baltic container market.

Ports of Finland, Estonia, Latvia and Lithuania compete with St Petersburg and now also Ust-Luga for Russian container transit. In addition, Gdansk competes with Hamburg-Le Havre range ports for transhipment volumes. In short, Russia plays very important part in the development of the Baltic container trade. It provides the main critical volume and size for the region and to a large extend defines trends in Baltic container shipping.

Recently Russia was accepted as a full member of WTO. This is certainly expected to facilitate the trade with this large economy. However from the shipping viewpoint, Russia's trade and production profile, its geographical location and cost base are all significantly different from what China was in 2001. The nation's income is dependent on the exports of raw materials and foremost oil and gas where WTO would have marginal impact. Therefore purchasing power to facilitate growth in (containerised) imports will remain to be dependent on the oil and gas prices – at least in near term – not tariff liberalisation. Shortly, the accession would have very minimal impact on container shipping. The draft and climate will remain the same and the market will continue to be served via transhipment in major European hubs. There is a subjective view that liberalisation may facilitate transit via neighbouring ports however.

<sup>1</sup> Ultra Large Container Vessels

<sup>2</sup> Including cabotage trades

**In conclusion**

Increasing competitiveness and aiming to attracting carriers and shippers would require ports to upgrade infrastructure, cranes, landside operations etc to provide required efficiency. However, in the current financial climate such changes are hard to make and investors are cautious as well as a few. Nevertheless, as indicated above, unlike shipping companies, port operators are more resilient businesses and attract institutional investors.

As most of the ports in the Baltic region will continue being feeder-fed, the increase in vessel size in the Baltics would not be as dramatic as on the major trades. Therefore leaving other options to upgrade often without substantial superstructure works, eg by improving operational productivity at existing facilities, improving management, yard systems and IT infrastructure.

The outlook for the Baltic is that it will continue growing strongly in longer term. Despite the current downturn and uncertainty in the Euro area, the region still has relatively low starting base in both economy terms as well as containerisation.

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*Article based on the presentation at the Baltic Ports Conference 2012 made on 5 September in Turku.*

# The Northern Sea Route – a viable alternative to Suez Canal Route as a liner shipping route?

By Tuomas Kiiski

The Northern Sea Route, NSR, (formerly known as a Northeast Passage) is a sea route passing through the Russia's Arctic regions connecting main lands of Europe and Asia. In the past the NSR has been traditionally ice-covered almost around the entire year. However during the last decades there has occurred significant loss of ice cover along the route due to the global warming in the Polar Regions. As a result, NSR's navigational periods have become longer and it is assumed that this trend will continue in the future. The process has been prominent to the extent that it has become possible to make realistic forecasts concerning of the route's future potential for commercial shipping between Europe and Asia.

This article considers the potential of the NSR mainly from the liner shipping industry's point of view. Liner shipping with fixed schedules, ports and routes is a demanding frame to work with. Unpredictability of scheduling is one of its worst enemies. Currently this is one of the main weaknesses of the NSR. It is commonly recognized that NSR's main advantage is a significantly shorter distance between the main Northern European and Northern Asian base ports compared to the current main shipping route via Suez Canal. The difference is about one third shorter between e.g. Hamburg and Yokohama. The advantage gained cannot, however, be exactly measured just by staring at the geographical distance between ports. The reason behind this is that ice conditions are constantly varying along the NSR, which makes it impossible to use exactly the same route. Besides, the NSR has at least three different routing alternatives with unique ice-conditions and draught limitations in each of them.

Currently there is significant interest among the shipping industry to harness the NSR for regular shipping. Therefore many shipping companies have already made trial journeys mostly with bulk ships along the NSR with encouraging results. This is mainly because the route is located nearby rich raw-material resources hidden underneath the icecap or below the seabed waiting to be transported via the route. These resources consist mainly of oil, gas and other natural resources that Russian Arctic has to offer.

When comparing the traffic in the NSR to the current main container transport route via the Suez Canal, there are several pros and cons that need to be taken into consideration in order to get a holistic picture of its real potential. The shorter geographical distance by using NSR can create significant savings in fuel and voyage costs. Ideally, the NSR could be a counter strike to slow steaming, which has become a growing trend in Suez Canal traffic. Both of these options are meant to gain savings in fuel costs, but using the NSR may enable to maintain the original transit times.

The NSR is still a hypothetical solution with a lot of uncertainties in it. There are several physical, financial and managerial constraints to the use of the NSR as a regular

liner shipping route. The most significant ones are those related to the physical conditions of the area and the current management system of the route. Prevailing difficult weather and extreme sailing conditions are also challenges that need to be overcome. The Finnish expertise in Arctic seafaring and in ice-breaking technology could easily come in hand for this purpose. The need for new Arctic equipped ice-breakers in NSR traffic is imminent because most of the Russian ice-breaker fleet is soon becoming at the end of its mileage. In the NSR it is mandatory to have ice-strengthened tonnage and to use ice-breaker assistance. Currently the supply of ice-breakers and their physical dimensions may also be a limiting factor for growing of traffic. The managerial constraints are related mostly to the present slightly complicated and unpredictable administrative procedures needed to undergo before using the route. From the economic point of view the current TEU-based ice-breaking tariff does not encourage to increase the traffic volumes. The NSR lacks also one important advantage that the Suez Canal route possesses: the availability of feeder-hub-ports along the route to get additional volumes. Politically the ownership of the Arctic resources and right to passage are also hot issues that need to be resolved.

As a conclusion you do not have to be a foreteller to predict that the NSR will become a more and more intriguing transport route in the near future as the polar icecaps keeps melting along the route as a result of the climate change. This will create longer navigational periods and possibly also totally ice-free periods on the route. The shipping operations will continue to be ice-breaker assisted until the arctic shipping technology enables the ships to sail solo via the NSR. Also the search and rescue capabilities along the route have to be promoted to a sufficient level. In the first phases the route will be most suitable for bulk shipping because of the rich supply of raw-materials along the route to be transported and due bulk transported commodities are more suitable for non-stop port to port traffic. The container liner shipping will eventually follow after the current administrative obstacles hampering the route's potential are solved; sufficient supply of ice-breakers and the infrastructure along the route is developed to an up-to-date level.

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## Immediate tasks for G20, regional associations and international economic organizations

By Viacheslav M. Shavshukov

The global crisis of 2008–2009 raised a principle issue of post-crisis development of the world economy. Geo-economic and geo-political events, natural and technogenic catastrophes in the beginning of the XXI century threatened the very philosophy of globalization and raised the question about its reversibility. It was a crisis of mankind, culture, economy, environment and all institution of the modern world, raising civilizational and social economic issues urgent for all countries, monetary authorities, investors, manufactures and consumers. The most important among these were about **the future of the global economy, the development vector of its architecture, the position of the leader of the world economy, the reversibility of globalization in the post-crisis period.**

Centrifugal trends in the EU, Latin America, The Eurasian Economic Community (EurAsEC) do not exclude de-globalization scenario. Thirty years of globalization history have elucidated obvious threats for non-competitive economies and new opportunities for social and social and economic progress. However, globalization benefited no only developed countries, but also a large number of developing ones – China, Russia, Southeast Asian countries, Israel, India, Brazil, Argentina, Mexico, Chile, South African Republic, Persian Gulf countries, Turkey, Eastern Europe.

At the same time, prosperity growth rates, accumulation of profits in OECD countries threaten traditions, customs, values of western sub-civilization and, what is more, the very stability of the foundations of democratic society. Globalization, having opened economic barriers, brought about new ethnical and cultural challenges to sub-civilizations, responding not only with a rejection of both "Occidental lifestyle" and western management standards of production transferred to developing countries, but also with a conflict of civilizations in European countries. The idea of European tolerance is undergoing a serious crisis. Workforce from Turkey, Balkan states, Africa, Asia failed to adapt to the social systems of England, France, Germany, Belgium, Switzerland, the Netherlands and Scandinavian countries. More than that, it has resulted in strengthening nationalism tendencies in the European consciousness, society and politics, in antiglobalism and protectionism. Pan-globalism might be replaced by regional globalism with large-size regional alliances sharing geo-economic and geo-political interests, single central bank, single currency, consolidated budget and common monetary policy.

Global crisis of 2008-2009 for the first time has demonstrated joint aspiration and ability of G20 to cope with such difficulties effectively. However, pendency of system-based problems and constant search of new sources for

growth under the new technological mode resulted in a smoldering situation and created expectations of a "second wave". These conditions necessitate further joint actions of G20 in order to provide for global financial stability and new sources for world economy development.

**At the moment, EU is in urgent need for higher rates of economic growth, strengthening protective measures of European economy and deeper integration.**

There are two possible ways in the course of solving these problems: paying off sovereign debts and providing for long-term financial stability. Overcoming debt crisis of Roman countries concerns not only Germany and France, but all zone of euro as it is a system-based EU problem. Its possible solution may be based on tightening budget discipline as well as budget integration. Financial stability can be guaranteed by consolidated efforts of the European Financial Stability Facilities (EFSF), European Systemic Risk Board, joint approach to recapitalization of credit institutions and constant support of bank liquidity by European Central banks.

**The USA, being the leading world economy, bears a particular responsibility and has to play an important role.** World economy will be given renewed momentum if the USA takes a resolution to cut budget deficit and lessens the mortgage debt load on households.

**IMF has appealed to Japan** as being the third world economy to cut national debt and carry out reforms aimed at increasing long-term economic growth rates. The country has all chances to repeat the "economical miracle", first of all, in a search for economically effective alternative sources of energy with its High-tech achievements being the basis of it.

**China, BRICS countries and emerging markets** as a whole with a high profit of current accounts and large stock of official international reserves may give rise to a growth of world economy by refocusing national growth targets from exporting to domestic consumption.

**The IMF and World bank group** should focus on the policy of providing global financial stability, new sources of world economic growth and solving civilizational problems of mankind.

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## “Clash of civilizations” in the Finnish-Russian relations?

By Ilmari Larjavaara

### Clash of civilizations

“Clash of civilizations” - a theory proposed by Samuel P. Huntington is very present in the Finnish-Russian relations. “Clash of civilizations” seems not becoming milder - in next years it can turn to be even more present and actual. According to Transparency International, the Finnish-Russian border is one of the sharpest corruption borders in the world. “Clash of civilizations” in the Finnish-Russian relations has created phenomena and problems that have not had best possible explanations and solutions.

It is an argument here that it is important to understand basic institutions and concepts for to solve concrete problems. Different societies may have rather different basic institutions that might be contradictory to each other's. What is more or less normal in Russia, may be punishable in Finland and vice versa.

### Everyone knows that business might require bribes in Russia

Everyone knows that business might require bribes in Russia, but if you get caught, it is very bad for you. A company that is caught bribing in Russia faces very negative publicity and drastic measures from the side of authorities in Finland.

If bribes are required from companies to operate in Russia, they are very alone to face this issue. Small Finnish entrepreneurs in St. Petersburg can be threatened to be pulled the muzzle, unless they do not pay bribes. Most troublesome are local corruption networks where different authorities team up for to cash companies. In these situations for companies there is no-one to turn to.

Officially it is not possible to discuss this question. By surface Finnish businessmen have a sharply negative view of bribes in Russia. There could be more open publicity and discussions of what is true in Russian environment.

Because the real things cannot be spoken out, Russian experts will go to grave with their secrets. You cannot ever tell that you have bribed (or what else did) in Russia, because this is a crime.

Trade experts have differing views of necessity of business corruption in Russia. It is described by some consultants that the use of these methods is practically essential. On the other hand it is recommended that the use of bribes should be avoided at all costs. There are no much recommendations, how to face this question in a practical level. If bribes are needed, this should be dealt in a very hidden and without any support from the official system in Finland.

Consultants promise that everything can and should be done legally in Russia, but then if it is not possible? Companies learn it by themselves, how one can cope and even be successful in Russia.

One issue are various organizational levels within companies. Between organizational levels in companies various groups might not understand each other's in a best way. Finnish CEOs do not want to hear of real conditions in Russia and view Russian workers as potential threats.

Russian salesmen think that their Finnish bosses understand nothing of Russia. There are wide gaps between the worlds.

Discussions of Russia in Finland are characterized by multi-level double standards and hypocrisy. Different spheres are far from each other's and poorly share a common language. In particular, the Finnish bureaucracy may not have enough touch with the business realities in Russia. Grass root level companies who operate in Russia might not much value state authorities in Finland.

How the companies operating in Russia actually manage to succeed? Nobody has ever committed any research of this topic. We do not know how widespread and compulsory bribing in Russia really is. It would be interesting to get an empirical answer to the basic paradigmatic question, whether it is possible to operate and succeed without corruption in Russia or are corrupt methods more or less compulsory. Anyway, for the Finnish companies to be successful it could be useful to learn more how to manage personal relations in Russia.

### There is a need of new approaches

What would be the right way to approach divergences of the business environments? It is a problem that in Finland there is no coherent and systematic policy how to approach question of corruption in business environment in Russia.

Finger pointing and punishment of companies do not help. These measures do not eliminate problems in the Russian side. What kind of policy authorities in Finland should take? There could be some international support networks that engage in business activities for them to be clean. One should have less moralistic and more practical level approaches to face bribes in Russian environment, to support companies' operations and to avoid risks related to bribes.

How do institutions develop in Russia in the near future? In West a common assumption is, of course, that WTO will force Russia to modernize. Another concept to describe present trends in Russia is “demodernization” – Russia at a fast pace turns to the past. Anyhow, when visas will be abolished, Russian mindsets and habits will land to Finland much stronger than now. Perhaps then we see the same development as in the drug policy - the otherness that was once most illegal and marginal will become nearly common and accepted, even in Finland.

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## Eurasian integration – a positive view

By Vladimir G. Sherov-Ignatyev

The perception of integration initiatives with a dominant role of Russia depends on the origin and age of the observer. Many of those, who were born in the USSR and whose best (younger) years passed in that country, sympathise the attempts of reintegration of post-soviet states. According to Gallup polls of 2007-2008, more than half of respondents in 10 out of 11 examined countries of the former Soviet Union (FSU) supported economic or political integration of former Soviet states (except Azerbaijan).

Meanwhile, many American economists criticize the last and the most successful attempt of that kind – the arrangement of the customs union of Russia, Belarus and Kazakhstan (CU RBK). They make an accent on higher efficiency of North-South integration in general case and on limitations of trade liberalization in customs unions compared with the free trade agreements (FTA).

Here we suggest some arguments in support of Eurasian integration, more serious than the personal sympathy. More precisely, arguments are necessary to defend the choice of European model of regional integration (customs union – common market – economic union) instead of open regionalism (a network of overlapping multilateral and bilateral FTA) – approach, encouraged and promoted by the U.S. Arguments are as follows.

**Customs union allows trade facilitation.** Comprehensive CU must have three features: 1) the common external tariff; 2) the common pool for collected import duties and the mechanism of their distribution among member countries; 3) eliminated customs control at mutual borders. The latter feature is of special importance, since cutting border crossing barriers alleviates access of locally produced goods to the neighbor markets. The scale of anticipated effect in the case of CU RBK is serious, since, according to Sergey Glazev, the former CEO of CU RBK, border-crossing waiting and procedures constitute in some cases up to half of the time of importing goods within the Commonwealth of Independent States, despite free trade among most of its members.

**The customs union can allow softening of some negative consequences of the WTO accession and of the resource curse.** Competitiveness of Russian manufacturing will fade in several sectors with the reduction of import tariffs after the WTO accession in 2012. Consequences for Belarus and Kazakhstan are similar, since these two countries, being members of the CU with Russia, are obliged to make the same tariff concessions. Competitiveness of locally produced finished goods is under threat also due to the well-known fact: Russia and Kazakhstan are resource exporting countries. As such, they suffer from the Dutch disease. It means, that during the periods of high prices for oil and natural gas, Russian Ruble and Kazakhstan's Tenge appreciate in real terms, making domestic goods more expensive compared with imported goods.

In these conditions the importance of mutual trade and cooperation of three countries grows, since the share of manufactured goods in intra-RBK trade is higher than in the

export of three countries to the rest of the world. This advantage becomes even more tangible with above mentioned elimination of border barriers between Russia and Kazakhstan (customs control on Russia-Belarus border was eliminated much earlier).

Regional aspect of competitiveness deserves special attention for such a large country as Russia. Agglomerations and sea ports usually benefit from global trade liberalization more, than landlocked regions and small towns. Russia's WTO accession is expected to aggravate the problem of regional disparities. Two capitals, Moscow and St. Petersburg, and a number of metal producing cities and import hubs will enjoy main benefits of the WTO accession. On the other hand, many of Russian regions with low per capita incomes and low degree of engagement in export are located in the middle of the country, close to the border with Kazakhstan. **Deeper regional integration gives a chance to such "Introvert" regions**, their manufacturing enterprises becoming able to expand to the neighbour market easier than before.

**Eurasian integration stimulates institutional competition.** Moving towards common economic space of three countries (CES RBK) requires the convergence of regulatory systems, and it is logical to build upon the more advanced standards. The comparison of the famous Doing business (DB) ratings of Russia, Belarus and Kazakhstan brings the shocking outcome: Russia is lagging behind its partner countries by most of indicators of the quality of business environment. Kazakhstan, Belarus and Russia hold, respectively 49th, 58th and 112th positions among 185 countries of the DB-2013 ranking. "Discovery" of this fact led Russian leaders to take steps to remedy the situation by simplifying bureaucratic procedures.

Some positive results of CU RBK/CES formation are country-specific. Belarus gained access to cheap Russian fuel and increased export of manufactured products. About 45% of machinery and 2/3 of food, traded within CU RBK in 2012,, originated from Belarus. Kazakhstan receives faster and easier transit, important for this landlocked country.

Summing up, there is a number of good news about the economic effects of Eurasian integration. Theoretical principles are important, but god and devil live in details, and it is worth analysing each integration initiative individually.

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## Finnish window in St.Petersburg – beyond its size?

By Elina Kahla

Working in the heart of city of St. Petersburg, at Bolshaya Konyushennaya 8, where the House of Finland, housing the cultural institute and various representative offices, is located in the fabulously renovated historical building from 1847, a Finn feels quite at home. Let me explain. Within the Grand Duchy of Finland (1809-1917), Finns made their living in these neighborhoods, some of them as craftsmen, industrialists or merchants, some others jewelers, servants and workers. In this building, Uno Cygnaeus established the first Finnish-language primary school. It is amazing that Finland's educational success (if the PISA test rankings from recent years are any indication) began here. There is a public Finnish primary school in the building again. In broader terms, one is proud that today connections between Finland and St. Petersburg, which are equal in size at about 5 million inhabitants, have been restored, people are traveling and getting to know each other. The Allegro express train takes only 3 h 36 min from one northern capital to another. Some of the previous mutual benefits have remained intact. Finns still deliver dairy products and construction projects, while the inhabitants of St. Petersburg travel west for leisure and shopping, for unpolluted nature, peace and quiet, or cultural tourism.

In recent years, tourism has grown rapidly and reached not only border towns like Lappeenranta and Imatra, but farther destinations like Lapland or Åland. Over time, Finns have more consciously invested in Russian travelers and built strategies around them. However, business logic diverges from grass-roots opinion. Visa-free travel is regarded both as a threat and an opportunity. According to estimates, if visa-free travel between the EU and Russia will be endorsed in 2018, incoming tourism from Russia to Finland will grow four or five times; in 2020 about 20-25 million Russians would visit Finland annually.<sup>1</sup> The inhabitants of the border towns Lappeenranta and Imatra are the most worried, since mass travel would bring crime, they wonder if their quiet life may come to an end. In polls, these attitudes were clear.<sup>2</sup> A statistician expert says that the younger generation, under 25 years, is most open, whereas elder generations of Finns may still be traumatized by war memories. "Would we be ready to climb out of the trenches and smile at our neighbors?" wonders a journalist.

Cultural sensitivity is needed to handle the discrepancy between business strategies and citizens' anxiety. Awareness of one's neighbor's history and culture would naturally not minimize a mouse's fear in the claws of a cat, but for a cultural institution it is a question of life and death. In the "information jungle" it is our mission to provide scholarship-based information on both Finnish-Russian history and hot contemporary topics. St. Petersburgers may not know that the Karelian Isthmus, including its capital, Vyborg, was once part of independent Finland; calling Vyborg "an ancient Russian town" is simply misleading, since it was founded by Swedes in 1293. In contrast, Finnish

"Karelia back" revanchists may seem more offensive than their actual positions are. It is the institute's privilege to address these issues in a friendly setting, by way of artistic and literary events, academic lectures, photo exhibitions and the like. These events reveal much more universal similarity than difference. The institute's competitive edge is to raise the profile of cultural dialogue. Only by dialogue and trustworthy information can the polarities between business logics and people's sensitivities be dissolved.

The House of Finland was originally built as a church mansion (podvorje). The Finnish and Swedish citizens amounted to some 25,000 in St. Petersburg already in 1880, since then, even more. Their parish life involved not only religious services but also schools and social activities. The three storey Finnish Lutheran Church of St. Mary proudly reminds us of its historical significance. It has not lost its mission, but rather is successfully undergoing with continual transformation. The majority of its parishioners today are Russian speakers, with Ingrian Finnish roots. For the Ingrian parishioners, the resurgence after decades of repressions and deportations to Siberia is part of their identity, their "otherness" as compared to the Russian Orthodox majority. How different would Finland look today if its majority denomination (78%) were not Lutheran, differing from Orthodox Christianity in their greater practicality and tolerance when it comes to human rights and interfaith questions?

Is it an advantage to be a Finn here? I often find myself answering that question, and always positively. To repeat the words uttered by Tsar Alexander II: "Finland is the only part of my empire which never has caused me any harm what so ever." This phrase was reformulated as "Consider it solved," by our minister for EU affairs, Alexander Stubb, who coined a slogan for the Finnish country brand.<sup>3</sup> This practicality is perhaps what makes things easier when doing business or travelling to Finland for stressed city dwellers.

In regard to the positive country brand, to represent the House of Finland in St. Petersburg is a dream come true. Perhaps, though, the window sometimes seems bigger than the house itself. This is true while matching of professionals in each subarea of cultural and other cooperative activity is complicated. Business success requires the establishment of personal ties, and is always a long term project. The director's appointments should perhaps not change every three years. One should raise efficiency via human capital and avoid starting from zero.

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<sup>1</sup> Konttinen J., 30.12.12 *Helsingin Sanomat*, D4 "Entä kun tulee se kahdeskymmenes miljoonas?"

<sup>2</sup> 82% of Russian citizens favour mutual visa-freedom with Finland, only 6% are against it, while the rest have no opinion. 38% of Finnish citizens favour visa-freedom, but 39% are against it. Rahkonen J., 10.1.13 *Helsingin Sanomat*, A5 "Suomi voi kohta olla valmis viisumivapauteen".

<sup>3</sup> Stubb, A. Consider it solved. *Blue Wings*, 2011, 32.

## The challenge of keeping the Gulf of Finland clean from oil – what should we do?

By Inari Helle and Sakari Kuikka

The Baltic Sea has always been an important route for transporting people and goods, and shipping activities have intensified further in the 21st century. Today, around 2000 vessels operate in the area at any given moment. As approximately 20–25% of the ships are oil tankers, dense maritime traffic has raised concerns about large-scale oil accidents.

The Gulf of Finland, the easternmost basin of the Baltic Sea, can be considered as a hot spot for this development. During the period from 1995 to 2012, the yearly amount of oil transported via the gulf increased 700 %, from 20 million tons to over 160 million tons. A major reason for this considerable growth has been Russia's investments in new pipelines and oil terminals. Although the Gulf of Finland seems to be a safe route for oil transportation given the political and economic stability of the area, the geological and climatic factors like shallowness, indented coastline and ice-cover in winter impose challenges for navigation.

These factors make also oil combating more challenging. The Gulf of Finland has a fragile brackish water ecosystem and it harbors many conservation areas. It is also an important migratory route for arctic birds. A large oil spill could potentially have major negative impacts on these nature values. Also direct and indirect monetary losses could be substantial, as shoreline clean-up activities are usually costly and time-consuming, and a spill could result also in bans on fisheries and fall-off of tourism. One problem is the uneven distribution of these risks among coastal countries, as Russia who transports the majority of oil has only short coastline and thus limited amount of resources at risk.

There are mainly two ways in which the negative impacts of oil spills can be avoided: to prevent oil spills from happening, or to apply effective oil combating after the spill before the slick reaches shoreline. Within the past 15 years many improvements in maritime safety have been carried out. These include e.g. the implementation of Vessel Traffic Services (VTS) and Gulf of Finland Reporting System (GOFREP), which monitor maritime traffic and offer ships information related to the safety of navigation. However, these measures have not been able to completely erase the chance of an accident.

Finland has also made major investments in oil combatting capacity. In Finland, oil combatting is based on mechanical recovery. Today Finland has altogether 16 oil combatting vessels capable of recovering oil independently in offshore conditions. However, the efficiency of vessels depends on many factors such as oil type and conditions at sea. For instance, when wave height exceeds 1–1.5 meters, even the recovery efficiency of large vessels drops sharply.

A major issue in oil spill management is high uncertainty. We do not know when an accident is going to happen, neither can we know the size of the spill or where oil slicks are going to drift. In this respect oil spills differ e.g. from eutrophication, which is an already materialized environmental problem and the effects of which are highly visible and have been studied extensively for many decades. Uncertainty also makes decision making challenging. How much should be invested in oil spill prevention and combating, when the consequences can be severe, but the accident may happen today or 50 years from now?

In order to answer these kinds of questions, we need to apply probabilistic modeling, which takes into account as many uncertainties as possible. Given that we cannot know what will happen, modeling is the only way to find the best possible solution. By combining all available information from field data of oil spills (luckily mainly missing from the Gulf of Finland),

laboratory experiments, models and experts we can screen different alternatives and prioritize between investments.

The results of this kind of analysis depend on the utilities we can expect to gain or, vice versa, the losses we can witness. However, gains and losses are extremely difficult to define and value, especially in case of nature values or human lives. In this respect, measures that prevent accidents from happening are important as immeasurable losses are not involved. Furthermore, the results of a recent research project<sup>1</sup> suggest that in the future it may be more cost-effective to invest in some preventive measures than to increase oil combating capacity. This conclusion derives largely from the high uncertainty related to oil accidents.

However, as maritime traffic continues to grow in the Gulf of Finland, it seems that we need to invest both in oil recovery equipment and in preventive measures. In the former the challenges lie especially in rough seas and ice conditions, where traditional methods are mostly ineffective. In the latter case more alternatives should be studied, including e.g. extended piloting regulations. It is positive that also private actors have become active in this sector. One example is John Nurminen Foundation's Tanker Safety project<sup>2</sup>, which is based on the idea that oil tankers send their route plans voluntarily to VTS centers before leaving port. In the end, it should be the interest of oil and shipping companies not to be involved in accidents that have large media coverage and a substantial negative impact on public opinion.

Given the uneven distribution of risks and the independent spirit of seafaring, it is also evident that no country can solve problems alone. Co-operation with neighboring countries is important especially regarding efficient and functioning maritime traffic control and adequate level of oil combating capacity. However, many improvements to common practice and more strict regulations need decision making at higher levels, like in the EU and International Maritime Organization (IMO). To be able to communicate our needs to these quarters efficiently, we need a firm understanding of the ecological features of the Gulf of Finland as well as of the technical and psychological characteristics of the accidents. This requires multidisciplinary research and a strong collaboration between biologists, marine scientists, meteorologists, engineers and sociologists.

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<sup>1</sup>More information (in Finnish):

<http://www.ymparisto.fi/download.asp?contentid=139647&lan=fi>

<sup>2</sup> More information: <http://www.puhdasitameri.fi/en/tanker-safety>

## Does it pay to combat eutrophication in the Baltic Sea?

By Kari Hyttiäinen

The Baltic Sea is an important source of subsistence, welfare and joy for millions of people living in the nine countries sharing its coastline. However, the sea is fragile and vulnerable to damage caused by excessive nutrient loads, oil spills and hazardous substances due to its physical characteristics and high human pressure. The Baltic Sea is a shallow and almost enclosed marine region with a catchment area that is four times larger than the sea itself and inhabiting more than 80 million people in fourteen countries.

Human-induced eutrophication is a particular problem of the Baltic Sea. Long-term excessive loads of nitrogen and phosphorus have increased the occurrences of massive algae blooms and hypoxic areas on the sea bed in addition to other undesirable changes in the overall functioning of the Baltic Sea ecosystem. These changes have reduced the possibilities for citizen to enjoy recreation and other ecosystem services. Unless the overall development of water quality is reversed, the future generations are not able to benefit from similar services of healthy marine ecosystem than earlier generations did.

In tandem with increasing environmental consciousness, the Baltic Sea countries have put increasing emphasis and effort in water protection since the 1980s. Countries have set up policies and investment schemes directed to reduce nutrient loads from industries, agriculture and communal waste water treatment facilities. Although efforts in reducing nutrient loads have had an effect, most of the commonly set targets have not been met and the Baltic Sea is still in poor condition. More effort is indisputably needed to reverse the undesired trend in water quality. This raises a question: how much more should the riparian countries invest in water protection? This can be answered from two points of view, an ecological and socio-economic.

The ecological viewpoint is unequivocal: society should reduce the nutrient loads to a level that leads to functioning marine ecosystem and a good ecological state of the sea. HELCOM Baltic Sea Action Plan (BSAP), an international programme targeting at restoring the good ecological status, is based mainly on the ecological viewpoint. The socio-economic viewpoint, on the other hand, focuses on the consequences of nutrient abatement on human welfare. This viewpoint was investigated in recent research project, conducted as a part of the international BalticSTERN research network. A cost-benefit analysis was carried out on the overall benefits and costs of implementing the BSAP. The consequences of implementing the BSAP were compared to the baseline development, in which the present level of water protection is maintained, but no additional investments are done.

According to the research findings, the overall benefits of load reductions clearly exceed the subsequent costs. Thus, the ecological and socio-economic viewpoints give parallel recommendations for the implementation of the BSAP: in addition to reaching a good ecological status of the Baltic, the plan also increases the overall welfare of people living in its catchment. That is to say, it is economically viable to

implement the BSAP. The overall benefits from improved water quality were estimated to be some 3800 million euros annually, while the annual costs of meeting the reduction target varied between 1500 and 2800 million euros annually depending on how the nutrient abatement measures were allocated across countries. The benefits exceed the cost for the evaluated project and all the intermediate levels of water protection between the BSAP and present level of water protection. On the other hand, more ambitious plans of nutrient abatement, that go clearly beyond the targets of the BSAP, would require large structural changes in agriculture and local food production, and are not likely to be economically justifiable with current technology.

The research findings also suggest that there is potential to reduce the overall costs of nutrient abatement by planning the measures cost-effectively and locally, i.e. such that the intended load reductions are achieved with the least costs and that the measures are tailored to local conditions in each watershed. Demand for new measures creates business opportunities for the industries to develop technologies for more effective nutrient reductions in waste water treatment, agriculture, forestry, industries, shipping and all relevant sectors causing nutrient loads.

One challenge for the implementation of the BSAP is that the benefits and the costs of nutrient abatement are unevenly distributed across different stakeholders, economic sectors, regions and countries. The clear gainers of improved water quality in the Baltic Sea are the citizen, industries and businesses (such as tourism) that enjoy and utilize the services and products of the sea. Sharing of costs and technologies, international financial instruments (e.g. Cohesion and Structural Funds of the EU) and joint nutrient abatement projects are possible tools to encourage implementation of the BSAP and to make it worthwhile for all stakeholders. Also the role of international organizations such as HELCOM and EU is important in facilitating and coordinating the process.

Quantifying the costs of nutrient abatement and the benefits of improved water quality is a challenging task. Despite several underlying uncertainties related to research results, the message is clear: the research findings give support to the decision makers to pursue the implementation of the policy targets of the BSAP. Failure to fulfil these targets would imply foregoing substantial societal benefits. Policy makers need to take strong action to safeguard healthy marine ecosystem for the future generations.

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# Oil transportation in the Baltic Sea – environmental impacts and future challenges for maritime transport

By Vanessa Ryan

The use of the Baltic Sea is intensifying. Sectors like offshore energy production are experiencing rapid growth, and this also applies to one of the most visible and intensive forms of sea use, namely shipping. The Baltic Sea is one of the most heavily trafficked sea areas in the world, with approximately 9 % of the world's cargo transportation taking place in this unique brackish water environment with its small water volume and slow water exchange. This, combined with the Baltic Sea's characteristically few species (most of which are living under constant stress due to the either too low or too high salinity) and already heavy pollution load, makes the Baltic sensitive to disturbance. Regarding shipping, these harmful disturbances include gaseous emissions, waste water discharges, underwater noise, and accidental and illegal discharges of oil and hazardous substances. Certain features of our sea also pose navigational hazards to shipping. The shallow water, extensive archipelago areas and icy winter conditions are only a few players in this game, which should be a game of strategy and skill rather than one of chance.

Baltic shipping decreased slightly during 2009 and 2010 but increased again in 2011. The expected and continued increase in shipping in coming years highlights the need for further improvements in maritime safety in the future, but also the need for further developing oil spill response methods and contingency planning. Although the Baltic Sea region is a forerunner in maritime safety and environmental regulation, and has benefited from its PSSA status, recent years (2004 – 2011) have seen over 100 shipping accidents annually – most of them a result of human error. Luckily, few accidents lead to pollution; this figure was 8 % in 2010. Measures like the coordinated Baltic aerial surveillance, which has proven to be a deterrent for illegal oil discharges, should be considered proof that protective measures indeed work, but should not lead to complacency. Rather they should lead to increased efforts to reach ambitious environmental protection and safety targets, and to efficiently catch and prosecute anti-pollution regulation offenders.

At present, around 11% of the world's oil transportation is carried out on the Baltic and the transported volume is expected to continue increasing; how fast remains to be seen. Some estimates predict a more moderate development compared to that of the past ten years, which saw oil transports in the Gulf of Finland almost quadrupling as a result of the rapid oil production and exports of mainly Russia. However, while oil transportation has the potential for creating catastrophic spill events of several tens of thousands of tonnes, spills caused by other vessels than oil carrying tankers should not be overlooked. Analyses by HELCOM's BRISK and BRISK-RU projects estimate that large-scale spills of more than 5,000 tonnes could occur in the Baltic once every 26 years, and medium sized spills of 300 – 5,000 tonnes once every 4 years (with sub-regional differences). However, even a small amount of oil in the wrong place at the wrong time can severely damage breeding or migrating populations of birds or important

spawning areas for fish. Overall cargo and passenger traffic is expected to grow rapidly in the Baltic Sea region, with container traffic having experienced a growth of 18% in 2011.

The maritime industry needs to develop into an environmentally ambitious industry, which instead of reacting to incidents which have already happened, or tightened emission regulation, set ambitious environmental targets. This requires a combined effort into technological development, emission control and fuel technology, noise reduction measures and fleet renewal (with an emphasis also on ship recycling), but it also requires setting boundaries where necessary; spatial and/or temporal shipping restrictions, as well as an active involvement of the shipping and related sectors in maritime spatial planning efforts both nationally and regionally. For example routing measures like avoiding sensitive areas or areas where oil pollution after a spill is more likely to reach the shoreline, can greatly affect the impact spills may have on the ecosystem or individual species.

We are all connected by the Baltic Sea, and the opportunities and resources it provides. While green and blue growth concepts are being developed, the inherent value of the environment and the value of the non-provisioning ecosystem services it provides are often left out of the equation - despite their importance. There are many ways in which we can protect these values from the harmful effects of shipping. Identifying and classifying the most vulnerable species and habitats both above and below the surface is the first step. Based on sound scientific knowledge about the effects of oil and oil clean-up methods on individual species and communities, but also of other harmful effects of shipping like noise disturbance and increased spatial demands, we can implement concrete measures for environmental protection.

We should also not forget that the only permanent solution to the problems caused by fossil fuel use and transportation is a substitution of these for more sustainable alternatives. Renewable energy strategies of the EU and targets set by individual countries in the region may yet lead to a slowing down of the rapid increase of oil transports witnessed in the region over the past decade, and this is something the region as a whole should aim for.

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## What explains foreign direct investment in the Baltic Sea Region?

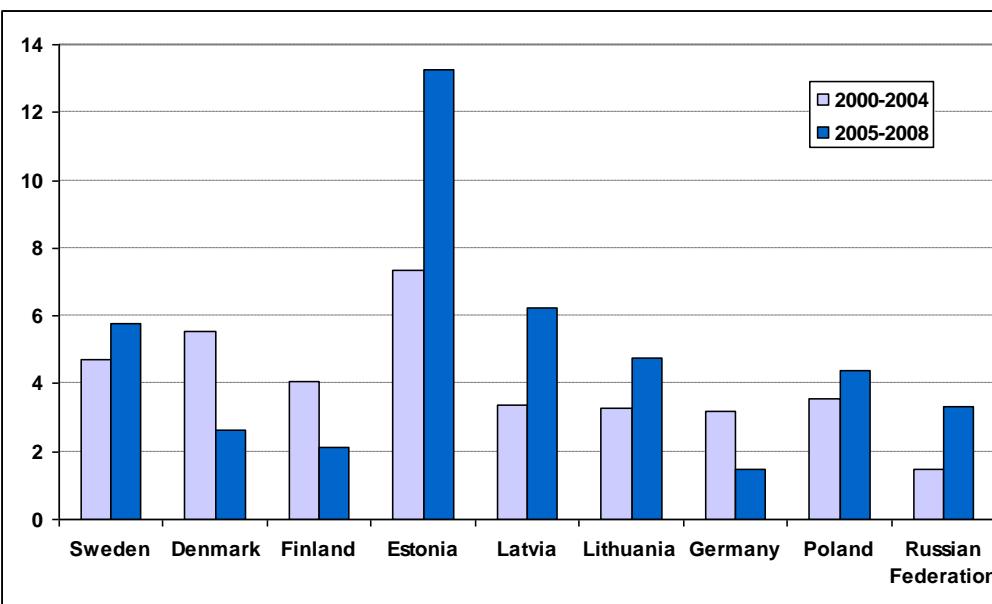
By Markku Kotilainen

We have recently prepared two research reports on foreign direct investment (FDI) inflows in the Baltic Sea Region (BSR).<sup>1</sup> In this column, I will briefly describe the main results of the studies.

We have defined the Baltic Sea Region as consisting of the following countries and regions: Denmark, Estonia, Finland, Germany, Latvia, Lithuania, Poland, Sweden, and the regions of St Petersburg, Leningrad Oblast and Kaliningrad in Russia. In the case of Russia, we had, because of lack of data, to use the statistics concerning the whole country.

In the following figure, we see FDI inflows in two periods. In the period of 2000 – 2004 most BSR countries received rather similar amounts of FDI as a proportion of GDP. Russia, however, received relatively less than the average, and Estonia relatively more.

**Foreign direct investment to the BSR, net inflows (% of GDP)**



Source: World Bank.

In 2005 – 2008 the Baltic countries received a lot of FDI. This is because their economies grew at a fast pace. Estonia's relative FDI gains were more than double what they were in the other Baltic countries. Also Poland strengthened its position in the eyes of foreign investors. Nordic countries and Germany were unable to get as much FDI as in the previous period. Sweden was an exception as it improved its situation from the previous period. Germany's rather low figures can at

least partially be explained by its big size and its capital richness.

In the first study (Kotilainen and Nikula, 2010) we investigated the determinants of FDI in the Baltic Sea Region in three ways. First, we studied the factors affecting FDI on the basis of the theoretical and empirical literature. Secondly, we studied the characteristics of the existing FDI in the Baltic Sea Region. Thirdly, we researched the investment motives through two firm questionnaires: 1) firms participating in the MIPIM real estate fairs and 2) Finnish firms active in the Baltic Sea Region (Finpro register)<sup>2</sup>.

In the theoretical part of the study, we used John Dunning's so-called eclectic theory on FDI as a starting point. Dunning covers and classifies a wide variety of investment motives, of which just a part can be studied empirically. We also covered the more economics based new economic geography approach on FDI and location. Using this survey, we formulated our empirical research questions.

The common results of both questionnaire studies were:

- 1) the most important reasons for FDI are market size and its growth potential, 2) companies do not see the BSR as a single market in their actual decision making process, 3) membership in the EMU may promote FDI, but the results are not very robust: obviously they are weakened by the already rather credible pegs of the Estonian, Danish, Latvian and Lithuanian currencies and the diversification benefits of the floating Swedish krone, and 4) governmental investment promotion organizations have a rather small role in the actual investment decision making process. Their role is rather in giving general information on the country's investment

environment.

The most important differences between the two samples of firms were: 1) in the real estate sector the majority of FDI is done through buying an existing firm, whereas in the sample of Finnish firms most FDI is done as a greenfield investment (establishing a new firm), 2) among the real estate firms Sweden, Finland, Germany and Poland are the most important destinations for FDI, while in the Finnish sample of firms (including more manufacturing and service firms) St Petersburg, Poland, Estonia and Sweden are the most important destinations, 3) in the sample of real estate firms R&D and the proximity of the Russian market are not important motives for FDI, contrary to the Finnish, more manufacturing and retail trade-oriented sample, and 4) among the real estate firms the potential for large increases in real estate prices is an important motive for FDI.

In the other study (Nikula and Kotilainen, 2012) we investigated foreign direct investment flows in 1995–2010 to

<sup>1</sup> Kotilainen, M. and Nikula, N. (2010) "Why Do Firms Invest in the Baltic Sea Region?" The Research Institute of the Finnish Economy (ETLA), Discussion Papers, No. 1229, and Nikula, N. and Kotilainen, M. (2012) "Determinants for FDI in the Baltic Sea Region". The Research Institute of the Finnish Economy (ETLA), Reports, No. 1. (See <http://www.etla.fi/en/publications/>.) The research was done in the context of the BaltMetPromo project, co-financed by the Baltic Sea Region Programme of the European Union. (See <http://www.baltmetpromo.net/public/>).

<sup>2</sup> In this case we studied Finnish firms' FDI in the rest of BSR.

the Baltic Sea Region countries econometrically. We used two basic models: the first one treats aggregate FDI inflows by countries, and the second focuses on bilateral FDI flows between country pairs. Because of limitations in data availability, the second model was built for a smaller group of countries. In this model we took into account the origin country of the FDI.

Our results show that macroeconomic factors such as corporate taxes are important determinants for FDI flows. We notice that these factors and their effects vary between the Baltic Sea Region countries.

Foreign trade with the investing country is also a statistically significant determinant for FDI, i.e. the countries that have trade with each other also invest in each other. On the other hand distance between countries doesn't explain FDI flows.

Institutional factors such as EU membership or a common currency are not statistically significant in our estimations but this could be because of data limitations and

because of the fact that these changes in countries' international status are incorporated in the other variables and are also foreseen by the investors.

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## The East is – empty

By Ilkka Henrik Mäkinen

*Millions are you – and hosts, yea hosts, are we,  
And we shall fight if war you want, take heed...*

The poem “The Scythians” from the Russian revolutionary poet Alexander Blok, written in 1918, paints in Kurt Dowson’s translation a powerful picture of innumerable hordes of “Scythians”, whose “slanted eyes” greedily watch the wealth of “Europe’s comely race”, while the poet predicts its impending destruction. The poetic picture achieves its hypnotic power not only from its dramatic and rhythmic language, but also from the fact that it was in its time recognisable as a - romanticised - description of potential reality: the oppressed masses of the East would eventually overthrow the old world order by force of their sheer numbers.

The poem reflects a traditional description of the demographic development of the world, a popular one due to its simplicity. The rich countries’ population is dwindling, while that of the poorer and more “backward” corners of the world grows incessantly. In time, this process will render Europe to a very insignificant place in the world both economically and in other respects. This general idea has shaped views on potential futures in many types of demographic environments.

Of course, this idea emanates from a specific demographic situation. It seemed true during a period when the populations of the developed countries began to stagnate because both the reproduction rates and those of mortality were bottoming out, while the populations of the somewhat less developed were still growing strongly due to falling mortality. But this would not last forever: even the “Scythians” now face the same grey fate.

The causes of the gradual emptying of Eastern Europe, and not least its villages, lie in well-known factors: low fertility, high mortality, and immigration that does not suffice to keep the population from diminishing. These processes have been at work during the last 60 years at least, however, they were masked by the “demographic reservoir” of the Southern and South-Eastern parts of the Soviet Union as long as it existed. Nativity in the largest Soviet cities fell below replacement levels already in the end of the 1950s (in Estonia and Latvia this line had been crossed already before the World War II), and fertility in the entire Russia hovered around the critical point until end-1980s, but as long as the gaps could be filled with in-movers there was no problem. However, in the economic uncertainty of the transition period nativity went “through the floor”, in Russia from 2.1 to 1.3 children per woman in only seven years, 1988–95. The first year of diminishing population in Russia was in fact recorded soon after the Soviet Union had been dissolved, 1994. The natural increase of population (births minus deaths) had turned into red already some years earlier.

It is however important to note that the cause of the diminishing population figures is not only low nativity. The chronically high levels of mortality even among middle-aged population makes the process run much faster than it would otherwise have done. During the first years of transition, Russia lost 600-700,000 persons in working ages every year. The death rate among males younger than 65 equals that of the entire Swedish male population, retirees included.

Looking at the mortality statistics of Russian Federation (and those of the surrounding ex-Soviet countries are rather similar in many respects), one is struck by the fact that the Russian figures exceed those of other European countries in so many categories, sometimes by so much that they seem incredible. For example, alcohol poisonings, according to Andrew Stickley and colleagues, are at a level of nearly 30 cases per 100,000 inhabitants (implicating the death of some 42,000 Russians!) per year, while European countries have less than 1 case. Russia is also nearly world-leading in homicide and suicide. The latter has, since the 1990s, wiped out a share of the population corresponding to the entire province of Novgorod (!). Considering that the figures for suicides and those for alcohol poisonings are of similar magnitude, and that those for homicide are not much smaller, the enormous scope of the influence of the excessive (and potentially avoidable) mortality becomes clear. The three above-mentioned causes of death, however, are not even among the largest killers in Russia or Eastern Europe.

Barring natural increase, the only possibility to maintain a certain size of population in an area is migration. According to Timothy Heleniak, migration, mostly from the Russian diaspora in the “near abroad”, mainly Kazakhstan, Uzbekistan, and Kyrgyzstan, can be estimated to have increased the Russian population by 3.6 million persons. This flow held the Russian population from dwindling even faster during the 1990s, however, the movement will unlikely go on forever, even though most of the Russians in the ex-Soviet countries have not returned. The Baltic countries, which had no such reservoirs (if the relatively small numbers of returning expatriates from the West is not counted) have since their newly-won independence experienced large-scale emigrations to both East and West. Between 1990 and 2010, the populations of Estonia, Latvia, and Lithuania diminished by 15%.

At the same time, the population of Eastern Europe is turning grey itself. The median age in Russia is 39.3 years, which places it among the oldest fourth of countries. Together with low fertility and high mortality, the relatively old (and rapidly ageing) population constitutes a major obstacle for economic growth, at least growth that is not based on the export of raw materials.

How are the Eastern European societies reacting to the problem? In 2006, Vladimir Putin raised demography among the central national themes in Russia by calling it “the most acute problem of contemporary Russia” in his presidential address to the Federal Assembly of the Russian Federation”. Numerous measures larger and smaller have been planned and taken since then, the most famous of them probably being the sizable “bonus” (exceeding 10,000 USD) for the second child, the lack of which in modern Russian families is considered as the main threshold to be crossed if Russia is going to replace its population in the future. Ukraine has “maternity grants” corresponding to between 3,500 and 14,000 USD to mothers from the first birth on. The Baltic States remain more passive.

A complicating factor in the assessment of the demographic situation in Eastern Europe is the uncertainty of the data. For example, while the Census of 2011 finds 11.5 million inhabitants in Moscow, it is also estimated that additional 1.8 million persons are actually living in the city but

claiming residency elsewhere, not to mention the illegally residing population estimated to 1 million. In other places, the statistics show more inhabitants than there actually are: the Latvian Census of 2011 counted 155 thousands (or some 7% of the entire population) fewer inhabitants than was previously thought due to unregistered emigration. On the positive side it may be noted that the nativity rates were higher than expected due to there being less persons to calculate the population-related figures upon.

As much as the Russian government might worry about the demographic situation, Russia is by no means the country that has been hardest hit in the region. The silent emptying of the Eastern shores of the Baltic Sea has been a process with astonishingly large consequences. According to Latvian demographer Juris Krumins, Sweden had a century ago 5.52 million inhabitants, while Denmark had 2.76 million, to be compared to 1.07 million in Estonia, 2.55 million in Latvia, and 2.83 million in Lithuania. Put together, the population of the three Baltic countries amounted to 78% of the combined number of Sweden and Denmark. A century later, in 2011, the populations of both Sweden and Denmark have nearly doubled, to 9.48 million and 5.56 million respectively, while those of the Baltic countries have been more or less stagnant or even diminishing, with 1.29 million

Estonians, 2.07 million Latvians, and 3.05 million Lithuanians living on their national territories. The current population of the Baltic countries is only 43% of that of the Scandinavian comparison. The picture painted by these figures is strong and counter-intuitive: it shows clearly that in the new demographics of Europe, the poorer areas no more act as suppliers of labour force for the richer ones, in fact, they do no longer even substitute their own populations but depopulate.

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## Lithuania's Berlusconi – the Viktor Uspaskich phenomenon in Lithuania

By Ruslanas Iržikevičius

Lithuania's political establishment remains puzzled by Viktor Uspaskich's continued success. A political party created by the Russian businessmen suspected of tax fraud is the third most influential political force in Lithuania. Will Uspaskich continue to be one of the most influential politicians in Lithuania, and what are the reasons behind his success?

Uspaskich is a native of Archangelsk, Russia, and arrived in Lithuania in the mid-80s as a welder. It has been said he was one of the best welders in the USSR. He chose to stay in Lithuania and at some point huge amounts of money began pouring into his pockets. Ignoring the origins of this money — it is a matter for the Lithuanian State Security Department to decide if any laws were broken — why do so many Lithuanians vote for him?

Lithuanians are referred to as the Italians of the Baltics, but an Italy without a Berlusconi is not Italy! Lithuania's Berlusconi is a symbol of La Dolce Vita. His voters want to be just like him. Possessing a charming personality, Uspaskich speaks the language of the people; his limited Lithuanian-language skills come across as endearingly folksy. Although easy-going, he is at the same time a very rich and confident person. Upon being asked which politician they would like to have a drink with most Lithuanians chose Uspaskich. How many Lithuanians politicians can weld, play a guitar, sing, tap dance and crack jokes during a single TV interview? Asked why he had so many female numbers in his phone he joked it was better to be a womaniser than to be gay.

Uspaskich loves the camera, and the camera loves him. His appearance in any program dramatically increases its viewership. He doesn't need to own a media empire like Berlusconi because talk shows already vie for his attention. It should be noted his electorate get most of their information from TV. One opinion poll director noted a pattern; when Uspaskich was busy in Brussels during his term as Member of the European Parliament, the Labour Party's popularity plunged. Then only a few days after his return to Lithuania and taking part in various TV shows, popularity of the Labour Party ballooned once more: without the Uspaskich balloon the party cannot fly.

The deepening divide between city and country helps Uspaskich nurture his electorate. The three major cities were conquered by the Conservative Party during the last parliament elections for the first time. Still, small towns dramatically affected by emigration are turning into the black holes in Lithuania; the educated are moving on and leaving their townsfolk behind. Thus a party with no political ideology is attractive not only to such an electorate, but also to new recruits.

It is difficult for newcomers to advance in established political parties. It's not in the Lithuanian character to work patiently towards a goal; if I can take it now I will. So instead of working their way up in traditional parties, many politically active Lithuanians take the easy way out by joining a new party for a chance at success. It's also worth remembering Lithuania has a tradition of new political parties being created just a few months before elections. Few of those make it to Parliament and generally die out before the next election.

Some of them, like the Labour Party, are still at large. It remains to be seen how long this will last.

A popular, funny, and rich man, Uspaskich was tolerated by the Lithuanian political establishment but never became a part of it. He is still an outsider, despite making various moves to be accepted into the "club". The political winds in Vilnius indicate his days are numbered. He has faced legal problems since 2006 due to alleged fraudulent bookkeeping practices of the Labour Party, which plays into the hands of various ruling coalitions. If he was said to have been "persuaded" to support a bill, the Labour Party was also seen to be willing to support it. However, he and his party seemingly crossed a line during the last Parliamentary elections.

A massive number of vote-buying cases alleged against Labour Party candidates set off alarm bells in Vilnius. If a political party starts attempting to buy its seats in Parliament this could spell the end of established parties. Established parties can compete in many ways with Uspaskich, but not with his money, especially if its origins are unclear. Such a hard-fought democracy already for sale? This is too much for many to bear. Uspaskich's immunity was swiftly stripped and legal proceedings against him are gaining momentum while his windows of opportunity are closing fast. He faces imprisonment; if he is to be sentenced it would spell the end of the party. The Social Democrats are already counting the new members that would pour into their ranks if the Labour Party meets its demise.

Uspaskich once said entering politics was a mistake. But was there really any other option in his mind? The man always appears to be on a mission. Lithuanians like to quietly speak about his real masters, but under no circumstances will they name them. Let that stay an open secret! However it seems this time the Lithuanian political establishment has won or Uspaskich's masters decided his mission is complete. Will the Italy of the North be able to live without its own Berlusconi? Not for too long it seems, because a second Lithuanian Berlusconi is already in the making.

To be continued...

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## Evolving threats to property rights in Russia

By Jordan Gans-Morse

The collapse of the Soviet Union and the ensuing chaos produced extreme lawlessness. In rapid fashion a society with massive industrial assets plunged into an institutional vacuum. Courts, law enforcement bodies, and state regulatory agencies capable of enforcing the rules of the game for a modern market economy had to be created from scratch or rebuilt from the remnants of socialist institutions. In the absence of effective state institutions, firms turned to alternative forms of protecting property and enforcing contracts. Mafia rackets and private security agencies provided physical protection, collected debts, and adjudicated disputes among firms. When large sums of money were at stake, contract killings became a prominent means of acquiring or protecting assets. In short, outright force or the threat of physical coercion became common tools for protecting property and ensuring adherence to business agreements.

Today, two decades after the fall of the Iron Curtain, high-profile cases of property rights abuses continue to dominate journalistic accounts of Russia, as well as many policy and academic studies. But this narrow focus is misleading. It offers a skewed portrayal of modern-day Russian business practices. In part, this is because such accounts often concentrate on a handful of tycoons and the extent to which these "oligarchs" hinder or promote the development of the rule of law.

By contrast, my ongoing research, based on surveys of Russian enterprises and in-depth interviews with Russian businesspeople, lawyers, and private security agencies, reveals a fundamental shift in threats to property rights in Russia. Whereas extortion rackets and other forms of physical intimidation once posed the gravest threat to property rights, state actors are now the primary aggressors. There has been a dramatic decline in threats related to private coercion, due partly to firms' increased reliance on formal legal institutions. By contrast, state threats to property rights have increased sharply. Key threats include seizing firms' assets, illegal corporate raiding, extortion, illicit fines, and unlawful arrests of businesspeople.

### The decline of private force

Criminal rackets now play a minimal role in Russian business. In the late 1990s, surveys reported that more than 40% of small firms experienced recent contact with protection rackets. By contrast, less than 8% of small firms (and less than 4% of all respondents) reported such contact in a survey I conducted during the summer of 2010. Similarly, whereas approximately 40% of businesspeople in the late 1990s reported having experienced violence or threats of violence, less than 5% reported such incidents in my recent survey. Research by Russian sociologists confirms these findings. N.S. Matveeva, for example, analyzed murders of businesspeople in the Central Federal District of Russia and found that such murders have fallen yearly, from over 200 in 1997 to 33 in 2005.

### The rise of law

Russian firms now use the courts extensively. The number of annual cases initiated by firms in Russia's commercial courts (*arbitrakhnie sudy*) rose from a low point of approximately 200,000 in 1994 to over 1 million by 2009 – a 400% increase. This rise is not due to increased conflicts but rather to firms' increased willingness to use litigation. According to my survey, 54% of respondents reported being more willing to turn to the courts today as compared to 10 years ago. Meanwhile, 33% of respondents said that their willingness to use the courts

remained unchanged, and only 6% of respondents replied that they would be less willing. Even far outside of the major cities, increased use of courts is apparent. As a lawyer in the Siberian town of Barnaul explained to me, "People more or less have come to resolve disputes in a civilized way, by going to court....[The courts are so full that] to move through the corridors of a courthouse is now impossible." Firms increasingly are willing to litigate even against the government. Between 2000 and 2008, cases against the tax authorities and similar government agencies rose from around 24,000 to over 90,000.

### The emergence of a predatory state

The decline of violence and criminal rackets is a significant improvement in the Russian business climate. But other types of threats have risen in their place. As Russian firms turned away from private force in the mid-to-late 1990s, they began to rely on corrupt government officials. For a fee, law enforcement officials offered many of the same services previously provided by criminal protection rackets, such as debt collection, contract enforcement, and adjudication of disputes. Along with law enforcement rackets, corrupt bureaucrats continue to pose a significant challenge for Russian businesses. At times, government officials themselves instigate inspections or harassment of businesses in order to receive bribes. In other cases, firms pay officials to selectively conduct tax, fire, or sanitation inspections in order to pressure competitors or counterparties in a dispute. In the survey I conducted, 25% of firms reported a violation of their legal rights related to collection of fines or payments by a government agency.

The most fearsome threat occurs when law enforcement officials, either at their own behest or on behalf of a paying client, threaten entrepreneurs with trumped up criminal charges such as fraud or money laundering. To avoid prosecution, firms are forced to pay bribes or sell off assets at below market prices. Nearly 6% of respondents — more than 1 out of every 17 firms — in the 2010 survey I conducted reported having been charged with crimes they did not commit.

### Conclusion

The Russian business world has undergone a remarkable transformation throughout the last two decades. The coercion and criminality of the 1990s have largely faded into the past, but new forms of corruption and extortion, often linked to state officials, continue to make Russia a rugged place to do business. Russian firms are increasingly willing to rely on the judicial system and law enforcement agencies to resolve business conflicts. In this sense, a "demand" for law is emerging from the private sector. Whether Russia's leaders are willing and capable of providing a "supply" of high-quality legal institutions remains to be seen.

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## FRUCT – Academia-to-industry cooperation engine and incubator of new competences and businesses

By Sergey Balandin

The main emphasis of FRUCT Association is incubation of new competences and businesses as a product of academic and industry-to-academia cooperation. FRUCT has been established in 2007 and nowadays unites teams from 22 universities of Russia, Finland, Ukraine and Denmark. Originally FRUCT was an acronym for Finnish-Russian University Cooperation in Telecommunications. The region of Finland and North-West Russia is the main geographical focus of the association, but nowadays it has partners and activities also in many other regions, e.g., Italy, Norway, India, etc.

FRUCT Association is an independent informal community with minimal bureaucracy overhead. It is community-driven provider of cooperation ecosystem that helps to find research and development partners. It is important to note that FRUCT does not pretend to ownership of the developed intellectual property and is not involved in IPR registration, i.e., when partners decide to create new IPR they directly negotiate conditions.

Also FRUCT is a forum to find partners interested in sharing costs of certain activities and services, e.g., FRUCT organizes regional outreach tours of lectures to promote technologies, attract best students to university study programs, find good employees, etc.

Many university groups are actively working to apply their scientific results in business. But to be efficient they need industrial feedback and guidance on up-to-date trends and demands. FRUCT is based on idea that cooperation of industrial and academic research is the key driver for growth of the innovation ecosystem and development of successful startups.

The main challenge is to facilitate development of such cooperation, i.e., propose a scalable process with high ratio of success stories. FRUCT was designed as an open innovation framework targeted in developing partnership between industrial and academic research. FRUCT projects target long-term research topics that are interesting for industry. Unlike topics related to product roadmaps, long-term priorities of companies usually are open and often even well visible via various challenges, joint research labs and so on. Focus on long-term research is more natural for universities and provides wider scope of opportunities for young teams, comparing to well-established areas with clear gurus. But such long-term research projects are very risky and often industry is ready to pay for results or clear progress, but not just for research, i.e., move risks to university. We address this challenge by giving students an opportunity to lead development of such projects. Of course it is voluntary activity and students know that there is no direct payment for such projects, but it is a huge opportunity to work on real research topics under supervision of top experts from industry and academy. Plus if project gets successful then often student receive some reward from companies or at least can present the project in challenges and award contests and so get compensation. Most importantly students are getting new knowledge,

understanding on how to use it and professional network. As a result FRUCT graduates are welcome to the best industrial and academic organizations and many decide to apply developed competences for own startups.

This approach is also beneficial for the supervising academia and industrial teams, as such projects fuels cooperation in the very early stage, incubates required competences and provides ground for further development of classical cooperation projects between the partners.

To be attractive for the students, FRUCT is active in community building activities, education renewal and organization of events and activities that increase students' interest and motivation to learn more about future of ICT. So we target to enhance interest to science and builds efficient and cozy infrastructure for collaborative work on distributed research projects. FRUCT Oy has been created as a business incubation and company for managing the association activities.

Yearly association organizes winter and summer schools, at least three free student conferences, helps students to publish over 70 papers, facilitates work of over 50 projects, takes part and wins many contests, grants and so on. FRUCT and IEEE ComSoc are the sister societies.

FRUCT association is created on top of voluntary community and nowadays turned into a competence and business incubator. The activities can be clustered to three groups: trainings, research and infrastructural.

In average FRUCT organizes free trainings on hot modern technologies once per 3 weeks and mostly cover region of North-West and Central Russia and Finland. Research potential of FRUCT is based on a regional network of 8 laboratories. The key research priorities are: mobile healthcare (m-Health) for early diagnostic, wellbeing, fitness and smart new services; Internet of Things and Smart Space technologies; geo-location, context-awareness and LBS; cross-platform architectures. Infrastructural activities are targeted to develop efficient distributed cooperation framework for FRUCT community and coordinate work of the professional communities. FRUCT supports four regional communities: Mobile Healthcare community, Smart Spaces and Internet of Things community «Are You Smart» ruSMART, Russian Qt community and Russian Mobile Linux community.

We welcome new academic and industrial partners to join our activities. More information can be found at [www.fruct.org](http://www.fruct.org) and by email [info@fruct.org](mailto:info@fruct.org).

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## The marine valley in Klaipėda – for development of Lithuanian maritime sector

By Julija Bendikienė

In 2008 the Government of Lithuania has launched the most ambitious goal ever to invest into its R&D market: 5 different programmes for development of 5 Integrated Science, Studies and Business Centres (called valleys) with public investment of about EUR 500 million (75% - EU funds) were launched with an aim to support the synergy of science, studies and business in different sectors. All valleys are located in 3 largest Lithuanian cities. One of five valleys – the Marine Valley - is located in Klaipėda, the only one seaport city of Lithuania. Though our coastline is one of the shortest among EU maritime countries (~90 km), the sea and the coastal region are very significant for the state's economy and welfare. Our maritime sector, comprising about 900 companies, is directly or indirectly linked to 18 % of GDP and creates around 30 thousand jobs, which accounts for almost 4% of all jobs in Lithuania. Despite positive economic effects, the Lithuanian maritime sector lags behind other Baltic Sea countries both in terms of the size and its value added per employee. Thus sufficient financial and scientific resources are required for stimulation of innovations and technological development. For this purpose main objectives of the Marine Valley have been set, including the creation of a modern research infrastructure; increasing the scope of R&D activities in maritime projects and raising global competitiveness of our maritime businesses.

The main initiator of the Marine Valley is Klaipėda University, since its establishment in 1991 concentrating its activities on marine science and academic studies. Its strong background was one of key pillars for physically settling the Marine Valley in the University campus and determining two major research fields - marine environment and marine technologies.

Different stakeholders, involved in the Marine Valley, play special roles: Klaipėda University consolidates modern research infrastructure and scientific potential, Klaipėda Science and Technology Park facilitates the cooperation between science and business in the region, Association "Baltic Valley" coordinates interests of associated key players of maritime industries. Such triple-helix partnership characterizes necessary elements of the research-driven cluster. As an emerging marine cluster, the Marine Valley has joined the network of European marine clusters of Sweden, Great Britain, Portugal, Ireland and France in recently commenced FP7 project REMCAP.

Being the flag bearer of the Marine Valley, Klaipėda University experiences the period of challenges. One of the tasks is to develop research infrastructure. Four new open-access research laboratories are established and gradually supplied with modern research facilities: Laboratory of Marine Ecosystems, Laboratory of Marine Chemistry, Laboratory of Researches of Reliability of Maritime Structures, Laboratory of Waterborne Transport Technologies. In two years the research facilities will be supplemented by new multifunctional research vessel for carrying out any modern oceanographic research. In November 2012 the contract for design and construction of the vessel has been signed with shipbuilder "Western Baltija Shipbuilding" (BLRT Group AS), located in Klaipėda.

Besides development of the research infrastructure, another task is of vital importance – to consolidate scientists

working in interdisciplinary maritime fields that are dispersed in different University departments, as well as other research institutes. For this reason the Marine Science and Technology Centre, as a knowledge core of the Marine Valley, has been established in the University. It incorporates open access research laboratories and unites scientists of different University divisions – the Coastal Research and Planning Institute, already internationally recognized in the interdisciplinary Baltic Sea and lagoon research, Mechatronics Science Institute and others. In collaboration with Lithuanian and foreign partners, scientists consolidate their efforts to tackle major marine environmental problems within different projects (CLEANSHIP, INNOSHIP, SAMBAH, MOMENT-UP, SUBMARINER, DEVOTES, VECTORS, ARTWEI, WEBLAB, REMOWE, MARINECLEAN, PARTISEAPATE, ECO-REFITEC, etc.).

To encourage formation of the innovation ecosystem in the Marine Valley, the Technology Business Incubator is to be opened in 2014 for start-up companies that need open space, special equipment and tools for virtual modeling and producing prototypes. However, several key issues should be properly approached in order to make the established infrastructure serve as high-performance platform for cooperation among research, education and industry:

- effective and clear management of infrastructure, with clear dedication to excellence and feasible key performance indicators (such initiatives as RAMIRI is a great possibility for improving management skills of personnel);
- implementation of smart specialization principle, avoiding duplication of resources of different players;
- closer interaction with businesses and continuous development of capacities required for translating research results into new products and services;
- encouraging mobility of researchers, inspiring their motivation for international competitiveness; raising entrepreneurial culture;
- availability of sufficient financial resources for operational phase of the infrastructure.

Overcoming of these challenges, cooperation with all stakeholders of the Marine Valley, networking with European infrastructures and scientific communities and devoting necessary resources will enable us to contribute to unlocking the potential for the blue growth.

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*Marine Science and Technology Centre*

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# The Yanka Kupala State University of Grodno (YKSUG) and its international projects in the Baltic Sea region (BSR)

By Irina Ledchenkova

The University named after the famous Belarusian poet Yanka Kupala has always been one of the most "Baltic" higher educational institutions in Belarus. One reason for this is the place of origin. The city of Grodno is divided by the river Neman, the basin of which unites Belarus with three other Baltic states – Poland, Lithuania and Kaliningrad region of Russia – and finally with the Baltic Sea. It is the Neman that created the topic for a number of projects in the region actively supported by the University:

- Tacis/Phare CBC Small Project Facility "Creation and Networking of the Belarus Bureau of the "Neman" Euroregion in Grodno".
- Tacis project "Regional Development and Nature Conservation in the Niemen Euroregion".
- INTERREG IIIB / TACIS № SV-148 "Cross-border cooperation of neighboring regions of Belarus and Lithuania for improving ecological safety of a common water basin".

Those projects apart from other things have resulted in strengthening the role of YKSUG in developing the strategies for Grodno region and cooperation with local authorities. And finally it led to the opening of the Bureau of the Euroregion Neman at the University in April 2012. The Bureau is responsible for coordination and development of cross-border projects in Grodno region.

The stable contacts of YKSUG with Polish and Lithuanian partners put the beginning for a new range of cross-border cooperation projects in such fields as tourism, ecology, cultural heritage, business and innovation. Such actions are giving an opportunity to solve the common problems and learn from neighbors.

It is the cross-border cooperation programme Poland-Belarus-Ukraine 2007-2013 that in 2011 gave funding to the project "Improvement of cross-border region attractiveness through introduction of ethno-cultural resources into tourist activities" coordinated by YKSUG. And it is the first time when the Belarusian university took the leading role in EU project. The project aims at improving competitiveness and cross-border tourist attractiveness in the region.

Apart from cooperation with institutions from neighboring regions the YKSUG has been developing its "Baltic" activities by networking with partners in Latvia, Finland, Germany, Sweden and Estonia.

One example is the Tempus-TACIS SCM-2003 Project "Transferring EU Quality Assurance to YKSUG" with Mjärdevi Science Park (Linköping, Sweden) as a lead partner. The action was finished in 2008.

Cooperation with the Riga Business School of the Riga Technical University (Latvia) presents another good example of academic interaction. The project was targeted at the creation of the Master of Business Administration Program (MBA program) in Belarus.

Among the presently running initiatives is the BalticAirCargo project funded by the Baltic Sea Region Programme 2007-2013. The mentioned project coordinated by Hochschule Wismar (Germany) unites 14 Partners from 8

programme area countries and aims at improvement of the air cargo transport sector by service oriented ICT-methods and processing logistic network. A number of important strategic decisions for further development of aircargo sector in regional airports is expected to be the project results.

Another interesting ongoing initiative to be mentioned is the Baltic Sea Region Caucasus Network (BASERCAN), the project launched by the Aleksanteri Institute of the University of Helsinki granted by CIMO, the Centre for International Cooperation within its North-South-South Higher Education Institution Network Programme, and funded through the development cooperation funds of the Ministry for Foreign Affairs of Finland. BASERCAN is planned to become an active instrument to increase student and teacher mobility between universities in Finland, Georgia and Belarus.

An important role in the Baltic vector of the YKSUG international activities is given to the membership in the Baltic Sea Region University Network (BSRUN) and the Baltic University Programme (BUP). While the first one mainly gives opportunities for administrative staff to network and launch new projects, the latter one provides the platform for teachers and students to cooperate for sustainable development.

International exchanges are an integral part of academic and administrative processes of the YKSUG and most of them are with the partners from the Baltic Sea Region. In 2011 the University joined two Erasmus Mundus projects coordinated by the University of Turku and one more by Mykolas Romeris University in Vilnius.

Thus, the projects with the BSR partners have always been strategically important for the YKSUG. And at the same time it often became the bridge for cooperation between the organizations inside and outside the Baltics.

The Republic of Belarus is not always directly associated with the Baltic Sea Region. But the example of one particular University and the overview of its international projects show how fully the country is in the Region at least on the level of people-to-people contacts. The status of Belarus as an Observer in the Council of the Baltic Sea States, its involvement in a wide range of EU funding instruments is leading to intensification of cooperation with the Baltic neighbors and results in new projects that are bringing more value for further development of the region from both sides of the border.

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## Borders to define a Baltic Sea region

By Karri Kiiskinen

It is easy to take for granted the freedom of movement in the Baltic Sea region especially after the Baltic countries and Poland joined the Schengen area in 2007. Border crossings have become a self-evident part of diverse projects activities as well as in everyday life. Even if we still tend to lead lives that look for roots rather routes, it is increasingly possible to encounter each other also "at home". It is, however, far less clear what it means that certain practices of border crossing have become self-evident, and what are their effects on the way that people live their lives in the region? Apart from the EU funded border-crossing programs, we also have those that put emphasis on local and regional cultural originality as means to support people in facing the demands of this "borderless" era. It seems that our capacity for bordering, that is, how we can negotiate the many borders in the BSR (Schengen, physical, social and cultural) is a force to be considered when deciphering the present/future processes shaping the region.

In terms of safeguarding the well-being of people in the present as well as in the future, issues of environment tend to come to the fore. Considering the future of the Baltic Sea itself it is a self-evident matter that national borders need to be transcended. One can ask, however, if the border related practices contribute in a sustainable future, and for whom? Within the EU, border crossings are increasingly understood in terms of shared practices networking, commodified culture (i.e. art, heritage) as well as objectified differences (often stereotypic images of national/regional/local cultures). Undoubtedly, these can serve well interactions across borders and the networking based on common interests but to what extent can these practices meet the demands of local well-being? Some (extreme) examples from internal and external EU borders suggest how people are engaged in actions for a common future.

First one has to note that there is nothing self-evident when it comes to borders in a "borderless" world. In case of such transnational regions as the Øresund region between Sweden and Denmark, where the actual everyday border crossings increase, there is also hit back effect which suggests that "nothing changes". National stereotypes seem to flourish since they simplify interactions ("others" are similar but different in a safe way) and when they can be used to emphasize the experience of border crossing (i.e. in order to attract tourists). Here also other, partly conflicting, experiences emerge when for daily commuters across the sound bridge, or migrants, border crossings seem to be "nothing specific".

At the Polish-Ukrainian external border of the European Union an immigrant is hardly able to cross the border without facing its strict controls; selectivity is a known and "self-evident" aspect of the border (i.e. smuggling, visa). The border is also affected by narratives of ethnic cultural heritage (Poland had to give up its eastern part to Soviet Union after II World War). Now this "common heritage" is not only a symbol of good relations (and networking) between

Poles and Ukrainians, but may suggest the capacity of local people in safeguarding local well-being at the border. Typically, cultural projects here engage local people at home and across the border by discovering local, multicultural material heritage - with diverse results. However, also the EU border itself can be engaged. As one Polish local actor put it: "It can be a crazy idea", but he seeks to "engage the structures". He organizes annually a religious procession to a chapel located at the borderline as well as a popular music concert. First, the audience is the local community, but then a public of 30000 people takes part in the concert at the borderline. For him, it is important that the EU defines the border, but since it is not doing that in a proper way, local heritage and culture is a resource for defining it. Now, a border crossing point is under construction in one of the concert locations.

It seems that the outcomes and cultural logics of projects can be increasingly diversified. Project actors may focus on pragmatic aspects (as in Finnish-Russian cooperation). Focus on pragmatic aspects is clearly not the only option for defining engaging local people. Also the EU funded cross-border cooperation programs at the external EU border (ENPI 2007-2013) define 'culture', not only in terms of support for cultural diversity, but also as a "difficult to define" area of cooperation. Thus, not only the EU border itself, but also diverse programs suggest space for thinking alternative border crossings and considering whose borders are addressed. In cooperation, routines are needed but there is also room for people who do "crazy" things, find new ways of including "others", and address those (often hierarchizing) processes that continue to mark, not only people, but also their futures as different.

In the BSR, the Baltic Sea is a natural border which is shaping the "self-evident" practices of border crossing. The question is how these contribute in cultural bordering also further away from the physical border? Perhaps the BSR can, someday, be verified as a transnational region where also everyday lives in many places are "nothing specific" (i.e. work migrants a resource also with intention and possibility to settle down). We can contemplate this "challenge" (also in future projects) by thinking the boundaries that tie us to places - not forgetting that this is already a reality for many.

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JOHN NURMISEN SÄÄTIÖ  
JOHN NURMINEN FOUNDATION



Co-funded by the Baltic Development Forum, the Centrum Balticum Foundation, the City of Turku, the John Nurminen Foundation and the Turku Chamber of Commerce

ISSN 1459-9759

Editor-in-Chief (responsible for writer invitations): Kari Liuhto  
Technical Editor: Leena Koivisto

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