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Government subsidies and the internal market – another evolutionary step for Europe's State aid policy

By Joaquín Almunia

A short history of State aid policy

Five years after the Schuman declaration of May 9, 1950, the six members of the European Coal and Steel Community started to discuss in earnest the creation of a common market. They set up the Spaak committee – named after its chairman, the then foreign minister of Belgium – which ended its work nine months later. Alongside the provisions that would keep the future internal market free from anti-competitive business practices, the report devoted a section to “financial assistance granted by the states”, stating that it must not favour individual enterprises or types of production. The rationale was that government subsidies could distort competition and undermine the integrity of the Single Market just as much as cartels and monopolistic positions of private enterprises.

This historical reference speaks to the political and institutional acumen of the early architects of the European Union, who would soon give to an independent authority – the European Commission – the power to control certain forms of support granted by national authorities to private companies. The so-called State aid articles – numbers 107 and 108 in the Lisbon Treaty – have not changed since the Treaty of Rome. These provisions have no equivalent anywhere else in the world. For almost six decades, their implementation has underpinned Europe's economic and social integration.

However, if the principles have remained unchanged, the State aid legal framework has been updated regularly. The European Commission's control over government subsidies has adapted to the growth of the public sector in Europe over the years. In addition – as the EU enlarged from the original six to soon 28 Member States – the system has grown in complexity, especially because the levels of government – and hence of aid-granting authorities – are structured differently in different countries. Finally, since 2008 a special State aid regime has successfully ensured that the massive support extended by governments to banks in distress would not threaten the integrity of the Single Market.

A modernisation strategy for State aid

As a matter of course, State aid policy has had to respond to the new conditions determined by the crisis well beyond the banking industry. In this juncture, most EU governments need to consolidate their budgets. As a result, it is difficult for them to take spending decisions. At the same time, growing numbers of Europeans hit by the recession turn to national and EU authorities for immediate support. The obvious way out of this conundrum is growth. EU countries must meet the people's expectations for realistic strategies to generate

growth and jobs in the future. Spending and tax policies are among the levers that governments have to create the conditions for a sustained and sustainable period of expansion. To help government authorities cope with this situation, I have launched a complete overhaul of State aid policy – the State aid modernisation strategy.

The main goal of the reform is to help national governments do more with less; that is, to make more efficient use of increasingly scarce resources. The reform will promote well-designed aid that fixes market failures and pursues common European objectives, such as promoting innovation, green technologies, and the development of human capital. The reform will also promote the incentive effect of public aid, which should not replace but complement private investment. Subsidising activities that would have been carried out anyway does not serve the common interest and, in any event, has become unaffordable. Another form of wasteful expenditure the new regime will discourage are the subsidies to unviable companies which, in some cases, can that keep them on life support for a very long time. In addition, the new regime will respond to the growing disparities in the fiscal capacities of different EU countries; a fact that can fragment the internal market. Finally, the modernisation of State aid rules is an excellent opportunity to use information technology to introduce more transparency into the system. State aid policy is ultimately about the use of taxpayers' money and the people have a right to know who is receiving aid, how much and why.

To conclude, the reform process will renew the EU State aid regime across the board over the next months. In December 2012 the European Commission adopted the first new-generation Guidelines devoted to the broadband sector. If everything goes according to plan, the rest of the reform package will be adopted in 2014. The State aid modernisation strategy is a prime example of how EU policy-making can respond to fast-changing conditions. As Europe's governments strive to improve their fiscal positions, our reform can help them lead Europe out of this crisis and address the dreadful implications it has for Europe's citizens.

Joaquín Almunia

*Vice President responsible
for Competition Policy*

European Commission



Finland will meet the renewable targets with forest energy

By Jari Koskinen

The European Union adopted targets for energy production from renewable energy sources (RES) in 2009. Ambitious targets were set for reducing greenhouse gas (GHG) emissions and promoting the use of renewable energies. Further underlying objectives include energy security, reducing import dependence for energy, and improving the competitiveness of the European economies. To reach these targets each EU Member State follows a promotion strategy of its own and uses different instruments for increasing the share of RES.

Finland has taken the renewable energy targets very seriously. The Renewable Energy Directive (2009/28/EC) sets mandatory national RES targets for each Member State. The target set for Finland is a 38% share of renewable energy in the final energy consumption by 2020. This is one of the highest in the EU.

The EU targets have influenced the Finnish energy policy in the past few years. We have updated the National Energy and Climate Strategy, which determines the energy policy outlines to be followed. Support mechanisms have also been updated. Changes have been made also to the taxation of fossil energy sources. Taxes on oil products, coal and peat should encourage the use of renewable sources. Among the criteria for the taxation is the carbon content of the fuels.

The most recent National Energy and Climate Strategy was approved by the Government in March 2013. The headline target for 2020 is that 38% of the energy consumption in Finland would be covered by renewable energies. One of the concrete actions to achieve this is to increase the use of forest chips for producing electricity and heat to 25 TWh by 2020. The Finnish Government wishes to significantly reduce the use of coal by 2025, mainly to be substituted by forest biomass. The production of biofuels and bioliquids in Finland is also expected to be mainly based on forest biomass or waste feedstocks. The share of domestic synthetic biogas is to be increased to 10% of the consumption of natural gas. The strategy also highlights the importance of energy self-sufficiency and development of domestic energy technology.

What is important now is to identify and create good national conditions for the growing use of renewable energy sources. Certain aid schemes have been updated in order to increase the use of bioenergy. One aim is to raise the competitiveness of bioenergy to a level at which the required growth can be achieved. New feed-in tariffs were launched in 2011 to support the use of forest chips in electricity production, and wind power. In certain respects, however, this has been a rocky road. Some of the envisaged aid schemes have not been realised as originally planned, or the aid payments have not led to the kind of investments they were aimed for. One major challenge has been the current economic situation, meaning that all over Europe we have been forced to reassess the use of Government budget funds for different purposes. The uncertainty and changes to plans have been problematic for the energy sector and investments. One crucial target is to create long-term and well predictable support schemes so that the state could provide the necessary guarantees to allow long-term planning by investors.

Already today the renewable energy sources provide one fourth of the total energy consumed in Finland and account for more than one fourth of the power generation. The most important renewable sources of energy in our country are bioenergy (wood-based fuels in particular), hydropower, wind power, geothermal energy and solar energy.

When we talk about increasing the use of renewable energy, the focus in Finland is on forest biomass, obviously due to our abundant forest resources. By-products and residues from wood processing industries (black liquor, bark and sawdust) have for decades been important sources of energy. Their supply naturally depends on the production volumes of wood processing industry, which is why no exact target for increasing their use can be set. Thus the main targets for increasing the use of wood-based fuels in energy

production have been set for forest chips, i.e. logging residues and small-diameter wood.

In Finland the use of forest chips has increased rapidly. Last year a total of 8.3 million cubic metres forest chips were used, which was again a new record. Of this 7.6 million cubic metres (about 15 TWh) was burned in heat and power plants and the rest was burned in private homes. If we look at the situation just one decade ago, the use of forest chips has increased nine-fold since 2000. In spite of this quite dramatic growth, the aim is to almost double the use of forest chips from the present to 25 TWh in heat and power plants by 2020. In practice the raw material of forest chips is comprised of branches and tree crowns from felling sites or small-diameter trees from young stand tending or first thinning operations. The efforts to increase their volumes also involve certain challenges. The amount of logging residue depends on the volume of final cuttings which, in turn depend on the roundwood markets and the activity of forest owners. In the same way, the amount of small-diameter wood coming to the market depends on the amount of forest management work that is being done. In terms of exploiting our forest resources there are no obstacles to increased energy use: in the past few years only about a half of the annual increment of Finnish forests (more than 100 million cubic metres a year) has been harvested.

Besides the practical challenges described above, certain new obstacles to using forest energy have been raised. Certain parties have called to question whether biomass and especially wood biomass is at all more environmentally-friendly than fossil fuels. The strongest criticism has been directed to tree plantations in the southern hemisphere and use of whole logs for energy. What has also been questioned is the whole concept of sustainability of the northern forest management. One key issue raised is carbon debt which may be created if e.g. logging residues are collected for energy. It is most valuable to talk about these issues and to make sure that our energy targets truly contribute to climate change mitigation. What is unfortunate, however, is that these discussions cause uncertainty in the field and, at worst, may slow down investments.

Finland has also been active and tried to convince the European Commission that, if it intends to introduce sustainability criteria for solid biomass for energy production, the criteria must not cause any new barriers for developing the markets for sustainably produced biomass. As regards logging residues and other forest biomass it is necessary to avoid the creation of a separate scheme and sustainability criteria for one particular end use of wood. Forest biomass which ends up in energy production should not be subject to criteria differing from those for timber or pulpwood.

For reaching the EU targets over the next seven years a lot of work needs to be done. The Commission published just recently, in March 2013, a progress report on how the Member States have advanced in promoting renewable energy sources. The Commission points out that the growth in the use of RES has been slower than was hoped for, and the trajectory shows that even greater efforts by particular Member States will be necessary in the years to come. Personally I am prepared to make every effort to make sure that, in spite of the great challenges we still have, Finland and the whole EU will reach the target and, through this, make an important contribution to climate change mitigation.

Jari Koskinen

Minister of Agriculture and Forestry

Finland

NATO and the Baltic Sea Region – an Estonian perspective

By Urmas Paet

It is no secret that the world around us is changing quickly. We have to face and overcome new challenges almost daily. Security is no exception. Therefore, NATO and its partners have to be prepared to face emerging threats. The defence of NATO and its partners in the 21st century depends not just on the existence of regular military forces, but also on our preparedness to flexibly address new threats.

There are many things that the Alliance and its partners have to consider. For instance, it is essential to address cyber security and develop NATO's ability to deal with cyber threats. Everything that we do in cyberspace has consequences in the "real world" too. In a way, the widespread use of different ICT and e-solutions makes us vulnerable. One particular step that we have taken to address this issue was the creation of NATO's Collective Cyber Defence Centre of Excellence in Tallinn. Its objectives are to elaborate new strategies to combat cyber threats and to provide training.

Another challenge is the declining of defence spending in NATO member and partner states. This is particularly problematic as, at the same time, certain other countries are actually increasing their defence expenditure. Decreasing defence spending is unsustainable. It can lead to new and even deeper crises. NATO agreed the 2% defence spending criterion in order to ensure the Alliance's relevance. Europe cannot afford to become a so-called security consumer. This is why Estonia spends 2% of its GDP on defence already for the second year in a row.

Then there are also NATO missions. Foremost among them is Afghanistan. Despite being challenging, the mission helps make our countries safer. The Afghanistan mission is the first one to have grown out of an Article V response. It has confirmed that NATO plays a vital role in guaranteeing international security, and that the Allies are capable of co-operation necessary for a large scale out of area operation. I believe all this is valuable experience in the face of potential 21st century challenges.

But if we talk about the Baltic Sea region in particular, then Estonia would like to see the Nordic-Baltic region as integrated and unified as possible. Security plays a very important part here. It is important to assure NATO's stronger presence and visibility in the Baltic Sea region. This would increase stability.

The decision at NATO's Chicago summit last year regarding Baltic air policing was a very positive one. The whole region benefits from Estonia, Latvia and Lithuania being better protected. And the participation of the Nordic countries in regular air policing exercises in the Baltic region is certainly a step towards the kind of security co-operation that we need.

Organising regular, large scale live format exercises similarly fosters co-operation. "Steadfast Jazz 2013" will

provide significant added value militarily as well as politically in raising NATO's profile in north-eastern Europe. This enables the Allies to test interoperability, to practice contingency plans, to make sure that NATO is ready for the worst case scenarios, and it also gives the opportunity to better involve the Alliance's partners.

Finland and Sweden are the NATO's closest partners. They offer an outstanding contribution to the Alliance and help increase security in our region. The Alliance should involve partners like Finland and Sweden in a wider range of NATO activities, training programs and exercises. This includes high-intensity conflict scenarios. On the other hand, we could think about the greater integration of Estonia, Latvia and Lithuania in Nordic Defence Cooperation (NORDEFCO) initiatives.

Nordic-Baltic defence co-operation also encourages EU-NATO co-operation. For instance, the Nordic Battlegroup helps increase interoperability between NATO Allies and EU members in the north. The Battlegroup concept in general is promising, despite the fact that we know there are politically difficult issues involved here.

Another thing that I would like to highlight is NATO-Russia relations. This significantly affects our region. Estonia supports mutual efforts to enhance reciprocal transparency with regard to military exercises, security doctrines and defence reform. But we have also seen the build-up of advanced offensive weaponry near NATO's borders. This is evident in Kaliningrad, but also in the Pskov and Leningrad oblasts. Militarising these areas is counter-productive to the partnership we hope both NATO and Russia wish to maintain and develop.

So in conclusion, as security challenges remain and as the world around us continues to change, we undoubtedly have many tasks ahead. But as some have even said that Sweden and Finland already are de facto members of NATO, we definitely have a very strong foundation for extending and increasing our co-operation. Of course NATO membership is a choice to be made by Finland and Sweden themselves, but Estonia would like to see the Nordic-Baltic region as integrated and unified as possible. That is why I am convinced that the path of co-operation is the right one to follow if our ultimate goal is to increase stability and security in our region.

Urmas Paet

Minister of Foreign Affairs

Estonia

Ukraine – in search of success in the modern world

By Viktor Mayko

It is my pleasure to address share with the readers of "Baltic Rim Economies" Ukraine's goals and priorities in the field of foreign economic relations as well as the prospects of Ukraine-Finland economic cooperation.

As an export-oriented country with the share of export in its GDP amounting to over 50%, Ukraine is keen to diversify its trade and economic relations by developing mutually beneficial cooperation both with the traditional partners and with new economic drivers of the modern world such as China, India, Brazil, Persian Gulf states along with other countries of Asia, Africa, and Latin America. We have a belief that such an approach will help Ukraine to strengthen its role as a proactive and reliable partner, open to the plentiful options of cooperation offered by the present-day world.

European integration, especially in the context of signing this year an ambitious and innovative Association Agreement with the EU, remains Ukraine's strategic priority. It is a cornerstone of systemic (and for the most part, painful) internal reforms aimed at achieving EU norms and standards in all spheres of life.

The Association Agreement is just a few steps away. It will lead to profound changes of the paradigm of our relations with the EU: from partnership and cooperation to political association and economic integration. We proceed from the understanding that the finalization of all technical formalities will open the way for signing of the Association Agreement by the end of this year. We consider the Association Agreement as a comprehensive tool of modernization and key instrument for moving the reform process further, particularly through gradual legislative approximation to the EU laws and regulations. Ukraine hopes to benefit from the establishment of the so called deep and comprehensive Free Trade Area (DCFTA) envisaged by this Agreement, by obtaining for its goods and services an unprecedented access to the world's largest market and by receiving additional impetus to further economic development through increasing flows of direct foreign investments in the real sector of the Ukrainian economy.

At the same time, we believe that our EU integration is an asset to the both sides. First, European Ukraine means more European security and stability. Secondly, European Ukraine means a secure energy supply and better communications. Thirdly, European Ukraine means a wider EU market, enormous in its potential and capabilities: as a country with the population of 46 million, Ukraine with an advanced industry and a fertile agriculture has to become a promising target for foreign investors, especially from the EU.

DCFTA is of crucial importance for the Ukrainian and EU businesses and consumers. It will not only lead to the opening of a common market but will also facilitate introducing European standards in business and investment environment in Ukraine. Thus, we are working on the idea of launching DCFTA before the whole Agreement is ratified by all EU Members States.

In this regard, it's worth saying that the European aspirations of Ukraine do not prevent us from developing mutually beneficial trade and economic relations with the Customs Union of the Russian Federation, Belarus and Kazakhstan, which is our largest economic partner with the yearly trade turnover exceeding 60 billion US dollars. Thus, Ukraine has to elaborate an effective framework to strengthen economic relations with the Customs Union. We are considering all options for establishing an effective mechanism of cooperation with the Customs Union, which should be based on our national legislation and be fully compatible with our course towards European integration.

Ukraine is keen to intensify bilateral trade and economic relations with Finland. Despite a substantial decrease in 2009

caused by the world economic crises, the trade turnover between our countries continues to grow from year to year.

The 6th meeting of the bilateral Trade and Economic Commission last December in Helsinki proved our joint interest and willingness to further develop our economic ties. We have good prospects for intensifying cooperation in construction, agriculture, fish industry, transport, telecommunications and other.

Ukraine considers Finland as a country with a rapid advancement and unique expertise in the field of high technology and innovations. Finnish solutions in different sectors such as environmental protection, energy efficiency, R&D could be very valuable for us. Collaboration between Ukrainian research institutes, universities and companies and Finnish research units is therefore important in order to keep abreast of recent developments in a number of fields. Several Ukrainian-Finnish scientific research projects are already under way, involving such sectors as geology, environment, forestry, and energy.

Our priority is to enhance direct investments from Finland. We believe that current amount of Finnish investments in Ukraine that barely exceeds 72 million US dollars, does not correspond to the existing potential, especially in comparison with the impressive Finnish capital flow to Russia.

More than 70 Finnish companies are successfully working in Ukraine nowadays in the field of processing industry, machine-building, metallurgy, pulp and paper industry. We encourage Finnish companies to start and expand their business in Ukraine, taking into account huge opportunities for foreign investments in our country.

Ukraine is trying to do its utmost to improve the business and investment environment, particularly by reducing administrative barriers and bureaucracy, introducing tax stimulus for investors. The Ukrainian authorities make every effort to assist Finnish investors in resolving their problems, in particular regarding VAT refund. We hope that the automatic system of VAT reimbursement has met the expectations of Finnish companies.

Ukraine might become one of the key countries for the Finnish business in Eastern Europe. The overall advantages of cooperation clearly outweigh the drawbacks. Ukraine is undergoing intensive modernization and is not lacking in some risks as an economic partner, but such risks are believed to be relatively limited. Ukraine's pursuit of improved energy efficiency and the use of renewable energy sources together with the development of energy and transport infrastructure, logistics systems create additional opportunities for Finnish investors. We are open for cooperation and are ready to start joint projects in these areas offering relevant support both at state and municipal levels.

I invite Finnish business to Ukraine for a serious, mutually beneficial and interesting work.

Viktor Mayko

Deputy Minister

Ministry for Foreign Affairs

Ukraine

The role of nuclear energy in European sustainable energy mix

By Romana Jordan

Energy is one of basic commodities of modern life. As it is based in engineering science, one would expect related debates to be highly technical. However, public debates on nuclear energy are amongst the most passionate of all. In fact, the predominance of emotional arguments can lead to political decisions which are not necessarily best for the people. If we based our decisions on the science of sustainable development, nuclear energy would play a fair part in our energy strategies. At present, the reach of our policy documents at the European Union level merely declares that individual Member States can freely choose their energy mixes and that nuclear energy can be an integral part.

Sustainable development of the EU until 2050

In order to understand our 2050 goals, it is important to first look at the EU's short term goal for 2020. By then, we have to achieve emissions reduction of 20%. The greenhouse gasses emitted by the energy sector make it the biggest air polluter and therefore it has to take on the biggest burden for reaching the set goal. Currently, the European energy policy is mainly focused on more efficient use of energy and achieving a higher share of renewable energy sources (RES) in our energy mix. Our legally binding goals for 2020 are to reach 20% share of RES and achieve 20% energy savings.

Long-term strategies of European climate-energy policies are no different. The European leaders have set the path towards achieving greenhouse gas emissions reductions of 80% by 2050 implying a practically emission-free energy. However, instead of focusing on enormous societal and technical changes that this goal requires, the current political debates remain focused around the same issues: more RES and more efficient use of energy.

An overarching objective of European energy policy, defined some years ago, is a holistic one: ensuring secure, competitive and environmentally friendly energy for Europe. The flexibility and dynamics that a high share of RES brings has therefore to be borne in mind when creating an adequate energy policy. A proper legislative environment needs to be created in order to allow for a creation of highly developed and interconnected infrastructure as well as adequate backup power generation. Personally I do not agree with those futuristic projections that an energy system based solely on small energy producers can be achieved in the next decades. On the contrary, I believe that in the mid-term, we will still require big power plants to provide us with secure baseload energy needed for stable electricity systems. Nuclear power plants are such kind of plants. They are reliable and they do not emit greenhouse gasses. Nuclear power can in addition remain competitive compared to other energy sources, even when we take into account costs of radioactive waste disposal and decommissioning.

Why are we then so afraid of questioning the future of nuclear energy?

Controversies around nuclear energy

The public image of nuclear power plants can be seen as those forest castles wrapped in the fog of mystery. Therefore there are a number of reasons for public distrust of nuclear power.

Firstly, a power plant surrounded by a fence where only the top of the reactor containment can be seen, naturally stirs unease and fear for the unknown. This is understandable as we tend not to trust things that we neither know nor understand. Indeed, a lot of knowledge is required in order to fully comprehend the functioning of a nuclear power plant. Holding a PhD in nuclear engineering myself, I can further state that there is never enough knowledge about nuclear energy as this is an extremely complex field which is constantly developing. In order to understand nuclear power plants, we need to know concepts from natural sciences, engineering as well as human and social sciences.

Secondly, radiation cannot be seen and therefore we are even more afraid of it. People tend to ignore that this very same nuclear radiation plays a crucial role of modern medicine.

Finally, while weighing the pros and cons of nuclear energy, experience plays an important role. Due to the big size of the nuclear power plants they are rather scarce. This prevents ordinary people from having a lot of experience with them. It is not surprising that those people who live in vicinity of nuclear power plants are in principle more supportive of nuclear energy.

The complexity of nuclear energy calls for a high level of safety. The core elements for achieving this are excellent technologies and human resources. In addition, the use of nuclear power should only be in democratic environments with a high level of safety culture, where only the experts are responsible for operation of the plants. Naturally, national legislation in line with guidelines and recommendations of the International Atomic Energy Agency is also important as well as its implementation ensured by experts of independent supervisory authorities. Policies are the cornerstone to ensure that nuclear power plants operate safely and securely. For this reason, the lack of serious mentions of nuclear power in EU strategic documents is a real concern. Current scenarios of the European Commission show that by 2050 nuclear power is expected to represent around 15% of primary energy in EU's energy mix. Similarly, Barack Obama, the President of the USA did not at all mention nuclear energy in his State of the Union address of 2013. This was regardless of the fact that nuclear energy represents around 20% of the USA's energy mix.

The future of nuclear energy

Based on our goals for achieving a sustainable energy mix, I believe that nuclear energy will remain an important energy source in the EU.

At the present time I see no alternative source to nuclear. Coal is unacceptable due to high and dangerous emissions and a higher share of gas will increase EU's import dependency. In the long-term, I can imagine a society dependent only on renewable energy sources. But we cannot pretend that this could be a mid-term solution. The share of RES can progressively grow as we develop more stable networks, better regulation and invest in new infrastructures.

Nuclear energy is currently faced with many challenges. By explaining scientific arguments we should increase public acceptance of nuclear energy. We should ensure safe disposal of nuclear waste and strong independent supervisory authorities that closely monitor operators and owners of all nuclear power plants. In this respect, the results of European Nuclear Stress Tests and analyses after the Fukushima accident can offer an invaluable basis for further development of European policy framework. Some regulatory bodies, in particularly in smaller EU Member States, can be faced with a lack of finances and human resources. This could call for a reflexion on a possible transfer of certain nuclear safety assurance competences from national to the European level.

As world population grows and we are struggling for space on our planet, let us not forget that only a cup of nuclear fuel suffices for total energy supply of an entire family for a whole year.

Romana Jordan

Slovenian Member

European Parliament



The Baltic Sea: stable and safe – for now

By Sampo Terho

Security in the Baltic Sea region is only as stable as the area's countries are at any given moment - and the potential security risks are diverse. I present here a few examples and countries which in my opinion illustrate the overall situation.

Sweden

Sweden has a tendency to cut its military forces. From 2014, there will only be a volunteer army where the soldiers are paid for their service. The size of this new volunteer army will be reduced to just 50,000. In comparison, we Finns have a conscript army, and even with a diminished reserve, we will have 250,000 service personnel.

As Sweden is reducing its manpower in the military, it will invest in security-related technology. It is also a major player in arms export when compared to Finland. The former exports 17 times more arms than the latter. Regardless of Sweden's neutrality, it has traditionally engaged in close cooperation with the United States. This is not, however, enough to secure the country's defence. The Swedish Commander, Sverker Göranson, has publicly estimated that if Sweden suffered a military attack, it could fight only for one week without help from other countries or alliances. This is why it is not surprising that discussion continues around the potential NATO membership of Sweden which – just like Finland – has not yet joined the organisation.

If Sweden and Finland or even one of the two were to join the NATO, it could polarise the Baltic Sea region as this would bring NATO nearer to Russia which views the organisation with suspicion. Finnish or Swedish membership could provoke Russia to perform a show of force. In practise this would mean pretentious field exercises in the Baltic Sea region.

Finland cooperates in the military field with Sweden and other Nordic countries. This cooperation is to some extent political, and some of it is "pure" military cooperation.

Estonia

It seems likely that the extent of military armament around the Baltic States as well as in Poland and in the Kaliningrad region will increase in near future. Even if the security situation is stable in the Baltic region at the moment, the issue of the size of armament as well as that of air surveillance will keep the area in high level security-related discussions.

Another aspect that may potentially lead to security threats in the Baltic States, is the question of minority rights and their status. It was only in 2007 when the longstanding stability in Estonia came under threat from the problem of the Soviet World War II memorial in Tallinn, the so-called Bronze Soldier. The Estonian government removed the Bronze Soldier from the centre of Tallinn. The statue has been historically significant for Russians living in Estonia and Russia considered the removal of the Bronze Soldier as an insult to Russians.

Agreement on border questions between Estonia and Russia has taken a step forward as the Prime Ministers of

the two countries held a negotiation in early April 2013. Estonia is the only EU Member State without a border agreement with Russia. The meeting was the first one over the border question for several years. Russia has not ratified the draft border agreement between the parties because in 2005 the Estonian Parliament attached to the contract some historical aspects which were not acceptable to Russia. Russia has a strong incentive for successful negotiations as it wishes to have a visa waiver program with the EU.

Russia

Russia continues to carry out a thorough reform of its military forces. This obviously requires adequate financial resources which are secured by a boost in economic growth. Investing in military forces is still high in the country's priorities for public spending, and in some discussions, the rhetoric in doing so has also strengthened.

If Russia wishes to continue increasing its military expenditure, it will need positive forecast for its economy. Nearly half of Russia's budget comes from energy production and taxes imposed on exports. This means that the size of budget varies greatly from one year to another as the price of oil changes constantly at the global level. At the moment, the size of the Russian budget is not stable as it grows too fast in relation to income.

Relations between Finland and Russia continue to raise interest also outside the region. Finland is highly dependent on Russian energy sources. Environmental risks in the area still include those related to Russian nuclear plants and the consequences of potential accidents would not be limited to inside the country's borders. The organised crime in the region cannot be completely left out from the discussion of the area's security either. Finland will be highly affected by the increasing number of Russian sea transports, construction of ports and new pipelines which are built in order to diminish the Russian dependence on transition countries. The traffic on the Baltic Sea will increase substantially when Russia is growing its export via the port of Primorski.

In conclusion, the situation in the Baltic Sea region is currently stable, but for example the risk for an environmental disaster is possible, and as the Bronze Soldier incident proved, individual disagreements between the different countries in the region are also still possible.

Full scale strategic warfare seems unlikely in the near future but the possibility of that can never be ruled out completely.

Sampo Terho

Member

European Parliament

Rail Baltica and Baltic-Adriatic Growth corridor influence to the regional cohesion policy

By Vilja Savisaar-Toomast

The future of the transport sector and especially its infrastructure for the next financial perspective and until the 2030 will be based on two main networks - core network and comprehensive network. Baltic-Adriatic Growth corridor is part of the core network and it will connect the Adriatic and the Baltic Sea. Main idea of this corridor is to build-up and fully implement the rail connections along the route. These railway connections will connect a great number of capitals and ports in many different member states.

To evaluate the influence of the Rail Baltica to the regional cohesion policies we have to consider the idea behind the core network and its purpose.

The core network will connect:

- 83 main European ports with rail and road links
- 37 key airports with rail connections into major cities
- 15,000 km of railway line upgraded to high speed
- 35 cross border projects to reduce bottlenecks

Rail Baltica

Since today Baltic region is basically cut off from the rest of Europe by rail. There is a rail connection between the three Baltic States and between the Lithuania and Poland but in reality this rarely can be called as an efficient railway connection. Furthermore there are currently no regular lines between the three Baltic States and there is no possibility for passenger to get on the train in Tallinn and drive to Warsaw or the rest of Western Europe. As a solution for this we have great hopes for the Rail Baltica project.

Rail Baltica Growth Corridor which is one part of the Baltic-Adriatic corridor aims to improve the competitiveness and accessibility of Baltic cities and regions by increasing their interaction and collaboration.

Rail Baltica Growth Corridor creates a cooperation platform that observes the needs of transport sector and its customers in line with green growth corridor principles.

Rail Baltica Growth Corridor brings benefits for

- City and regional authorities
- Transport service providers
- Logistics centres
- Intermodal terminals
- Public transport authorities
- Universities and research centres
- Transport users - passenger and cargo

When considering the Rail Baltica corridor we have to make difference between the three stages of Rail Baltica project.

I and II stage of Rail Baltica project cover the existing rail network – the goal of the first two stages is to upgrade the existing network to max speed of 160 km/h. The main difference is that this network is Russian gauge and it already connects many regions, cities and towns in Baltic States.

The III stage of the Rail Baltica project includes building up a new high-speed European gauge railway connecting

Helsinki, Tallinn, Riga, Kaunas, Warsaw and also some towns on the way.

This creates a very good opportunity for member states to connect the European gauge high-speed network with local Russian gauge network.

Regional cohesion policy

Estonian railway network in 60s and 70s of the last century was very well covering the all country. Then the railway had a great importance in regional cohesion policy and played an important part of the transportation of goods and people.

Unfortunately the Estonian railway network today connects only few towns and regions. There are many reasons, why the importance of railway has diminished. Also I cannot say that Estonian state has put much effort and funds into railway in past 20 years. But it seems that it is changing now, the state and the public rediscover the importance of railways and there are already some initiatives from the towns and municipalities to reopen some connections. Considering the future this is very important that there is a well-connected and well-functioning local network in order to make the Rail Baltica work with full efficiency and capacity.

As planned at the moment Rail Baltica will have three main stations in Estonia. It will connect Tallinn Central Station, Tallinn Airport and Pärnu town. Those three stops are with great importance but we need to go further locally. People need to get to those stations and I personally support the idea that the local network has to offer very good connection and cooperation with the new high-speed line.

For the cargo the new line connects or gives possibilities to connect ports in and near Tallinn. Related to cargo the existing local network is not used very much for local goods. At the moment the main amount of freight comes from Russia to our ports and is shipped away or vice-versa. At the same time we can see daily hundreds of trucks driving along the Via Baltica from Helsinki, Tallinn to Warsaw, which very well shows that there is a need and possibility for faster and cleaner transport of goods on railways on the same route.

I hope that thanks to the Rail Baltica the Estonian railway network will look like mixture between the past and the future – including high-speed line to Europe and has a good well-functioning and well-connected local network.

European projects like Rail Baltica does not only bring European value but can bring lots of benefits to the Member States affected and to their regional policy.

Vilja Savisaar-Toomast

Member

*Committee on Transport
and Tourism*

European Parliament



In a sea of challenges

By Nils Torvalds

You don't actually have to do anything more than look at the metropolitan areas around the Baltic; by all standards, it's a shallow sea with a lot of people living at its shores. From St Petersburg at the Neva to Riga at the Daugava to Vilnius at the confluence of the Vilnia and Neris rivers to Warsaw at the Vistula to Copenhagen in the southwest and further to Stockholm and Helsinki (almost) in the North, you have – all together – 85 million people living by and with the Baltic Sea.

I have lived all my life by the shores of the Baltic and I started to navigate it – in a small rowboat – and fish in it at about the age of six. For a very long time, "it" was just there and I didn't think of it as anything changeable. Or if I perceived any changes, they were cyclical. In August every year, you would find the jellyfish there and the next spring, when the ice melted away, you wouldn't find even a trace of them. But in August they would appear again as a sign of everything going its normal way.

In the beginning of the 50s we fished and found it fun. Sometimes we would get "cat fish", meaning fish we didn't think were fit for human consumption. Those fish we carried to Zaida, who kept a small store. She had a lot of cats and we could get a couple of lollipops in return. We had started to exploit the Baltic Sea.

I cannot pinpoint the moment when I started to realize that something was changing – and not changing in a cyclical way. I'm afraid it was rather late. In the 80s I was the co-owner of a sailing boat with very strict rules about who could and had to sail at which time of the summer.

In early June the water is fantastically clear. And cold. Tacking against the wind is an adventure requiring a lot of woollen underwear, but sailing into a natural harbour in the evenings, you enjoy the safety of seeing five meters of crystal clear water. You see every stone and rock.

But in late July the story is very different. The water gets murkier and in part that is related to the cyclical process. But a part is not. Anyone who has sailed in the Finnish archipelago knows that now on windless days, the surface of the sea is covered with a carpet of blue-green algae. In the very early stages of this process of blooming algae we probably thought that the green stuff was just the annual pine blooming leaving its usual thin carpet of pollen on the surface.

We were wrong.

I also noticed that a change in the catch when fishing. A regular day's catch in my childhood was mainly European perch. If we were very lucky, we might get a Northern pike. Much later my favourite catch would be flounder. In the last ten years I haven't got a single flounder.

Now we know that something is going on in our Baltic Sea, but in all likelihood we don't see the whole process and as human beings we have a tendency to opt for easy and simple explanations.

The first challenge is salinity. We all know that the Baltic is *brackish*. But the word brackish doesn't actually tell us anything. Water can be brackish in hundreds of different degrees and every degree has a certain impact on flora and fauna.

We began to understand a part of it during some years in the 80s. Cod fishing at that time was a free-for-all. In any other form of fishing with a hook you need bait – either a worm or a small fish. But cod you could get with just a big hook. People bragged of getting 20 or 50 cods in one hour. (That's the real problem with amateur fishermen: they – we – easily get greedy and pull up more than we are able to use properly.)

Then the cod vanished. Grudgingly, we came to realize that the cod was dependent on the amount of salinity in the water. So we started to wait for the saline pulse from the North Sea. Old people in the archipelago said that when the cod comes, the war comes. And roughly speaking we had had wars every 20 years. So, we just had to wait and the salt water would come.

But no, it wasn't that easy. The salinity of the Baltic is of course not just defined by the pulse of higher-saline water through Oresund and the Danish straits. It's also defined by the more than 250 rivers flowing into the basin.

Statistically speaking, the saline pulse should come in December or January, and the reason for that is apparent. During those months the northern rivers are likely to be frozen and therefore the inflow of fresh water at its lowest. But if we get more rain and warmer winters, the fresh water inflow in the Baltic will be greater and "the outward pressure" in the Oresund and the Danish straits bigger.

We most probably see this change already and one piece of evidence is the flounder. It doesn't like its water too brackish, so it goes south. And it's not the only species. The blue mussel also depends on higher salinity, which in turn has further implications: the eider feeds on the blue mussel.

We have fairly complicated food chains in our sea, and these food chains get even more complicated by the simple fact that fresh and salt water doesn't mix easily. That leads to very different results in different parts of the basin. What we might now experience as a challenge in the Finnish archipelago isn't – yet – a challenge along the Polish or German coast.

When we add to this that we also face an immense challenge in seabed areas in the Baltic that are already dead. Even if we succeed in making agriculture more sustainable, we still know that more intense rain showers and/or torrential rains are likely to occur. That will overload the rivers with more oxygen-consuming material, which again will make life more complicated for the fish. As a probable indication of that I now get more freshwater fish or "near-to-coast fish" in the outer archipelago.

In the Fisheries Committee of the European Parliament we are trying to find solutions to a well-known problem: in an unregulated commons everybody is trying to get as much as possible. In this sense we are experiencing what Garrett Harding described in "Nature" in 1968: the tragedy of the commons. But Elinor Ostrom's take on the same problem provides a more optimistic look: if we are able to establish functional rules, we are also able to salvage the commons.

The political problem seems to be that we easily define a problem only from our own point of view. How our neighbours define it is – by default – the wrong way.

One example of this undefined – and therefore unregulated – common interest is the salmon. This "king of all fishes" in the Baltic is heavily regulated for professional fishermen, but for *innocent* amateur fishermen, probably fishing the same amount of salmon (as the quota is given in pieces of fish, not in tons), there is practically no regulation.

That is not a sustainable solution. The Baltic is our sea. Due to the relative shallowness of it, it is immensely vulnerable. At the same time we have probably disturbed all the natural habitats in one way or another. We have done it by racing all over it with bigger and noisier boats, by building summer cottages on any and all islands, by liquidating other forms of employment in the coastal area and thereby forcing small villages to subsist mainly on tourism. That has created new conflicts between tourism and fishing, where tourism has opened up privately-owned fishing waters.

And yet – we still don't see our common interests.

Nils Torvalds

Member

European Parliament

Security policy in the north

By Tom Packalén

Geopolitics naturally affects Finnish security policy. Finland is situated in the middle of Scandinavian countries, Russia, and the Baltic States. The Northern Baltic Sea Region states have plenty of defence policy solutions. Finland's northern and southern neighbours, Norway and the Baltic states, belong to the NATO. Russia is one of the great powers of the world on its own, whereas Finland and Sweden rely on neutrality and their own defence.

History affects Finnish security policy, too. Finland became independent in 1917 after being part of both Sweden and Russia. Finland was able to retain its independence during the Second World War, despite two wars against the Soviet Union. These wars had a huge impact on Finnish thinking. Due to non-existent or minor help from other countries, Finland has relied on its own defence.

The world has changed in many ways after the Second World War. However, people do not change, which is usually forgotten when people interpret history. Nowadays it is a trend to talk about Wide Security instead of simply talking about peace and war. Wide security includes a range of threats from terrorism, weapons of mass destruction and diseases to global warming. There is a rationale to use the concept, but it clearly makes it more difficult for people to understand the entity.

Carl von Clausewitz famously pointed out that "war is a continuation of state policy by other means". The concept of security can be divided to hard and soft security. Hard security includes the military threat and the ways to prevent it. Moreover, the new ways to fight wars, such as the fashionable cyber security, are a part of military threat. However, the same regularities still apply to warfare. One cannot conquer a country with cyber warfare; it is still done by soldiers. Therefore, we must understand the basic nature of war and see trends of warfare as part of bigger picture.

The threat of war consists of ability and will. Currently, Finland has excellent relations to its neighbouring countries. There is no visible military threat to Finland. Nevertheless, we still have to prepare for possible threats because armament and conditioning for the weapons systems take a long time to be operative. It is hard to predict the future. Who would have predicted five years earlier the fall of the Soviet Union, the breaking of the Berlin wall, the 9/11 attacks or the beginning of the Arab Spring?

Furthermore, it is hard to predict the future of Russia. Russia is a military superpower in Eurasia and the only one of our neighbouring countries that has the ability to attack our territory. This fact has to be taken into account in the consideration of Finnish defence policy. Russia has a reserve of twenty million man and massive armed forces. Conceiving of worst-case scenarios is a common form of strategic planning to prepare for and minimize contingencies

that could result in different problems. There is no assumption from the part of Finland that Russia has a will or a reason to attack Finland. It is of high priority for Finland to maintain and further develop our good relations with Russia.

Military pressure on Finland is unlikely but not impossible. Russia's dependency on energy exports

can lead to problems for the Russian economy if the price of energy decreases significantly. This could also put a strain on the domestic affairs and affect the development of democracy. On the whole, development of both Russia and the European Union in the medium and long term is uncertain.

The future of Finland must be put into a broader perspective. Finland has been able to maintain very effective armed forces and a large and motivated reserve despite its small defence budget. Operative forces that use very modern weaponry are combined with more passive but decentralized regional and local troops. The new fighting doctrine that the land forces have introduced responds well to the challenges the modern warfare and the rise of firepower present in the battlefield. Adaptable system also enables the effectiveness with a limited budget. Moreover, there has traditionally been a strong will to defend Finland and, according to recent studies, this will still prevails.

In the end, Finland can only rely on its own defence, which must be maintained properly. It is desirable that we could increase the amount of cooperation, and we already have cooperation with international players. But what should be the next step? The Common Foreign and Security Policy of the European Union hardly is a sustainable solution. The EU is merely a paper tiger and not a military force that Finland could rely on.

Partners in cooperation should be searched from the Nordic countries where we already have the Nordic Defence Cooperation (NORDEFECO). Cooperation could even be developed in to a defence alliance e.g. with neutral Sweden. Finland and Sweden could supplement each other's weaknesses with their own strengths, which would result in a credible defence alliance.

After all, it must be remembered that the best guarantee for peace for Finland are good foreign relations and a credible military defence.

Tom Packalén

Member of Parliament

Finland



Tuition fees in Finland for foreign students outside of EU/EEA -area

By Arto Satonen

Tuition fees have been under a lot of discussion in Finland lately. On the background there is my bill about collecting tuition fees from students that come to study in Finland outside the EU / EEA -area. At the moment there are no tuition fees in Finland, so anyone can come here to study and take the advantage of our free education system. The Finnish tax payers cover the costs. There are 200 MPs in Finland and 117 of them signed my bill. I collected signatures with my colleagues Jukka Kärnä (Social Democrat), Ari Torniainen (Centre Party) and Reijo Tossavainen (The Finns).

Main content of the bill is to allow Finnish universities to sell their education to solvent foreign students. There are lots of this kind of students in the developing countries of Asia, for example in China, India, Russia and other CIS countries. Globally education is already a huge business. For example, in Great Britain there were over 400 000 international students in 2011-2012 even though all of them had to pay tuition fees. Globally there were about 2.1 million students studying abroad in 2000 and in 2009 there were already 3.7 million students studying abroad. In Scandinavia Sweden and Denmark have changed their system lately and are now collecting tuition fees from foreign students and are developing a new export from education. In Denmark this reformation was carried out in 2006. Immediately after this the amount of students decreased, but at the moment Denmark has already nearly reached the 2006 level. The Finnish education system has a good reputation thanks to good success in the PISA researches, and therefore Finland has a great potential in education business.

At the moment there is an experiment on tuition fees going on in Finland, but this experiment is very limited. For example, the polytechnics are only allowed to sell degrees of higher education, which are really uncommon degrees in Finland. The influence of this experiment is marginal, because it's not even possible for the polytechnics to sell their main product, the basic degree. In addition, most of the universities don't even take part in this experiment, so the education for a foreign student is either free or chargeable depending on which university and degree the student has applied for. In this kind of situation it's really difficult to sell the education and therefore the experiment was doomed already before it even started. At the moment the most attractive universities in Finland don't even market themselves outside Finland, because the budget-based funding doesn't allow them to increase their number of students. The average cost of an academic year is around 8000 euros.

It's not possible to collect tuition fees from students coming from the EU / EEA -area, because the tuition fees have to be same for everyone inside that area – including the Finnish students. There has been no discussion on collecting tuition fees from Finnish students as it's clear that no would support this idea. Also in the future the free education for Finnish students is an important issue for my party, the National Coalition Party. Our goal is to give every Finn an opportunity to educate himself as well as possible. But it would be possible to collect tuition fees from students who

come outside the EU / EEA -area. To ensure that there wouldn't occur radical changes in the number of university students, the suitable level for tuition fees should be set experimentally by slowly raising the fees closer and closer towards the actual cost of the education.

It would be fair to let those foreign students who decide to stay in Finland and work here after their graduation to deduct their tuition fees in taxation. Finland needs foreign students and foreign employees, but we simply can't afford to educate academic workforce for other countries for free. However, at the moment huge amount of the foreign students move abroad after finishing their free studies in Finland. This is not fair for the Finnish tax payers as it seems that the benefit from the free education goes to other countries. Therefore it is reasonable to offer free education only for those people who decide to stay in Finland also after their graduation. The easiest way to actualize this is to give tax deduction for those who stay and work in Finland.

However, some people couldn't afford paying the tuition fees even though they had the right to deduct the fees in taxation later. For example, we could use the development aid to pay for the education of the students coming from the developing countries. It would also be rational to found a fund which would award talented but disadvantaged people by scholarships. It's important to get talented students and with all kinds of backgrounds.

MPs from six out of eight parties in the parliament have signed the bill. In the preliminary debate most of the MPs supported the bill, but it got criticism from the MPs of the Green and the Left Alliance. The most distinctive arguments for the criticism were the calculations, which claimed that the present situation is almost profitable if you also count in the rents, food and other expenses that the students have to pay. Obviously the ones making these calculations didn't realize that the students would still pay these expenses in addition with the tuition fees. Many student unions have also criticized the bill, but luckily some also support this idea. Especially those who have seen this experiment work in practice, like Lappeenranta University of Technology, have supported the bill. In addition, one MP called me a racist because of the bill. However, I don't think that someone who says that Finnish tax payers shouldn't provide free education for a Chinese student who will work his whole career in Canada, or the other way round, is a racist. The next step is that the bill will go to the Committee for Education and Culture for a hearing and hopefully after that it will be taken to the Ministry of Education to be modified to an actual law.

Arto Satonen

Member of Parliament, Vice-Chairman

National Coalition Party's Parliamentary Group

Finland

Baltic Sea region at the heart of Poland's and Finland's foreign policy

By Janusz Niesyto and Jari Vilén

Nordic, Baltic and Visegrad foreign ministers met at the beginning of this year in February at the one of the oldest and most historical Baltic sea cities in Gdansk. This meeting was described by the host Polish Foreign Minister Radosław Sikorski as the beginning of a new process. It was also a clear and present evidence of Poland's new interest in Baltic Sea Region.

Poland in recent decades made substantial efforts to move first from Eastern towards Central Europe and now more to the North. In the EU's internal dynamics of recent years the Baltic Sea region gained a special position – being the most competitive, effective and politically stable area of the European Union. This should be an incentive for countries to work even more closely together. Finns and Poles have decided to establish a more in-depth and structured cooperation. A special Joint Communiqué defining the context of closer cooperation was adopted by Prime Ministers of Poland and Finland **Donald Tusk** and **Jyrki Katainen** in December 2011. Relations between Helsinki and Warsaw have never been better.

The European Union's Baltic Sea Strategy (EUSBSR) which started a few years ago was a success for all of those who wanted the Union to pay more attention to this unique area within the EU. Co-operation in the Baltic Sea region can already be seen as a model for other regions. Germany, Poland and all other EU countries in the region represent one-third of the entire EU population and almost one-third of its GDP and trade. Countries in the region are already seriously interdependent in their economies which can be seen especially in the trade and investment flows. Intra-regional trade in the Baltic Sea is 30-50% of the regions countries' foreign trade. In the current crisis and the political turmoil in the EU Baltic Sea region represents a rear predictability, political stability, effective governance, and economic growth in the Union.

For Finnish exports about 40% and for imports about 45% are related to the Baltic Sea economic area and for Finland's foreign trade about 80% is done via the Baltic Sea. For Poland the Baltic Sea area means 38,5 % of exports and 40 % of imports. The Baltic Sea region has almost become an internal EU sea, where the cooperation with Russia plays a special role. The existence of the Baltic Sea economic development is therefore especially important to us Finns and Poles. The Polish economy has continued to grow throughout the current financial crisis in the last two decades

and Poland has been the most positive example in the whole EU. Not forgetting that also in the Baltic countries the EU economy will grow faster than in the other EU countries. New positive sign of common confidence is Latvia's willingness to join the euro by January 1st, 2014. Also Poland has clearly stated its willingness to adopt the common European currency.

The Baltic Sea region has all the potential to grow as a reference and cooperation model. Success in this requires effort and commitment from all Baltic Member States, as well from Russia. For Finns and Poles, one part of the Baltic Sea cooperation is particularly concrete and visible. Finland grants each year more than 1.2 million visas to Russian citizens and Russians are expected to make more than three million trips to Finland, as well as to leave Finland with more than billion in tourism revenues. Russia's commitment to this co-operation is essential and necessary. Poland introduced a small border traffic for the Kaliningrad district, thereby facilitating people to people contacts.

What we need for our Baltic Sea region is even more co-operations, better communication at all levels and strong leadership for joint projects. Similarly, the importance of a common cultural and value identity should not be overlooked. More understanding encourages shared innovation, entrepreneurship and creating economic growth, prosperity and stability.

Janusz Niesyto

*Ambassador of Poland
in Finland*



Jari Vilén

*Ambassador of Finland
in Poland*



Greifswald and its international activities within the Baltic Sea Region

By Arthur König

“While steeped in tradition, the Hanseatic City of Greifswald is also a modern university town within the Baltic Sea Region, and as such resolutely oriented towards the future. The city’s particular geographic location has resulted in close and diverse cooperation with Scandinavia, the Baltic States and the neighbouring country, Poland.” – This excerpt from the City of Greifswald Mission Statement highlights the importance of international ties within the Baltic Sea Region for the city’s development.

Due to its geographical position, Greifswald has been fostering close contacts with other Baltic Sea countries for centuries. Greifswald was able to develop into a powerful trading town within the Hanseatic League, and the gabled houses in the historic old town are a reminder of the city’s heyday. Today, Greifswald is an active member of the modern-day Hanseatic League, the New Hansa. In addition, the city makes use of other cross-border networks, such as *the Union of the Baltic Cities* or *the European Route of Brick Gothic* in order to maintain and develop international cooperation. Greifswald has been influenced not only by its Hanseatic past and present, but also by a period of Swedish rule. For over 180 years, Swedish kings determined the city’s fate as well as that of the whole of Western Pomerania. During this time, Greifswald was the seat of the chief judicial and ecclesiastical authorities. The Swedish rulers also invested a lot of effort in developing the University of Greifswald, which was to become the first Swedish university ever. The University has always been heavily influenced by foreign lecturers and students, who have also lent an international flair to the city itself. Research into the Baltic Sea area has long been a priority at the alma mater. The Greifswald Institute for Nordic Studies, the first of its kind, was founded in 1918. The binational degree course is the only Master’s degree programme in Baltic Studies in Germany, was launched in the winter semester 2008/9. The two-year programme is set up in cooperation with the University of Vilnius in Lithuania. Greifswald has a long tradition of forming partnerships with universities from the Baltic Sea Region. In the 1980s, it established partnerships with the University of Eastern Finland (1981), the University of Lund in Sweden (1985), the University of Szczecin in Poland (1985) as well as with Denmark’s second largest university, the University of Aarhus (1988). In 1992, the University renewed its partnership agreements with the universities of Tartu, Riga, Vilnius and Klaipeda. The choice of language study courses offered at the University of Greifswald is a reflection of its close ties with its Baltic Sea neighbours.

In addition, the University heads a number of international research projects in the Baltic Sea Region. To name but a few, in 2009 the German Research Foundation established the International Research Training Group ‘Baltic Borderlands – Shifting Boundaries of Mind and Culture in the Borderlands of the Baltic Sea Region’, a cooperation

between the Universities of Greifswald, Lund and Tartu. The initiative aims to qualify approximately 20 doctoral and 5 postdoctoral researchers and will run until 2014.

Furthermore, the Institute for Geography and Geology is a lead partner in the EU-financed INTERREG IIIb project, ‘AGORA 2.0 – Heritage Tourism for increased BSR identity’. The project aims to find ways to improve the common identity of the Baltic Sea Region by developing its natural and cultural heritage. The project comprises 25 partners from 9 countries bordering the Baltic Sea.

One of the most important networks for cooperation in the fields of life and health sciences is ScanBalt BioRegion. The organisation currently comprises 67 members from the EU Baltic Sea Region, Northwestern Russia, Norway and the Netherlands. The members represent more than 60 universities, over 1,200 Life Science and Biotech companies, including nearly 700 research organisations.

A number of town-twinning agreements are the direct result of the University’s close contacts with other Baltic Sea nations. Six of Greifswald’s seven twin towns can be found along the Baltic Coast. The city’s oldest twinning agreement, with the Finnish town of Kotka, dates back to 1959. In 1990, the twinning agreement with Lund in Sweden came to an end, but it was via Lund that the contact with the city of Hamar in Eastern Norway was established and later formalized by a twinning agreement in 1997. In addition, Greifswald also has close ties with Poland. Friendly relations with the small town of Goleniow have been maintained since 1986, culminating in a twinning agreement in 2006. Greifswald’s most recent twinning agreement with the harbour town of Szczecin was signed in 2010. All three cities share a common regional identity within the Euroregion Pomerania. Greifswald also maintains friendly relations with Tartu in Estonia, its partner in the cross-border climate protection project ‘TwinTownClimate’.

The above examples demonstrate the close ties between the city of Greifswald and the Baltic Sea Region. The development of the region will foster better living and working conditions within the whole area, which is important to all cities. Greifswald is fully aware of the importance of promoting close collaboration with and within the Baltic Sea Region and puts a lot of effort into setting up and maintaining networks and continuously develops new project ideas.

Arthur König

Dr., Mayor

City of Greifswald

Germany



Security in the Baltic Sea region

By Sverker Göranson

During the years of the Cold War, the Baltic Sea region served as an armed frontline between the eastern and western blocs. Today, the situation is quite different. The area is considered an area of increased cooperation and shared political as well as military partnerships. It is also an area of stability and security. In order to maintain and further develop this positive momentum, we must constantly work on continued integration in all fields, cooperation and frequent dialogue between all partners involved, outside as well as in the region.

The Swedish Armed Forces have two distinct and important contributions in further stabilizing the Baltic Sea region. We are engaged in military cooperation with the countries in the region in a multitude of different areas ranging from high level visits to common exercises and training. But we also maintain a military capability to be able to refrain from using military means for conflict resolution, if the security situation should worsen.

In a compact environment as the Baltic Sea, trust and predictability between the partners involved both outside and in the region are fundamental in building security. Increasing energy transports along with the Nord Stream pipeline are examples of the ever developing trade flows in the Baltic Sea, which is one of the busiest waterways in the world. In a broader perspective, these flows can integrate the region. But we should also be aware of the potential environmental risks with increased trade in the Baltic Sea, risks that concern us all in the region.

Closer integration and cooperation in the Baltic Sea region will become even more important in the future, since challenges in a globalized world very often are transnational. An increased cooperation and engagement between all partners in the region, Russia included, is therefore imperative.

Russia is currently improving, transforming and modernizing its military capabilities. Such major transformation is difficult to achieve, and plans often have to be adjusted. Indeed the Russian Armed Forces share many similar challenges as other countries. However, the modernization reform program is very ambitious and will, if successful, alter the current military posture in our region. An increased Russian military capacity and interest in the Baltic Sea region will require creativity and mutual understanding within the security partnerships between all nations in the Baltic Sea region, Russia included. Therefore, various arms control regimes and confidence building measures are still vital in the region.

Given the overall positive security development during the last 20 years in the Baltic Sea region, the cooperation between the Nordic countries and the Baltic countries has evolved. The Nordic-Baltic cooperation is a natural development as we share a common sea, geographical vicinity and values.

The Nordic countries have a long tradition of cooperation in several areas. We share a unique kinship based on a common linguistic and cultural foundation. With a long history

of cooperation between our countries, we have a relationship built on mutual trust and respect. But it is crucial to nurture and continuously develop and deepen our cooperation. In order to take further steps in our integration, each country must be ready to compromise and dare to challenge traditional national identity markers.

Even though the Nordic countries have chosen different forms of security policy arrangements, we have successfully worked together in creating a more peaceful world, both in our vicinity and far away as in the Balkans and Afghanistan. Experiences from the Nordic defence cooperation, the NORDEFECO, will also matter in future projects to come. The NORDEFECO cooperation today stands as one model for the development of Pooling and Sharing inside the EU as well as for NATO and Smart Defence. The current partnership between the Nordic countries cannot be seen separately from the cooperation within the EU or NATO. It is complementary and specifically designed for our region.

The Nordic countries also conduct different forms of common exercises and training. Since some years, the Air Forces from Finland, Norway and Sweden conduct Cross Border Training (CBT) in the northern parts of our countries. And last year, an agreement was signed between Sweden and Denmark concerning CBT in the south.

There are also potentially interesting areas of bilateral cooperation in flexible formats within the Baltic Sea region. I.e. the current Swedish-Finnish amphibious cooperation has the potential to also include a maritime command with sea surveillance (SUCBAS), sea traffic control as well as Pooling and Sharing. The role model for this thinking is the Belgian-Dutch common naval command.

Luckily, the Baltic Sea is no longer a military buffer zone. Today it serves as a link to trade and integration. People to people contacts are the foundation for mutual understanding and trust, which is imperative for a continued regional integration.

Partnership like the NORDEFECO and the Nordic-Baltic cooperation are examples of partnerships that have the potential to deepen the security dialogue within the region. It is in our common interest that the Baltic Sea remains a sea for peace, trade, integration and economic growth. But if we want to obtain a real inclusive regional security dialogue, we also need to engage Russia more. Security in the region must include all countries around the Baltic Sea.

Sverker Göranson

General, Supreme Commander

Swedish Armed Forces

Sweden



The Baltic Sea countries are fore-runners in cooperation in coast guard functions

By Jaakko Kaukanen

All authorities are looking for savings and trying cope to with a continuous line of budget cuts. The Finnish Border Guard is no exception in these times of recession. To perform the tasks that society expects with fewer resources is a delicate and difficult task. One of the key ways of doing more with less is cross-border cooperation.

On the European level, cooperation between coast guard agencies is taking its first baby steps and is looking to find solutions suitable for all. The European Coast Guard Functions Forum (ECGFF) was created just a few years ago but is proceeding fast on educational issues, for example. The forum has also pin-pointed the tasks that are commonly regarded as functions of the coast guard.

The Finnish Border Guard is one of the few agencies in the whole of Europe that is capable of performing all coast guard functions in their sea area. The Hellenic Coast Guard is another example of a single agency coast guard. In most European countries the tasks have been divided between two or more agencies that perform these functions at sea.

Goal for Coast Guard Functions

The European Coast Guard Functions Forum (ECGFF) has identified several tasks that can be considered core coast guard responsibilities. These activities include for example search and rescue, maritime border control and maritime surveillance, maritime safety and security, fisheries control, maritime customs activities and law enforcement.

The objective of the Coast Guard Functions Forum is certainly not the creation of a single European coast guard nor is it an attempt to influence member countries' organisational issues. The target is simply to promote best practices and find cost efficiency through cooperation.

On a European level the cooperation also requires agencies to cooperate with Member states. The ECGFF has brought together the key maritime-related agencies, such as the EMSA (European Maritime Safety Agency), Frontex (European Agency for the Management of Operational Cooperation at the External Borders of the Member States of the European Union) and the EFCA (European Fisheries Control Agency).

By bringing the EU's agencies to the same table, the ECGFF will also engender cooperation between these different sectors. This kind of cooperation has been called for many times in speeches but has not been put into action so well. Hopefully the Commission will take note of this progress when preparing the EU's Maritime Security Strategy this year.

Sixteen years and still going strong

The Baltic Sea countries have shown the way in terms of inter-authority cooperation for almost two decades. The Baltic Sea Region Border Control Cooperation (BSRBCC) has established a cooperation forum for operational matters, with 24/7 contact points in all the countries around the Baltic Sea. It also has a secure information-sharing system called Coastnet, which can be used to pass information from one country to another quickly and safely.

In 2013, the Finnish Border Guard holds the presidency for the organisation. The events will take place mainly during the summer season and can be described as very

operational. Here are just a few examples: a seminar for divers, an international on-scene coordinator course, a seminar for aviation experts and a boarding team seminar.

How to see over the horizon

Where are the savings and cost efficiencies that should come through improved cooperation between authorities? The truth is that the beneficiaries could be other than the coast guard and maritime authorities. Through improved surveillance of the sea area and the ability to pin-point unlawful actors like vessels that are discharging dirty bilge water or that are contravening the fishing regulations, the biggest beneficiary from the cooperation is clearly the environment. Other agencies are the winners when one considers the sharing of know-how. Sharing best practices and especially lessons learned can be worth a lot financially when mistakes can be avoided rather than repeated.

From the citizen's point of view, when ships and mariners sail from one country to another, the standard of care they receive should be roughly the same no matter whose waters they are in. Of course the point is to let the 99% go and focus on the 1% who do not want to play by the same rules as the rest of us. Finding the criminals on the job requires lots of intelligence work and surveillance capacity, which no single country has. This has been one of the basic factors behind the Baltic Sea Region Border Control Cooperation (BSRBCC). This year, sea-related operations are underway which will be carefully planned and executed after common intelligence work with BSTF (Baltic Sea Task Force on organized crime).

At a different level, in the EU, the Common Information Sharing Environment project (CISE), proposed by the EU's Integrated Maritime Policy, aims to develop situational awareness of all activities at sea. The Finnish Border Guard is leading ten EU countries in a cooperation project that aims to bring together the EU's operational actors from various sea basins (Mediterranean Sea and Black Sea for example) to jointly contribute to the development of CISE. We hope that we can put the experience gained at the Baltic Sea area to benefit even larger sea environments.

To conclude, to do more with less is certainly possible when not all the available resources are being put to efficient use. My aim was to show this with a few examples from the Baltic Sea area and by describing the ongoing process at the European level as well. The beneficiaries from cross-border cooperation are often not the actors them-selves, but one should remember that in the long run, we all benefit from cleaner and safer seas, which is much too difficult to quantify and impossible to put a price on.

Jaakko Kaukanen

*Chief of the Finnish
Border Guard*

Lieutenant General

Finland



Operational energy security in NATO context – looking to the future

By Arunas Molis and Florinda Giacomelli

In recent decades energy security has proven to be one of the priority interests of states and therefore subject to international relations. This is a direct effect of the post-Cold War panorama, in which economic capacity and the possession of great sources of raw materials has affected the definition of a new geopolitical equilibrium. The growing prominence of the energy factor in international relations may be comprised under four big issues: climate change, security of supplies, energy efficiency and environmental protection. The security dimension of energy supply and distribution has gained relevance in international debate due to most states' overdependence on external energy suppliers which are frequently plagued by political instability. Other reasons are armed attacks to energy storages and distribution systems carried out by pirates or terrorist groups, the number of which has increased during recent years. Ultimately, technological progress has developed new tools and solutions beneficial to armed forces such as portable solar chargers for electronic devices, electrical engine transport, more efficient power conversion systems, etc. These dynamics have proven the transversal nature that energy has across a variety sectors, including industry, economy and defense. It is for these reasons that the NATO Alliance has recently initiated a multilevel debate about the military aspects of energy security.

History

NATO touched on the energy security topic for the first time during the Riga Summit of 2006, but the real debate began at the Bucharest Summit in 2008 with direct references to protecting critical energy infrastructure and military energy efficiency. The debate continued at the 2010 Lisbon Summit when the NATO New Strategic Concept "Active engagement, Modern Defense" was adopted. This document clearly states the relevance of energy security as a critical topic for the Alliance, not only because energy supply has risen as a potential security issue for NATO planning and operations but also because the Alliance itself has to develop its capacities and policies to be able to face an evolving security environment.

The Chicago Summit (May 2012) could be considered as the turning point towards a practical approach to the topic: "we will work towards significantly improving the energy efficiency of our military forces; develop our competence in supporting the protection of critical energy infrastructure; and further develop our outreach activities in consultation with partners, on a case-by-case basis". The Final Declaration also supported the establishment of a NATO Energy Security Centre of Excellence (NATO ENSEC COE) in Lithuania in order to contribute to NATO's efforts in this area.

Main principles

There are many international organizations working in the field of energy security, so it is crucial to avoid overlapping the work done by NATO and other actors and institutions. The goal in this field is instead to add value to the existing debate. In fact, because of its transatlantic nature, its intelligence sharing platforms and its efficient communication network, NATO could harmonize efforts in energy security between member states and increase mutual and beneficial cooperation.

Avoiding duplication is also fundamental because there are already a number of bodies within NATO dealing with energy security; first and foremost the Energy Security Section within the Emerging Security Challenges Division established in August 2010, the NATO Allied Commander Transformation (ACT) and NATO HQ are responsible for education programs, training and exercises in this area.

Today NATO is facing a dual challenge trying to live up to its ambitions while trying to steer the global debate towards a more sustainable energy future. A practical approach to the topic is therefore necessary – one that will feature education and training projects because, above all else, energy security has to be constructed through cultural and behavioral change, especially in the military context where the topic is quite new.

NATO energy security centre of excellence

The key actor in this regard is the NATO ENSEC COE, a multi-national, joint military and civilian-supported organization sponsored by six Nations: Estonia, France, Italy, Latvia, Lithuania and Turkey.

The ambition of the Centre is to establish itself as a leader group of study on the topic of operational energy security and military energy efficiency. Thanks to its international dimension and to the cross-cutting nature of energy security, the Centre will work to identify solutions for energy security issues such as energy efficiency in the field of operations, smart defense, energy supply reliability and critical energy infrastructure protection, among others. These are challenging targets that will be pursued through cooperation within NATO and with the main international organizations that deal with energy security, other NATO COEs, universities, think tanks and research centers. The Centre's upcoming activities confirm its international nature and agenda: end of May in Baku – "Cooperative approach to energy security: view from NATO and beyond" Conference; end of October in Washington DC – "2013 Target Energy Conference"; and planned for 2014 – the advanced research workshop and industry exhibition "IESMA 2014".

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Baltic security – a word of caution

By Claes Levinsson

Russia is in the process of launching its biggest rearmament effort since Soviet times. Annual statistics show that Russia between 2011 and 2012 has increased its military spending by 16 %, and last year's investments equalled to 4.4 % of its gross domestic product. The Russian rearmament has importance to all EU and NATO member countries, but with a particular strategic focal point in the Kaliningrad oblast. An area with a unique geographic status as an exclave nestled between two NATO members and considered to be of great strategic importance for Russia. Kaliningrad is significant because it is a possible area for confrontation since it entails not only a military dimension but also other potential security problems related to visa regimes, customs agreements, environment, cross-border smuggling and trafficking.

Although the Baltic Sea region is nowadays considered to be a relatively low-tension area, a Russian rearmament could fuel old habits of suspicion and possibly create new lines of divisions. The region is a prioritized area in Moscow's military planning and is being reinforced as part of the modernization of the Russian armed forces. The decision by NATO a few years back to deploy missile interceptors and radars in Romania and Poland provoked a fierce reaction from Moscow, which in turn threatened to deploy Iskander tactical missiles in the Kaliningrad region as a response to the United States' missile shield plans. In November 2011 a Voronezh-DM early warning missile defence radar station was put into use and in April 2012 the air defence was equipped with S-400 *Triumf* air-defence missile systems. This year NATO extended its Baltic air-policing mission to 2018. Moreover, five Ivan Gren-class landing craft ships are currently being built in the Yantar shipyard in Kaliningrad, each of them able to carry up to 13 main battle tanks or 60 armoured personnel carriers and 300 marines. Kaliningrad also has storage facilities for tactical nuclear weapons.

The rearmament of the Russian military, and subsequently its western flank, is not only due to modernizing outdated material, but also an effort to deter NATO. Clearly, the recent enlargement of NATO has created security for the members of the alliance, but it has certainly not created a mutual relationship between NATO members and Russia, where the latter agrees upon and fully participates in the current security architecture of the region. Even if the Vienna Document and the Open Skies Treaty is in force, the all-important CFE Treaty - which regulates conventional armed forces in Europe and sometimes referred to as a "cornerstone of European security" - is not. This makes the current Russian rearmament and the possible response from NATO of particular importance for the Baltic Sea region and the NATO borderlands. Above all because any further build-up of offensive military capacities near the alliance's border runs the risk to decrease an already fragile trust and create more uncertainty between NATO and Russia. It would therefore be naïve to *a priori* rule out possible rapid changes that could have drastic consequences for the security environment.

The matter of uncertainty goes to the very heart of the central question in Baltic region security; the guarantee of

safety and ultimately how to know, who and what to trust. It is related to basic concepts of human psychology and can even be described as "existential" conditions of human relations. It is not an occasional or transient phenomenon but something that is part of our everyday life and of very existence. If threatened, both people and states will take necessary measures. Those measures are usually defensive but can occasionally also be offensive in nature. It is sometimes enough to exercise caution and just wait for the threat to dissipate, but it is perhaps more common that some kind of preventive action has been taken that enables a more active approach to this kind of threat. On a regional level, where formal structures of defence and security arrangements exists, this kind of preparation and proactive stance to security might be seen threatening to the other side and provoke a reaction that might transform a perceived danger to an overt threat.

This kind of strategic by-products is usually described as a security dilemma. The development of military strength, postures and all other activities taken by one side to strengthen his own security, can be seen as a threat by the other side who in his turn takes measures to increase his own security. The security gains on both sides are therefore illusory; security has been decreased rather than increased. The security dilemma is telling us that security can be a game of negative-feedback; the less secure a state feels, the less his adversary will feel as well. Reversely, it is also a game of positive-feedback; the more security a state feels, the more secure his adversary will feel, because it won't have to do anything that could provoke a reaction from the other side. This security dilemma is what fuelled the nuclear arms race during the Cold War and, indeed, much of today's many contemporary conflicts.

Consequently, what is needed is not more military hardware in the Baltic region, but an active stance by all parties to deepen and broaden existing regional multilateral arrangements to support and strengthen channels for dialogue and engagement, and again to fully implement the CFE Treaty for the purpose of further increasing security through a mutual consent to regulate size and introduce inspection regimes to facilitate transparency on military capabilities and technical composition. It is high time to once and for all agree upon a viable Baltic security architecture for the 21st century.

Claes Levinsson

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The Baltic Sea Region – strategies, projects and cooperation

By Slava Khodko

One territory, common management, two strategies

There are a number of grounds defining the Baltic Sea region as a single territory. We are united by common history, common environment and common infrastructure. The Baltic Sea, on the shores of which we live, unites borders of the coastal states. We should recognize that there is a great interdependence among the inhabitants of the territory.

This interdependence has become a trigger for the appearance of wide range of programmes and organizations, as well as related projects for the development of the region. And we can find some signs that these programs and organizations often duplicate the functions and capacities of each other. So the approach to the management of the region is clearly uncoordinated.

We see the apparent lack of the common view of all the actors that are affected by the problems of the region. For example, we can talk about the existence of at least two strategic documents, the planning of which addresses the Baltic Sea region – the Strategy of social and economic development of the North-West Federal District until 2020 and the European Union Strategy for the Baltic Sea region. The coordination of strategies, the formation of a common view on strategic development of the region are required. Such view could let regard the region as a single substance from the marketing point of view. Only this approach would let consider the territory of macroregion as a product which will form the basis for the promotion programme in the region. Such programmes could become a positive instrument to improve the competitiveness of the Baltic Sea region. We have examples of such work - a project ONE BSR is very significant here.

Taking into account the experience and the urgent need for understanding of the processes, ANO "North-West Development and Investment Promotion Agency" in cooperation with the Center for cross-border and interregional cooperation of HSE, St. Petersburg branch, conducted a study and organized a series of events on searching for common ground between the Strategy of social and economic development of the North-West Federal District until 2020 and the European Union Strategy for the Baltic Sea region, and between their action plans. For this purpose the Agency and the Center actively cooperate with the Council of the Baltic Sea states and with the Baltic Development Forum. Special focus was on creation of the platform for the continuity of the successive presidencies of Germany, Russia and Finland in the Council of the Baltic Sea states.

From the joint strategies to joint projects: 5 steps.

The work being done gives grounds to say: now it is time for the transition from coordination of the strategies to coordination of action plans, and, furthermore, to joint projects. 5 steps could be proposed as an action programme:

1. Completion of the work on the coordination of the strategies.
2. Study on the coordination of action plans to the strategies.
3. Creation of sectoral programmes in the priority fields of cooperation, such as environment, energy, transport and tourism etc.
4. Selection of priority projects for joint implementation.
5. Formation of additional content for the Partnership for Modernisation between Russia and the European

Union, giving him a special Baltic dimension. The main method of implementation of the process is a creation of conditions for the transfer of technologies related to investments. Thus, creation of innovation centers will be the basis for the industrial development and therefore for the wide application of the principles of public-private partnerships during the realization of these particular projects.

Pilot phase of the process has been already begun under the support of the Secretariat of the Council of the Baltic Sea states. Today, there are pilot projects in the field of agro-industries in the stage of development. They were developed in the framework of implementation of programmes in the Baltic Sea states. At the moment the conditions for their implementation in central Russia are being created.

The activity in the area of shipbuilding, environment, ITC, energy and resource management, etc. could be developed in the same way.

Conclusion

Still the continuity of the presidencies of Germany, Russia and Finland in the Council of the Baltic Sea states is the most important. Aware of this fact, the Center of cross-border and inter-regional cooperation of the HSE, St. Petersburg branch and the "Centrum Balticum" Foundation have sent to the Minister for European Affairs and Foreign Trade of the Republic of Finland Alexander Stubb and the Deputy Prime Minister of the Russian Federation, Dmitry Kozak a joint letter, which justify the need for such continuation, and the readiness to make practical work on the deepening of coordination of strategies and their action plans is expressed.

We see improving of coordination role of the Council of the Baltic Sea states as one of the decisive conditions for the formation of opportunities for coordination and cooperation in all areas.

Baltic Development Forum Summit and the Congress "Baltic Week" which will be held in March 2014 in St. Petersburg could be those sites where discussion on cooperation and strategic approach would have special public importance.

Current information is presented on the web-page of the Centre of the Northern Dimension Development www.nddc.ru.

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Russia

Opportunities for Finland – the Arctic and Russia

By Kai Paananen

Finland has a neighboring country with a growing – despite of the recent less positive news – economy. The Russian economy grew last year some 3.5 per cent, and the target for 2013 is 3.7 per cent.

The Russian state budget is linked with the Urals oil price (97 US\$ per barrel). The entire Russian economy and society is significantly dependent on the export earnings of oil and gas. The price of fossil fuels – also affected by shale gas prospects particularly in the United States – is a key source in analyzing Russian developments.

Finland has a remarkable potential in Russian markets.

Russians consider us Finns as reliable partners. This – supported by the common border and railway network – constitutes the almost one and only real competitive edge compared to our contender countries.

In particular, off-shore projects offer huge potential in our offering for Russian markets and partners. 2/3 of the gigantic oil and gas reserves in Russia are located in off-shore areas, and most of these in the Arctic region.

In order to commence production in these oil, gas and LNG fields, Russia needs harbors, gas-drilling platforms and vessels, support vessels equipped with significant ice-breaking abilities, strong ice-breakers, and major LNG vessels. Finnish sea and Arctic technology industries may substantially benefit on these needs, but this requires competitiveness and Finnish holdings in the key technology and production companies. Clearly the most important competence center is Aker Arctic.

I was personally privileged to have an opportunity to safeguard the existence of the present Arctech Helsinki Shipyard in 2010. A key condition for today's joint venture was the order of an advanced multipurpose ice-breaker for the Russian Gulf of Finland operations. The order was negotiated by the largest shipping company in Russia Sovcomflot (SCF), Russian Harbor Administration Rosmorport, STX and SET Group.

During the times of today's news flows, it is interesting to note that many serious Russian actors were openly expressing opinion that they would prefer this Arctic ship building knowledge to be based on solely Russian-Finnish cooperation rather than three party cooperation. These opinions were justified by the long term experience of the Finnish-Russian cooperation, and the knowledge and needs of the both parties.

Possible Finnish-Russian ice-breaking cooperation in the Gulf of Finland may open opportunities for new Finnish-based icebreakers. The possible operational cooperation was most recently discussed at the joint meeting of the Finnish-Russian Economic Commission in late March 2013 in Turku.

It is evident that that the emphasis and business focus in shipbuilding is moving to the Far East. This development can also be seen in the Russian shipbuilding industry. This means that the position of the Finnish world-class expertise in shipbuilding and, in particular, Arctic technologies is not at all self-evidently safeguarded in the future. We must work hard in order to play a key role in the Arctic shipyard businesses.

Ways to enhance Finnish–Russian Arctic cooperation are many. An important step would include establishing a

bilateral Sea Technology Innovation Program. From Finland this platform should be participated by Finnish Innovation Fund (SITRA), research institutes of the sector, and various companies in the sea technology businesses. Supported by public institutions and through networking, also SMEs may have their important role in sea technologies and Arctic projects.

The Northern Sea Route (NSR) offers a huge potential also – and particularly – for Finland.

Last year, 46 ships passed the route. The fastest journey took only for 7.8 days. Sea transport professionals estimate that NSR may save at least 30 per cent of the costs of the traditional Suez route.

The gradual opening of the NSR opens numerous opportunities for Finland. The traffic needs advanced technologies in terms of ships, ice-breaking, and harbor, communications and rescue infrastructure. In addition, NSR will bring Finland closer to the center of global logistics. Finally, after thousands of years, Finland will be able to come out of the periphery!

To utilize these thrilling opportunities, Finns must openly explore various options and start hardy actions in promoting the new route and especially the Finnish role in its logistics. A key project is to construct a railway from Rovaniemi to Norway's Kirkenäs ("Polar Sea Railway").

In Finland, we have so far promoted the Polar Sea Railway all too modestly. Good work is done by Lapland, they have planned the railway in many practical ways. Good attitude is presented by Norway, their Minister of Transport and Communication Marit Arnstad supported the project in Kirkenäs in February 2012. The railway is also widely supported by foreign specialists of logistics, and even by Chinese. Here we may easily see the common interests of the globe's North-East nations.

Now here in Finland, we should formulate a national stand on the Polar Sea Railway; how to plan it, to finance it, to construct it; what would be the schedule; who would participate as partners?

The Polar Sea Railway would cost – naturally, depending on the implementation – some 2.5–3.5 billion €. The construction could be started in early 2020s, and the first train would depart before 2030. By this, the Northern Sea Route will be one of the key sea routes in the world and would work as a bridge between European and Asian markets.

But the question remains will Finland take this challenge, serve as a key logistical platform from and to the route?

Kai Paananen

CEO

SET Group Oy

Finland



The Arctic shipbuilding market – a real opportunity or a distant dream?

By Esko Mustamäki

From the history of navigation, we know a number of great pioneers, who explored our globe centuries ago. Our interest toward exploring the Polar Regions was initially driven by the need to find a Northern route from Europe to Asia. The concepts of looking for the Northwest Passage and the Northeast Passage, today better known as the Northern Sea Route, are both about 500 years old.

But Arctic navigation is much older than that. Mankind has travelled by sea since prehistoric times. Tribes, who had migrated to the Northern parts of the globe, used their boats whenever the ice conditions in the water systems allowed. Over time they developed their boats to cope better with the ice conditions they encountered. This was the beginning of Arctic shipbuilding.

Today the drivers for Arctic shipbuilding are both growing transportation needs in the Arctic areas as well as the exploitation of natural resources in those areas. The exception to this is the market related to the Antarctic. In this area, the vessels need to perform two tasks, to supply the research stations and to make oceanographic research.

The Arctic is an area of high oil and gas resource potential. A remarkable part of the remaining global oil and gas resources has long been thought to exist in the high North. This area includes the United States, Canada, Greenland, Iceland, Norway and Russia. All these countries have vast natural resources in form of oil, gas or minerals in the Arctic region. The known Arctic oil and gas resources are vast, but over half of the sedimentary basins are completely undrilled. Thus the Arctic region is the last major frontier for conventional oil and gas exploration.

The known Arctic oil and gas resources are over 400 billion barrels in total if measured in oil equivalent. Some 20 % is oil; the rest is gas and gas condensate. Compared to the worldwide resources, the Arctic resources correspond to 30 % with regard to gas and 13 % with regard to oil. Calculated in oil equivalent, the Arctic resources correspond to 22 % of worldwide resources. About half of these resources are found on Russian territory, one fourth in Alaska and rest is divided between the other countries. When these resources are exploited in a large scale, a large number of vessels of different types are needed.

A lot of drilling is required in the Arctic, both for exploration as well as for production. Each drilling party may require 10 vessels to support the drilling unit. The vessels needed are different types of supply vessels, ice management vessels, oil spill response vessels, accommodation vessels etc. All this is, of course, very much depends on prevailing conditions. In the production phase, some support vessels and ice management vessels are probably needed. Additionally, a fleet of oil or gas carriers is needed. The number of these depends, first of all, on the production volume and secondly on the transport distance. Each production facility may need 10 to 20 carriers if the transport distance is long. In case of gas it usually is, as the gas is transported to a terminal close to the customer.

The total need of vessels also depends on the schedule. How the exploitation of the Arctic oil and gas resources is growing and who is buying the produced oil and gas? In any case, we are talking about hundreds of vessels during the next 20 years.

To the Arctic shipbuilding market, we may include some Sub-Arctic regions with need for ice-going tonnage. These

regions are Baltic Sea region, Sea of Azov, Caspian Sea, Sea of Okhotsk, Sea of Japan and Bohai Sea. As the ice conditions in these areas are not as severe as in the Arctic market, the amount of required special tonnage is smaller than that required by the Arctic areas.

The Arctic market related to transportation needs, other than oil and gas, is easier to predict as the transportation need is existing and well predictable. The need for vessels is thus caused by growth in traffic and replacement needs. The number of vessels required is, however, not great.

The risks are completely different in case of the market related to oil, gas and minerals. In these cases a very large investment is needed to start the exploitation. In most cases the vessel investment is a marginal investment and only done after the final investment decision concerning the production is in place. And these multi-billion dollar investments depend on the development of the global economy, oil and gas price development, or metal price development (in case of minerals). For a ship owner or a shipyard it is therefore extremely difficult to predict the schedule for a specific project.

The Shtokman gas field in Russian Barents Sea is an example of how demanding these projects may be. The field was identified in 1981 from offshore geophysical surveys performed by research vessel Professor Shtokman, according to whom the field was named. Geological studies of the field were launched and in 1988 the first exploration well was drilled. The result of the well testing was ready the same year. More than 2.4 trillion cubic meters of commercial-grade, free gas was added to the State reserves balance. About 30 years later a joint venture company Shtokman Development AG was formed to develop this gas field, ranking number 10 in the World. In August last year, we could read that the development of the vast Shtokman gas field will be put on hold, as the project was not feasible at current costs. For many years this field has been considered one of the most interesting fields from the point of view of Arctic shipbuilding. Today, it is again a prospect far in the future.

Luckily many other projects continue. Delays are common, but the projects are going ahead. There are several active projects today, and many more are expected to start within the next couple of years.

But is the Arctic shipbuilding market a real opportunity or a just a distant dream? Based on today's expectations regarding the future global energy consumption my answer is yes, the Arctic shipbuilding market is a real opportunity. But I believe some fields may not be started as soon as expected. I believe the growth rate in Arctic oil and gas will be lower than previously expected.

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The Nordic Countries on the top of the world in snow-how*

By Kari Liulto

Only a few years ago, the Arctic was not known for much more than simply being in the opposite end of Antarctica. But due to the melting of the ice cap, the Arctic agenda today consists of a number of issues that each carries such importance that countries thousands miles away have a close interest in the area. One of the items often mentioned are the possible navigation opportunities that open up the Northern Sea Routes, NSR when the ice melts. ... Another important agenda point is the role of the Defense force. ... Exploration of oil and gas resources is also a sensitive issue. ... Also, the exploitation of minerals in the Arctic, especially rare earths, is followed closely around the world. ... There is a lot of hype in the media about the Arctic.” (Holm, 2013, 1).

From the media hype to the Arctic realism

Media hype 1: the Northeast Passage will become a major maritime transport route between Europe and Asia: when compared with the Suez Channel the distance between Europe and Asia via Northern Sea Route (NSR) is 25-40% shorter depending on a point of departure and arrival (Lloyd's, 2012; Holm, 2013). The distance between Hamburg and Shanghai, for instance, is over 5000 km shorter via the NSR than through the Suez Channel. A shorter distance may save fuel and a couple of weeks in transporting goods between Europe and Asia, and as time is money (100,000€ per day for a shipping company), the NSR is becoming an attractive transportation route (Hahl, 2013). In addition to the transportation between Europe and Asia, natural resource exploitation in the Russian Arctic may significantly increase the maritime traffic in the NSR (Brigham, 2013).

Before falling into the media hype, one needs to remember that the NSR is at the moment economically navigable only half a year due to thick ice. Secondly, there is a lack of large ice-going ships and tankers. Thirdly, thick ice puts an extra pressure on ships and piloting vessels/icebreakers¹ assisting them and reduces the travel speed, which eats the benefits offered by a shorter distance (Lasserre, 2011). Moreover, there are no service centers in the Arctic region in a case of emergency with a ship or its personnel. Therefore, it does not come as a surprise that less than 100 ships sailed through the NSR last year, whereas the corresponding figure for the Suez Channel was more than 20,000 vessels (Holm, 2013).

It is possible that the global warming opens the NSR and thus, enables transportation throughout the year. Secondly, one cannot completely exclude the political instability in the Suez Channel or in the Strait of Bab-el-Mandeb, which would automatically increase the role of the NSR in the trade-related transportation between Europe and Asia. At the moment, the North Asian countries, China, Japan and South Korea, cover close to 20% of the EU's foreign trade turnover (European Commission, 2013), and this share obviously grows significantly in the future. *“China is expecting to reroute 5-15% of Chinese ship transports, mostly container traffic, by 2020 to Northern Sea Route”* (Hahl, 2013, 3).

Media hype 2: the Arctic region will become the leading oil and gas producing region of the world: a US geological

survey indicates that the Arctic region holds 30% of the world's undiscovered gas reserves and 13% of the undiscovered oil deposits (European Commission, 2012). Despite the fact that the region possesses a significant share of the globe's hydrocarbon reserves, one should remember that the Arctic resources are expensive to be exploited, and as long as unconventional gas and shale oil keep the energy prices at the relatively low (tolerable) level, oil rush to the Middle-East of the High North, the Arctic, will not materialize, though the role of the Arctic region will inevitably grow in the global gas production when the globe's second largest gas producer, Russia, is forced to move her gas production there.

Media hype 3: the Arctic region will become a cradle for an international military conflict: despite the fact that 3 countries with the largest military budget in the world, namely the USA, China and Russia, have shown a growing interest towards the Arctic (Blank 2012; IISS, 2012; Jakobson and Peng, 2012), I do not recognize sufficient forces which would ignite an international military conflict in the region in the foreseeable future (see Voronkov, 2011; Yarovoy, 2011; Holm, 2013). Here one needs to remember that *“most of the Arctic (and in particular most of the estimated hydrocarbon deposits) is under the sovereignty and maritime jurisdiction of the Arctic States”* (Koivurova, 2013, 7). I do not believe that Arctic fishing would create an international military conflict, though it has from time to time caused some disputes between the countries, such as Norway and Russia (Hønneland, 2013). Despite the fact that Russia aims at extending its Arctic territory by claiming that the undersea Lomonosov Ridge is an extension of Russia's continental shelf (Petters, 2013), it is everything but certain that the claim, to be submitted to the UN by the end of 2013, will be accepted. Even if the claim would be accepted, it hardly would cause an international conflict.

I assume that the NSR will increase its position in the global transportation but does not challenge the leading position of the Suez Channel in the Europe-Asia trade, unless there will be a force majeure (e.g. a nuclear explosion) preventing the shipping through the Suez Channel or the Strait of Bab-el-Mandeb. Secondly, the share of the Arctic oil production will remain marginal in the global scale decades to come, as the Arctic production is not competitive due to higher drilling costs. On the other hand, Russia is forced to move a significant part of her gas production to the Arctic, since its traditional gas fields in Western Siberia are depleting within the following 3 decades. A half of the country's energy consumption is met with natural gas, and there cannot be seen a major change in Russia's energy consumption by 2030 (Ministry of Energy of RF, 2010). As Russia represents close to a 20%-share in the global gas production, the stake of the Arctic region increases in the forthcoming decades. Thirdly, I do not believe that an international military confrontation would start in the Arctic region due to its natural resources or new territorial claims.

Ambassador Hannu Halinen (2013, 2) intelligently phrases as follows: *“All in all, in the Arctic there is no hype, but there are no easy wins, and no gold rush, either.”*

From Nordic snow-how to the Arctic business

Due to their geographical location on the top of the world, the Nordic countries possess many advantages which make them natural born leaders in the Arctic business. The Nordic

¹ Myllylä and McEwan anticipate that *“the demand of Arctic and ice-breaking know-how is increasing. Knowledge is critical to the Arctic super powers and they are willing to cooperate with the Finns. After all, Finland has manufactured 60 percent of the world's icebreakers”* (Myllylä and McEwan, 2013, 15).

people have during the course of thousands of years been “genetically engineered” to survive in harsh environmental conditions; cold temperatures, snow and ice, and long dark polar night lasting for several months. Moreover, our ancestors have used to live in isolation, which has developed our skills to survive without outside help. Some consider that the harsh environmental conditions have favored punctual, systematic and anticipatory behavior of our forefathers, which still can be seen in the Nordic business culture of today.

The Arctic construction experience, Arctic wind power mills, cold-resistant devices and voice interfaces for communication, cloud services, e-solutions and virtual platforms are required in order to get remote assistance in harsh weather conditions or simply to spend free time with online games, in the Arctic (Poljatschenko, 2013).

Despite the fact that the Nordic people have built-in Arctic experience, even our snow-how has to be adapted to the Arctic requirements, since there is a major difference between surviving a couple of weeks in temperatures below -40 °C and living in such conditions for several months.

An easy and relatively inexpensive way to transfer Finnish snow-how to Russia’s Arctic would be to construct a railway connection (around 70 km) from Salla to the St. Petersburg-Murmansk rail road with € 80 million (Myllylä, 2010; Kaleva, 2013)², and thereafter, to lease a section of the Murmansk Port for a Finnish port operator. This exercise would open an Arctic foreign trade outlet for Finland, and in turn, it would aid transferring the Finnish snow-how to the use of the Murmansk region.

From Santa Claus to Saint collaboration

The Arctic gifts are not generated by Santa Claus but by intensive international collaboration, since egoistic national interest-seeking competition will lead to a lose-lose situation, as none of the countries in the world possesses required resources, skills and experience enabling it to exploit the Arctic opportunities alone.

I wish to conclude by stating that ice is nice, since I am convinced that countries aiming at exploiting the Arctic opportunities need Nordic snow-how in order to do it in an economically and environmentally feasible way.

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² The Finnish authorities seem rather reluctant to develop this connection (YLE, 2012).

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Shipping in the Baltic Sea – stormy waters ahead?

By Carsten Ørts Hansen

As a response to the environmental challenges the Baltic Sea is facing, the International Maritime Organisation (IMO) has established the area as an Emission Control Area (ECA). Since 1 July 2010 the fuel sulphur content has to be below 1%, and further be reduced below 0.1% from 1 January 2015.

Regulation is not new to the shipping sector. Ever since Captain Plimsoll started his campaign against the “coffin ships” in the 1870s a series of international and regional regulation has affected the competitive condition for the sector. Also it is well known that new regulation constrains maneuverability but also often meet fierce resistance from those who have done well under the old conditions.

What might be new is that strict regulation does not have to be a competitive disadvantage for all shipowners. High standards may even be in favor of some ships or fleets, because it is easier for them to comply than for competitors. Hence, an industry or group of companies may occasionally even lobby for higher levels of regulation for the simple reason that it will increase their competitiveness.

For all shipping in the Baltic Sea the current relevant question is who will be earning or burning after 2015? The answer depends on the technical choices made by shipowners and not at least the specifics in the regulation.

There are three choices for shipowners who wish to continue sailing in ECA from 2015: Switch to marine gas oil (MGO), install an exhaust gas scrubber, or switch to liquefied natural gas (LNG) as fuel. A study made by Det Norske Veritas concludes that the LNG fuel solution is the most cost efficient solution in a 20 year perspective and new ships should run on LNG. However, the age of the ships operating in the Baltic Sea is fairly evenly distributed from new to about 40 years old, and it therefore takes about ten years to replace 25% of the fleet. In fact a large number of shipowners therefore only have the choice between MGO or a scrubber to secure that their vessels or fleets can sail in the Baltic Sea from 2015.

This particular choice depends on the age of the vessel and how long time it spends in the ECA zones. The younger a ship is, and the bigger the amount of time it will spend in the ECA zones, the more financially sound a scrubber installation becomes. For newer vessels, installing a scrubber would therefore enable them to compete at a relatively lower cost than the older vessels, who are not candidates to a scrubber installation due to inability of repayment of the investment before the end of their commercial life. A recent study made by BIMCO shows that a ship that operates in the ECA zone 33 % of the time, has to have 10 years of commercial life left to reach a positive net present values of its scrubber investment.

Older vessels are forced to use the expensive MGO resulting in substantial higher operating cost. As a consequence a potential large number of older competing ships will to be pressed on their earnings or ultimately be pressed out of the market from 2015. This will off course be in favor of newer ships and create turbulent condition for older ships that might be forced to leave that market. In that case better prices could also be charge by the remaining ships in the Baltic Sea.

To prevent a radical change in the competitive landscape critical voices of the regulation have argued for a transitional

period in which these older ships are exempt from the requirements. However, at the same time other points to the fact that the design of the requirements has been known since 2008 and that it would turn already installed scrubbers into extra costs and not investments. The same voices argue for the importance of properly enforcement since there is an incentive for cheating, thus gaining competitive advantages. Another example on how regulation is a complex arena of interests is the recent discussion in the IMO subcommittee Bulk Liquids and Gases (BLG) concerning the exact pH value for discharged scrubber water. Here one member state had sent in a survey of the pH value in discharged scrubber water which had been carried out in cooperation with an independent consulting company. A fixing of the pH value of discharged scrubber water is decisive for the scrubber suppliers' production of scrubber systems and thereby for the shipowners' choice of system. However some other member states opposed the pH value recommended by the survey and the discussions stranded. This leaves ship owners who already have decided to invest in scrubbers in trouble assessing whether they should choose open or closed scrubbers or use MGO as alternative fuel to meet the requirements.

The specific details in new regulation therefore determinate the investments in these new technologies. For vessels or fleets not able to comply with future legislative requirements there will be a severe impact on profitability but also significantly impact the residual value of fleets and the value of any security taken over vessels.

So regulation is not an innocent activity and ECA zones are not only about cleaner environment. It is also an example of how the focus and work of creating competitiveness advantages can shift from the ship to onshore activities in a complex arena of national interests, technology, calculations and practitioners from the industry. Because transnational regulation made by e.g. EU and IMO affects the competitiveness of ships and fleets it is important for shipowners to know, manage and influence the development of new regulation. Such an understand could be established through research activity that are critical of the univocal nature of most mainstream shipping regulatory literature but also works inter-disciplinary since the issues involved are various and demand inter-disciplinary treatment from technical, economic and political domains. CBS Maritime is an interdisciplinary platform and we hereby invite practitioners and researchers to participate in this investigation.

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Green co-operation in the eastern Gulf of Finland

By Olli-Pekka Brunila and Anni Anttila

Almost 15% of the world's maritime transportation is carried out in the Baltic Sea. In 2010, approximately 809 Million tonnes of cargo were handled in the ports of the Baltic Sea. The market share of the traffic volume in the ports of the eastern Gulf of Finland (HaminaKotka, Vyborg, Vysotsk, Primorsk, St. Petersburg, Ust-Luga) covered approx. 21% of the total traffic tonnes in the Baltic Sea in 2010.

The Baltic Sea is one the busiest and most polluted seas in the world. The condition of the Baltic Sea has been studied for many years. Its oxygen level has increased slightly, but the situation is still quite bad. There are no benthic animals in the Baltic Proper, and large areas of the seabed are either suffering or dead. The condition of coastal waters in the Gulf of Finland has improved in outer archipelago areas since 2006. There have unfortunately been some nitrogen and phosphorus leakages, but the overall situation has not changed much in the past few years. The most common challenges of the Baltic Sea countries deal with increasing the oxygen level and reducing eutrophication, nutrients, sulphur, CO₂, GHG and pollution from agriculture and transportation.

Port and maritime legislation in the EU

The EU has a lot of different regulations that influence the European ports and their management. All port related EU legislation does not however affect the environment. Especially in Finland all ports have strict environmental regulations. Ports have to follow national environmental policies, environmental management systems, environmental permits, Environmental Impact Assessment (EIA), and of course the EU legislation. Many Finnish ports have various independent environmental projects that are meant for boosting the environmental status of the ports and for protecting the surrounding environment.

The EU has directives for habitats, fauna and biodiversity. There are also different regulations and directives for emissions, noise, soil, waste and air quality, and pollution from ships. Especially the so called "Sulphur Directive" has created contradictory feelings in Finland. Some experts say that the "Sulphur Directive" may cause unemployment, whereas some experts think that the directive can create new opportunities and new business possibilities. Perhaps the truth is somewhere in between? At the moment Russia has not consented to the IMO regulations of sulphur emissions, which might cause increased land base transportation from Finland to Europe via Russia. It has also been discussed that the industry investments in Finland will affect other countries and they will therefore also distort the competition in the European market. At the moment the maritime industries have to adapt to the "Sulphur directive", IMO regulations, and other new legislations, and move on to future challenges.

Ecologically friendly port

The Russian port legislation is not on the same level as it is in Finland and in the EU. The need for environmental regulations and instructions for sustainable development is acknowledged. One key element in the competition between the Baltic Sea ports now and in the future will be their environmental status and their capability to response to the challenges of sustainable development. According to the EU

Strategy for the Baltic Sea Region, the co-operation between the Baltic Sea countries should be improved in order to develop the environmental protection. Another aim is to engage the Russian partners in the matters of e.g. environmental protection, water quality and innovations. In this project two ports in the eastern Gulf of Finland, Ust-Luga and HaminaKotka, have taken up the challenge in the form of a collaborative project called the "Ecologically Friendly Port". The main focus of the project is to increase environmental awareness. The competition between these two ports is forgotten, and the mutual goal is to protect the Baltic Sea with the help of cross border co-operation.

The citizens and different stakeholders in Finland have the opportunity to influence public affairs concerning for example port construction. The citizens of Ust-Luga in Russia are concerned about the environmental impacts of the construction of a new port and town. The concept of "Port in a city" is not familiar to the residents. In Finland many ports are in or close to the cities and the environmental effects on the citizens are taken into account. Also the hydrometeorological, biological and anthropogenic effects on the Ust-Luga Bay and its coasts will be studied. Tools for protecting and monitoring the environment are: Environmental Strategy for Sustainable Development, and Eco-Monitoring Centre.

To continue the cross border co-operation and the fruitful environmental protection activities in order to save the common Baltic Sea would be the best possible outcome. This article is based on the project "Ecologically Friendly Port" (EFP). For more information on this project, please visit http://ecoport.rshu.ru/index_eng.html.

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Baltic maritime transport on rough sea

By Juha Kalli

There are only two years left until 2015 when the regulations on the marine fuels will limit the sulphur content to 0.1 percent in the Baltic Sea, the North Sea and the English Channel. In 2011, more than 7500 ships visited the Baltic Sea, and the number is increasing. However, in 2015 the fuel costs will face dramatic increase due to new regulations. Ships need to change from Heavy Fuel Oil (HFO) to much more expensive middle distillates (Marine Gas Oil, MGO). According to the studies of Centre for Maritime Studies, the additional fuel costs will be around 400 million euros per year for shipping to and from Finland. The costs will be much higher if the price difference between the two fuel qualities grow in the future. For example, in summer 2008 the price difference was around 480 euros per ton which would mean additional costs of nearly 1 billion euros for Finland in a year.

We need to keep in mind that the estimated additional costs are direct costs, and the indirect costs are often neglected in the studies. Effect of huge increase in demand of MGO (up to 15 million tons) in 2015 may lead to higher prices of diesel fuels also on land, increased reloading and feeding, modal shift, economic losses in specific sea ports, loss of industries, negative effects on employment etc. Indirect effects will most probably be unequally distributed among the industries and communities and therefore should be studied in more detail.

HELCOM countries have decided that they will send an application to International Maritime Organization (IMO) to designate the Baltic Sea as NOx emission control area (NECA). It is, however, still unclear when the application will actually be sent. This would mean that when visiting the Baltic Sea ships built after 2016 need to be Tier III compliant. Tier III is a standard NOx emission limit for new marine engines when sailing inside the NECA. To reach demanded NOx reduction of Tier III, a ship need to use special technology or alternative fuel i.e. catalytic converter or liquefied natural gas (LNG). It is estimated that the Baltic NECA alone would increase the transport costs by 5 percent.

There have been years of debate in the IMO about the measures to abate carbon dioxide (CO₂) emissions of shipping. Certain methods have already been developed and approved (i.e. energy efficiency design index) but it is interesting to see how the market based measures (MBMs) will be adopted or whether they will not be used. It will also be interesting to study what kind of effects these measures will actually have on the emissions and on the maritime traffic. The effects may not be straightforward or easy to forecast. We may face surprises in the future, some of positive nature and some negative.

All these actions to reduce emissions of shipping are well justified. SO_x and NO_x contribute to the air quality and have harmful health effects. In addition, they have unwanted effects on environment as an example the eutrophication of the Baltic Sea. CO₂ is a greenhouse gas affecting the global

warming and climate change. Maritime transport and industry in the Baltic countries, due to the regional differences in legislation, is under heavy pressure to survive in the changing operational environment. The risk for the industry is that increased transport costs cannot be added to the price of the produced commodities. Instead the additional cost of transport is taken from their profit.

Shipping companies have been relatively silent about their future plans. However, there are some indications about the different strategies how the changing operational environment will be confronted. Surveys on Finnish shipping companies revealed that there are at present two basic strategies: 1. tighten the belt, be passive and watch what happens and 2. be aggressive, find new possibilities and make investments for the future. Implementation of the passive strategies can be seen as delayed investments in low emission technologies but there are several examples with determined investments and proactive future plans.

However, applying the current environmental legislation is not always enough, and more proactive companies might find competitive advantage. Tightening of regulations also boosts innovations. At present, the industry in Finland is frantically searching solutions to survive the risk presented by maritime transport. LNG powered ships may be one of the solutions arising as a winner. It is a long term solution because of high capital costs and therefore feasible only in new-build ships, but it would comply with both sulphur and NO_x regulations. Use of LNG would also decrease CO₂ emissions making it comparatively proactive environmental technology for shipping industry. The debate is hot around the proposed locations and building of LNG terminals. Price of LNG is very competitive and its joint use with land industry could enable profitable terminal operations.

I predict that the Baltic shipping will change in the future. There will be more specialized ships designed for SECA (and NECA) operations. These low speed vessels will utilize environmental technology, gradually taking bigger and bigger share of the transport markets. This will also put pressure on the seaports at the area. To guarantee unchanged lead-time in the supply chain, more flexibility and efficiency in port operations are needed.

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The WTO Academic Programme and Saint-Petersburg State University

By Marc Auboin

Since the creation of the WTO, and even before, the institution has been working in partnership with the academic world in a variety of ways. However, the intensification of global trade links and the creation of a global trade institution have increased the demand for higher education on trade and trade-related policies issues. In the run-up to the Doha Ministerial Meeting (2001), the international community agreed to increase its financial support to increase the supply of knowledge, technical assistance and teaching of existing agreements of the World Trade Organization, notably to developing and emerging countries. This effort could not be possible without the involvement of the academic community, for example in WTO regional trade policy courses. In 2009, the creation of the WTO Academic Program brought the concept one step further. The aim was to broaden WTO involvement with universities across the whole range of activities typically completed by higher education institutions, be it research, teaching or curriculum development. But this is not only about the WTO itself. It is about fostering the links between universities which are part of the programme and create a network of universities able and fit to produce and disseminate knowledge on international trade. After a stringent selection process, the World Economy Institute of Saint Petersburg's State University (SPU) has been awarded one of the 15 chairs, despite strong competition in this area of the World. The Chair holder, Professor Sergei Sutyurin, and his team, have gone a long way in fulfilling the objectives of the program – at an important time for Russia, namely its accession to the WTO.

1. Objectives and mid-terms results of the WTO Chair Programme

The main objectives of the Programme are to (1) build lasting relationships with institutions from developing and developed countries by granting financial support to selected institutions, over a period of four years (2) support trade-related teaching by providing WTO support for the development and delivery on courses on trade policy (3) foster additional research in trade-related matters and foster co-operation between Chairs through joint-research, academic exchanges, shared lecturing arrangements, etc, (4) encourage and extend outreach and communications, for example through Chair holders organizing public activities aimed at disseminating research and promoting discussion on international trade and trade co-operation.

An Advisory Board oversees the Program, composed of the WTO Secretariat, academic partners, beneficiary institutions, and donors. The Advisory Board reports to the WTO Committee on Trade and Development. Among the fourteen universities or academic institutions which had been awarded a Chair, are, inter alia, the University Gadjah Mada (Indonesia), the University of the West Indies; Shanghai's Institute of Foreign Trade (China); Argentina's Facultad Latino Americana de Ciencias Sociales (FLASCO), and, as indicated above, the World Economy Institute of SPU. The full list of participating Universities can be found on the WTO website (www.wto.org).

At the mid-term review held in Geneva on 25 June 2012, the Director-General of the WTO hailed the progress made

on fulfilling the above-mentioned objectives. For example, he mentioned that the 15 chairs had produced in two years more than 100 pieces of research, including books, working papers, articles, case comments and databases. Also, the Chairs had enhanced the didactic function of universities by steering the public debate on trade policy issues in a variety of ways. One good example is to be found in SPU's experience.

2. The contribution of SPU to these objectives

There could not be a better period for Serguei Sutyurin's team to contribute to public opinion's awareness on trade policy matters than the recent period, which has seen the Russian Federation to join the WTO. The demand for information, clarification on the broad and smaller stakes of Russia's accession by the media, the public and policy-makers has been intense (more than 50 interviews and media participation for 2012 alone) - the World Economy Institute has been able to provide the full scale of its expertise during this period. It had patiently built the foundations for it, developing considerable experience and knowledge on WTO matters over the years. Its knowledge platform includes a flagship higher education (Masters) program on international trade, extensive written material (including books of case studies), numerous pieces of research, and even a regular radio program on international trade. In the first two years of the Chairs program, the World Economy Institute was able to step up its trade policy work and outreach, in particular the backdrop of Russia's accession to the WTO. In 2012 alone, with WTO financial support, the World Economy Institute has increased its output: three books and 50 research papers have been produced, 10 international conferences attended and one major international conference on international economics organized at SPU. In doing so, it has benefited from WTO staff support, including on research results, lectures to students, and curriculum development.

There is no doubt that the World Economy Institute has strengthened its role as a reference point in Russia on international trade matters during this period. In addition, it has been very active at integrating the network of other WTO Chairs, resulting in intense academic exchanges. All in all, the WTO Chair program appears to be a win-win proposition for both the country of origin of the university, the Chair, and the WTO itself. It eventually complements other partnerships that each university is able to develop – leading to more exchange of knowledge and more informed policy debates on the stakes involved in the expansion of international trade and globalization.

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WTO

Russia in the World Trade Organisation – improving the chances of success

By Fredrik Erixon

Russia's entry into the World Trade Organisation in August last year has been nothing but smooth. There have been flare-ups with other members, and it seems safe to say that in the next 12 months there will be several new Russia-related cases opened up at the WTO's Dispute Settlement Body in Geneva. Russia has also shown it is not a member that has joined in order to constructively help new negotiations to move forward. In fact, tensions related to Russia's role has in some parts run so high as to question its membership in the premier world trade body.

None of this is surprising. The dominant view in the Russian political elite is critical of free trade and international rules that discipline attempts by governments to rig the trading rules in favour of its domestic firms. In the past decade, there has been no appetite at all in Kremlin to view its accession to the WTO as a platform for larger economic reforms to spur competitiveness and economic growth. There was never any serious perceptions that Russia's accession would be similar to China's – an opportunity, seized by the political leadership in Beijing, to push ahead with root-and-branch economic reforms, going far beyond the immediate membership conditions of the WTO.

Yet none of this is to suggest that Russia or the world would be better off by having Russia outside the WTO club. Russia will benefit from its accession. Admittedly, its exports will not get much of a boost because they are dominated by the hydrocarbons and minerals (representing more than two thirds of total exports) and they are already traded at zero or very low tariffs. But Russia will benefit from lower prices of imported consumer and industrial goods, and, hopefully, from an increase in foreign direct investment (FDI). Its ossified service sector will also channel significant gains. The World Bank recently estimated that WTO accession will lift Russia's GDP by 3 percent in the medium term and as much as 11 percent in the long run.

Yet one should be careful not to exaggerate the benefits of Russia's accession. There are two sources of doubt. First, for a WTO accession to yield significant economic results – for Russia and its trading partners – it requires comprehensive economic and institutional reforms outside the scope of trade policy. The vector for gains from trade is often the degree of competition in markets. Clearly, Russia has a deficient structure of economic and commercial policy, leading to far too little competition between domestic as well as foreign companies. Its position in the World Bank's Doing Business Index, for example, puts the country in the company of slow-reformers or non-reformers rather than the growing, outward-looking and reform-friendly emerging markets. Russia is a BRICs country in name only. The programme for economic modernisation has yet to deliver sweeping economic and institutional reforms. This may change, but nothing suggest that the fractioned political leadership in today's Russia plans necessary reforms.

Second, Russia is likely to fail in implementing the full set of obligations that come with membership and it is not a wild

guess that Russia will neglect to respect politically sensitive rulings against it by the WTO's dispute-settlement body. As the WTO itself cannot enforce rulings, the system requires that countries respect the authority of the dispute-settlement body. This risk of Russian disobedience is underlined by Russia's recent history of flaunting international agreements and, as in the case of the Energy Charter Treaty, withdrawing from agreements.

Such behaviour is corrosive for the dispute-settlement system. And, again unlike China, an appetite to boost merchandise export to other countries is not going to be a disciplining factor. Fear of losing market access will not really work in the case of Russia as its exports do not stand to increase much by WTO accession. The fear that Russian insubordination will unravel the entire dispute-settlement system is, however, hyperbole. Other countries, including big emerging markets, have a great interest in respecting the rules and rulings because the benefit from them. But it points to a need for other countries to devise strategies in order to make the most of Russia's accession.

As Russia's biggest trading partner, the European Union has stronger interests than others to take leadership on Russia's post-accession process. A first step is to establish a special mechanism to monitor Russia's implementation of WTO agreements. The WTO secretariat, and forums for diplomatic exchange in the WTO, offers similar services. But these processes are slow and cannot be part of a rapid-response operation. Furthermore, they are not accessible for those firms that will be hurt.

The EU should also start to move on the issue of a post-accession EU-Russia agreement. It has been discussed many times before – but always been kicked into the future as WTO accession has been a critical condition for the EU to go for a formal agreement. The EU also has an interest in starting negotiations soon with Russia over a Bilateral Investment Treaty (BIT). Importantly, it is also in Russia's interest to deepen its integration with the European market – both in trade and investment. Its interest in better investment protection has grown and some of its export products face market access problems that WTO accession will not address. These talks should begin as soon as Russia joins the WTO. They may not be strong enough reasons for Russia to honour its implementation targets, but they would increase the opportunity cost for Russia to misbehave.

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Does Russian accession to the WTO matter for the competitiveness of domestic companies?*

By Sergey F. Sutyryn and Olga Y. Trofimenko

On the 16th of December the 8th WTO Ministerial conference unanimously made a decision to accept Russia as a member of the organization. After a ratification of related agreements followed by a notification to the WTO, in August, 22nd, 2012 Russia became the 156th member of this international body.

It is hardly possible to give a definite answer to the question of how the accession to the World Trade Organization would affect the competitiveness of Russian business entities. Firstly, this comes from the fact that any forecasts describe possible ways of development with some degree of probability. Second, the WTO membership can have both negative and positive impact on the level of competitive power. Which of the two trends prevails – will be clear for some time past.

The main threats that could lead to the reduction of domestic business entities competitive abilities is related to the fact that as a result of trade liberalization some goods and services might become cheaper. Foreign producers should be able to attract more Russian consumers than before. Indeed, price reduction on imported goods and services can occur not only through the decline of duties as such, but also because of the other components of liberalization. Thus, the maximum amount of customs fees was reduced by 3.3 times.

Assessing the risks of competitiveness reduction of concrete Russian companies as a result of trade liberalization, it is necessary to consider the fact that Russian negotiators managed to introduce various tracings of liberalization in trade in goods (pace, size and type of duties). The length of the transition period for different products varies. The final bound rates were imposed to approximately one third of the tariff lines on the day of the accession. Market access for some products will be liberalized by gradual moves in several years. It is assumed that domestic companies will properly use additional time by focusing on the modernization of production, and improvement of product quality.

Second, even a rather significant reduction of import duties does not guarantee the price lowering, or it may not be so significant. In particular, the reduction of duties might be used by intermediate participants of supply chain as a means of increasing their profits.

Finally, talking about a possible competitiveness decline of Russian business entities it is important to pay attention to the fact that under the new conditions the rules of subsidizing will be tougher. This is true with regard to all types of subsidies provided both by the federal and regional authorities.

At the same time certain elements of the WTO legal system can contribute to the competitiveness of Russian producers. First of all, such consequences might appear from lower prices generated by already mentioned liberalization of tariff and non-tariff measures. Many Russian industrial companies depend heavily on imported components and equipment. It is worth to mention that about half of the commercial import to Russian Federation comes from machinery, equipment and vehicles.

Second, one can expect some positive changes in the priorities system of national economic entities, which evaluate various options to improve their competitiveness. The company either undertakes various steps (introduction of new technological solutions, staff skills improvement, organizational development, etc.), the implementation of which is able to improve its market positions or relies on all kind of state support (import duties, subsidies, technical barriers, licensing, etc.). As a result of the accession, the relative utility of intra-company measures to improve competitiveness increases, and for the rationally acting economic entity such strategy might become preferable.

Third, being a member of the WTO, Russia must not only adhere itself to rather strict set of international rules. Russian companies, on their side, have the right to demand from foreign partners comparable discipline with regard to their products. If necessary, the country might use the existing dispute settlement mechanism.

Fourth, in the medium term, some positive outcomes might appear from the fact that, as a result of accession negotiations,

Russia reserved the right not to participate in the Agreement on Government Procurement for at least four years.

Fifth, according to the majority of experts, one of the positive results of the Russia's the WTO accession could be an increase in foreign direct investment (FDI). This might happen due to the general improvement of business and institutional environment in Russia in general, and an investment climate in particular. It might also result from the boost in the degree of transparency and predictability, as well as from the country's obligations regarding the liberalization of trade in services. Additional commitments taken by Russian Federation in the field of intellectual property rights (IPRs) protection also matters. Concerns about vulnerability of the IPRs in Russia were mentioned in numerous surveys of foreign investors, as one of the major constraint for investment flows into Russia. All in all it is known that FDI have the potential to generate a wide range of both direct and indirect positive effects. In particular, they might lead to competitiveness growth not only for individual companies directly involved in the investment process, but also for entire industries, and even for clusters of national economy.

In order to sum up, it should be noted once again that the high degree of uncertainty about the possible impact of Russia's accession to the WTO on the competitiveness level of Russian businesses is still remaining. This uncertainty is related, on the one hand, to the fact that it is extremely difficult (if possible) to separate clearly the effects of accession itself from the entire package of other factors that affect the capacity to compete. The final result will, for example, reflect fluctuations in the exchange rate, which can both dampen and strengthen the impact of trade policy liberalization.

On the other hand, even if we assume the possibility of an isolated study of the accession effect, it would be still very difficult to predict exactly the nature of domestic producers' reaction on new economic condition. In a way the accession to the WTO could be compared to the purchasing of expensive equipment (which was bought by the most of the other market players). If you know how to use it, it would increase the competitiveness of your products. If you are not able to operate the equipment properly, you will neither cover the costs and nor avoid losses.

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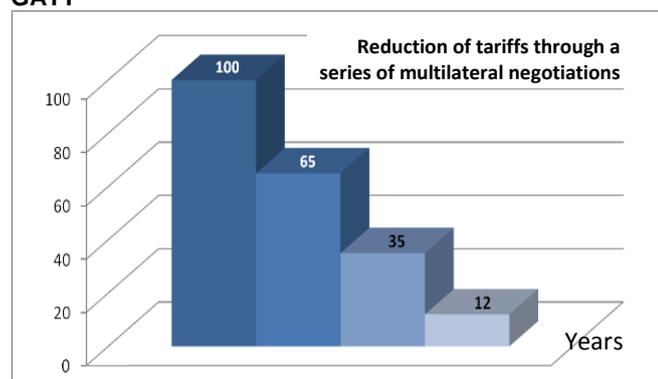
**The paper was prepared within the WTO Chairs project at St. Petersburg State University.*

Evolution of regulatory measures – from tariff to non-tariff

By Vladimir Salamatov

Trade remedies became the primary tool of international trade regulation after the World War II. Reduction of import duty rates or 'tariff protection' was indicated as subject matter for the first rounds of multilateral trade negotiations in the process of General Agreement on Tariffs and Trade elaboration which was signed in Geneva in 1947 (hereinafter - GATT 47)..

Figure 1 Reduction of Tariff Protection Level during GATT



GATT 47 reproduced Chapter IV of the Havana Charter, the Charter of International Trade Organization (hereinafter - ITO) titled *Trade Policy*.

Discussions on establishment of ITO were held on the basis of United Nations from 1946 to 1948. Fifty nations had signed the Charter of the Organization but eventually the ITO project was not implemented. The reason of the failure was US refusal to ratify the document. 23 nations agreed to accept a part of ITO idea in the form of transformed Havana Charter - GATT 47: Australia, Belgium, Brazil, Burma, Canada, Ceylon, Chile, China, Cuba, USA, France, India, Lebanon, Luxembourg, Norway, New Zealand, Pakistan, the Netherlands, South Rhodesia, United Kingdom, Syria, Czechoslovakia, and the Union of South Africa.

As shown in the Table 1, the first five rounds of multilateral negotiations within GATT concentrated on reduction of tariffs to lower the international trade barriers. During the GATT 47 (prior to the WTO establishment) tariff protection level was reduced by 88% in total.

Table 1 The stages of multilateral trade negotiations

Time period	Negotiation round	Agenda of negotiations	Participating countries
1947	Geneva Conference 1947	Tariff reduction	23
1949	Annecy Conference	-«-	13
1950	Torquay Conference	-«-	38
1956	Geneva Conference 1956	-«-	26
1960-1961	Dillon Round	-«-	26
1964-1967	Kennedy Round	Tariff reductions and development of Anti-dumping code	62
1973-1979	Tokyo Round	Reduction of tariffs and development of a number of agreements and codes	102
1986-1994	Uruguay Round	Reduction of tariff barriers, development of agreements on non-tariff barriers, improvement of GATT system, trade of services, and establishment of the WTO.	125

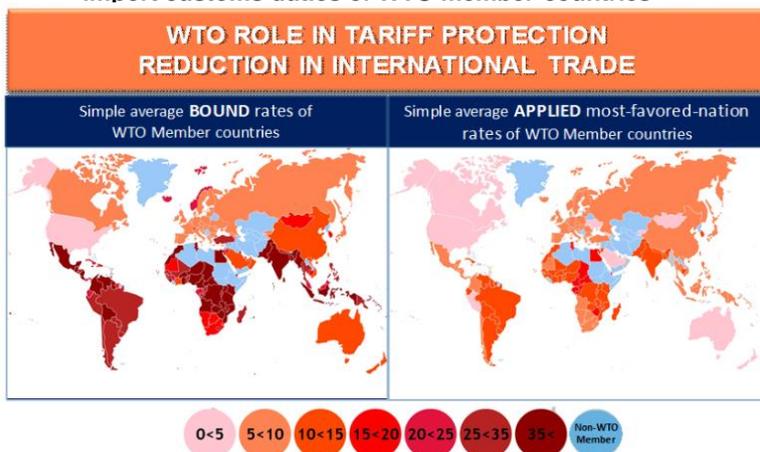
The fundamental principles of GATT 47 underlay the negotiations and tariff protection reduction: Most Favored Nation principle (hereinafter - MFN) and the binding of tariffs.

While analyzing tariff protection data of any WTO member-country it should be clearly identified which values to be taken into account: final binding level or actually applied tariff. Figure 2 shows WTO data on binding level and applied rates of import customs duties in WTO member-countries.

These 'tariff maps' developed on the basis of the WTO Secretariat data clearly illustrate the practice of tariff regulation by the WTO member-countries: average applied tariff is lower than average binding level. WTO member-countries set up rates within the range from 0% to binding level.

Protection level for agricultural products is presented separately on Figure 3 for benchmarking purposes. Tariff protection level for agricultural goods is traditionally higher than the simple average level (almost for all WTO members).

Figure 2 Comparison of bound and applied rates of import customs duties of WTO member-countries



Tariff maps reveal that the average level of tariffs applied range from 0 to 10% for North American and Eurasian countries and 10-15% for the majority of South American and African states. If we proceed from simple average indicators and introduce the element of foreign trade turnover structure, i.e. begin to analyze the average weighted tariff, its level turns out to be even lower. The explanation is that the bulk of trade is carried out by developed countries which tariff protection level ranges from 0 to 5%, and because the tariff protection for raw goods is set at the minimal level in the majority of countries. Hence the role of tariff protection as a regulating tool in international trade is continuously reducing.

Despite the fact that many WTO founding countries, e.g. India, retain rather high binding levels for certain goods, efficiency of regulating impact of this instrument declined considerably.

Benchmarking table of average applied rates of import duties and average binding levels for import tariffs in trade in agricultural and food commodities is presented below (Table 2).

Table 2 Comparison of applied and binding rates for agricultural products of certain countries

TARIFFS FOR AGRICULTURAL AND FOOD PRODUCTS:
average applied and bounded rates (%)

Country	MFN Applied Duty rates					Final bounded rates
	2000*	2008	2009	2010	2011	
Australia	1,1	1,4	1,2	1,2	1,2	3,5
New Zealand	1,7	1,5	1,5	1,4	1,4	6
USA	4,9	4,7	4,7	7,2	5,0	4,9
Russia	9,9	14,2	13,2	13,5	14,3	10,8
Ukraine	н/д	13,0	9,7	9,8	9,5	11,0
Argentina	15,0	10,3	10,3	10,3	10,4	32,4
Brazil	15,6	10,2	10,2	13,7	10,3	35,4
China	15,9	15,6	15,6	15,6	15,6	15,7
India	47,4	32,2	31,8	31,8	н/д	113,1
South Africa	5,8	9,3	8,9	9,0	9,1	39,2

Source: WTO

*Figures of New Zealand, Russia, and China date back to 2001.

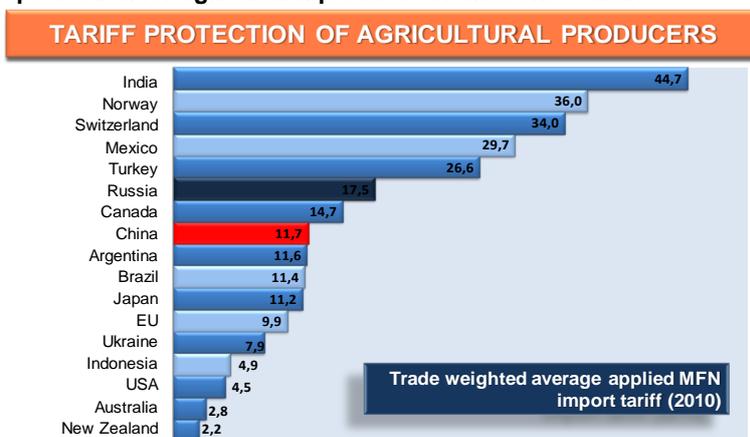
Average binding level for agricultural products agreed by Russia as a result of the WTO accession negotiations falls within the group of the most liberal tariffs. At the same time, it holds position close to the upper limit in this group.

Special attention should be paid to early mentioned high binding level in India. Despite the fact that actually applied average tariffs are nearly 4 times lower than the binding level, the legal opportunity for existence of such increase of tariff protection clearly reflects the reason for necessity of the Russia's accession in WTO. As a founding member, India, took part in all rounds of negotiations and had an opportunity to defend its interests for each commodity item since establishment of GATT / WTO. The average protection level of 155 member-nations was considerably lower at the time of Russia's accession than the initial level. This definitely diminished opportunities for the negotiating team to preserve maximally possible tariff protection level.

More objective analysis of negotiations' outcomes and tariff protection level needs to take into consideration the structure of goods import to customs territory of the Customs Union and weighted average figures of tariff barriers.

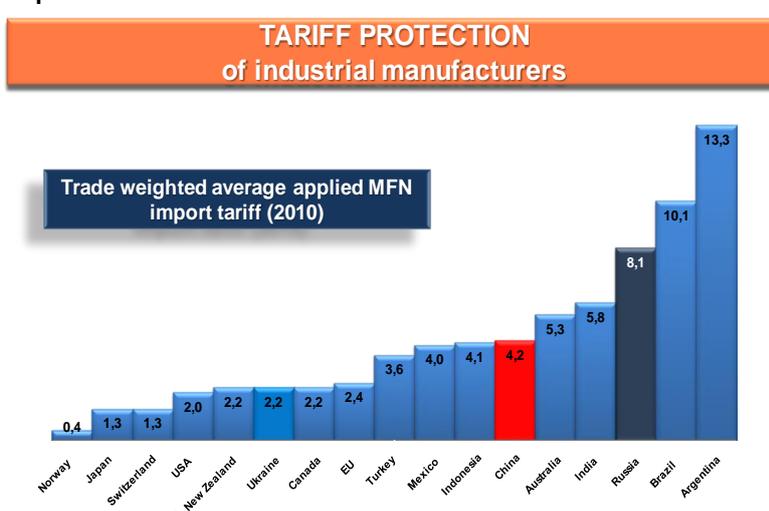
Following the logic applied in the paper, the diagram below reflects weighted average import tariff for agricultural products (Figure 3):

Figure 3 Difference in weighted average level of tariff protection for agricultural products of different countries



As shown in the diagram if the average binding level for agricultural goods totals ca. 10%, then the weighted average applicable protection level reaches 17.5% (based on 2010 import data).

Figure 4 Difference in weighted average level of tariff protection for industrial commodities of certain nations



For industrial goods (Figure 4) the situation differs more significantly. Weighted average indicator of tariff protection for industrial goods amounts 8.1% (based on 2010 import data). It confirms the overall conclusion for simple average applied tariffs. Protection of agricultural goods, just as in the majority of WTO member countries, is twice higher than the protection level for industrial ones.

It should be noted that weighted average tariff for agricultural commodities in India is also the highest in the given example. At the same time, it is 2.3% lower than in Russia and 7.5% lower than in Argentina in terms of industrial goods.

At the same time, presented diagrams demonstrating tariff protection levels are relative as they account only one-year supply structure. Building the diagrams on the basis of 2012 trade statistics and / or for several years in future will clarify presented data and the conclusions drawn.

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Educational integration for sustainable economic development

By Ihar Hancharonak and Tatyana Prannik

The assumption that the new economic order accompanied by the so-called technological revolution requires to a certain degree new approaches in public administration seems to work well. The mentioned above technological revolutions affect not only production of material valuables but also such seemingly inviolable processes as, for example, the Weberian model of public administration [1].

In most cases those revolutions inflict dynamic changes on our existence patterns. The age of ICT and e-government presents ample testimonies of this interconnection.

Human capital is the major factor of the present-day economic growth and the top agenda of social-economic policies. However, it would not be sufficient to simply admit the fact to make a breakthrough in this sphere's development. Deeply reaching transformations in the education area in line with the current (post-industrial) challenges are wanted. Among such are personalized and life-long services that would be supported by internationalization and dramatically new technological solutions.

With no innovative international training programmes for the modern generation of executives it is not deemed possible to create favourable environment that would promote development of innovative economy and business technologies as well as generate new ideas and foster cooperation in the innovations sphere to achieve a synergetic effect in elaboration and implementation of new technologies.

The present article claims the necessity of diversifying educational programmes in public administration. The authors focus on the innovative practice-oriented MA programme that accumulated the advanced international experience (outcomes of the Baltic Sea Region Programme "EGOPRISE" and a two-year's span of cooperation with the Korea Institute of Public Administration) and competence-driven approach [2, 3] used in the process of the educational programme's elaboration.

In the Baltic Sea Region a similar programme has been developed only in Örebro University (Sweden). The course presents the students with the knowledge and skills of ICT use in public administrations. The University of Mannheim (Germany) has introduced an elective programme "E-government: Methods, Technologies and Processes" in the MA diploma study courses "Information Systems" and "Business Administration". The programme's schedule includes featured classes in legal foundations of e-government and the potentials of ICT solutions for public management.

Among the EU counterpart e-government programmes the following could be mentioned: the master programme in the University of Trento (Italy) and executive short course in Maastricht School of Management (the Netherlands) as well as the study courses in Modul University Vienna and Danube University Krems (Austria).

Independent master degree programmes in e-government are available in Russia and Ukraine. The National Academy of Public Administration, Office of the President of Ukraine, launched in 2010 and has been teaching a study course in e-government. Highly qualified personnel for the e-government sector has been trained since 2011 at eGovernment Center of Saint-Petersburg National Research University of Information Technologies, Mechanics and Optics. The Center offers an MA study

course "Governmental Information Systems Management" and implements a distance learning programme "E-government and Innovation Governance Technology". Moscow Metropolitan Governance University trains public managers in the programme "E-government and Information Society" for their further work in information and analytical departments, public bodies and state organizations engaged in development of informational environment.

A new MA programme "E-government" that accumulated advanced European and global experience has been recently launched in Belarus stirring a lot of interest among the CIS-group countries and members of the Eastern Partnership.

There is still considerable lack of knowledge, managerial skills and competencies in application and development of e-services for citizens, businesses and, as a matter of fact, for the system of public administration itself. E-government experts should become called-for at all levels of public administration. The authors are convinced that the newly appearing international practice-oriented MA executive programmes will create a pool of highly skilled professionals and secure the states' efficient functioning; foster development of integration processes; promote mutually beneficial cooperation in trade and economy, investment and innovation areas; and eventually support the evolvement and sustainable development of competitive regions, the Baltic Sea Region being undeniably one of them.

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Chinese vector of Eurasian integration

By Sergey Kizima

In January 2012, Barack Obama announced the Pentagon's new military strategy, which is scheduled to shift focus from the Atlantic region to the Asia-Pacific region. It cannot be regarded otherwise than as an attempt to curb the growing influence of China in the strategically important area for the USA.

The growing contradictions of the United States and China form a favorable background for the development of good relations between future Eurasian Economic Union (EEU) and China. Aggressive behavior of the United States to China increases geopolitical importance of EEU for Chinese side. The chances of a favorable long-term scenario of development of relations increases due to the successful geo-strategic position of the emerging EEU. It is a kind of continental rear for China, which will "fight" with the U.S. on its maritime borders. Any geopolitical doctrine tells us about how important it is to have a calm and protected rear when dealing with a dangerous opponent on the front. The stability and prosperity of the EEU becoming China's most important factor in the success of the struggle for world domination.

An important factor in the location of the future EEU for the serious interest of China is its access through Belarus, Kaliningrad region and the border with Finland to the European Union. One of China's most important strategic objectives is to convince the elite of the European Union is that they don't need to support the U.S. in the coming geopolitical struggle. And it was done well by China in recent years. Remarkable progress has been made in relations with the countries of the EU, for which the ability to export their goods at the rapidly growing Chinese market is vital to overcome the economic and financial issues related to regional European crisis. Several EU countries agreed on strategic partnership with China since 2008, and the number of investment projects from the part of Chinese business is permanently increasing. As an example we can consider the relations between China and Germany, the most important country in the EU policy-making. Germany over the past decades has exported to China 16,000 forms of technology (\$ 50 billion amount), accounting for 38% of total imports of technology to China from the EU, and China in 2011 became the largest investor in Germany by number of investment projects, surpassing the United States.

No less important is the fact that the European Union became one of the most important trade partners of China, and the availability of unrestricted communications for trade through the territory of the future EEU is a potential strategic advantage for China. At the moment, the overwhelming volume of China's trade with the EU is coming by sea routes that the U.S. can easily block at any time. The geopolitical position of the future EEU promises to add new routes for EU-Chinese trade as a result of global warming, which will create opportunities for use of the Northern Sea Route (NSR). The supply of goods to Europe from North-East Asia by the NSR will be shorter in comparison with the currently used route and that will become good reason for the convergence of interests of the future EEU and China, and the intensification of cooperation between them will become even more serious. The US cannot block the EU-Chinese trade at the shores of China and Russia without a declaration of war and warfare. Both described above potential routes for China's trade with the European Union (through the land

territory of the future EEU and the NSR) are free of restrictions from the side of the US.

Equal importance to the strategic security of China has also resource potential of the emerging EEU. Of particular importance are the energy resources. It can be expected that in the next ten years, China's dependence on imported oil (in case of maintaining of high rates of economic growth that is likely to happen) could increase to 400 million tons a year. Delivery of the huge amounts of oil from the Persian Gulf, Venezuela and Africa depends on the ability to defend the long maritime communications, what Beijing is currently not able to fulfill. With an increase in tensions with the US and in the risk of getting energy resources from traditional sources, China can expect a sharp increase in imports of energy resources of the future EEU. In addition to oil, the natural gas is also increasing importance as an environmentally friendly source of energy, which is important for China because of the ambitious plans for the solution of environmental problems. Important for imports is also coal.

The task of policy makers in the future EEU is the maximization of the bonuses of China's increasing dependence on good relations in this area. It is necessary to create a modern economy with important innovation and investment. The capacity and experience of the development of China's economy in these areas at the moment are far ahead of the level of Russia, Kazakhstan and Belarus. Hundreds of the world's largest corporations in China have opened their scientific and technological centers. In addition, China itself currently has its own leading transnational corporations (TNC). The positive dynamics of the number of TNCs in China is celebrated in the annual ranking of Fortune Global 500 - the list of the 500 largest transnational corporations (TNCs) of the world by profit. If we compare 2005 data with the data of 2012, instead of 16 TNCs from China has now 73 most profitable companies in the world out of 500.

China is rapidly becoming a country with an increasing concentration of capital and new technologies. Attract Chinese investment, especially connected with high technology industry, is the most important task of the leaders of the Eurasian integration. It is expected that in the next decade China will invest in other countries from 1 to 2 trillion dollars and states of the Eurasian integration sphere should get their share. At the same time, it is expected that China will not particularly encourage the movement of high-tech industries from China into the territory of the future EEU. China has clearly defined task – multiply high-tech production on its own territory, which is the best way to quickly increase GDP per capita and to build a modern economy. China is ready to move from its territory outdated or low-profits factories, what is already happening in its cooperation with the countries of Southeast Asia. To avoid such a scenario, it is necessary to implement the program of Chinese high-tech investment, based on achievement of particularly warm political relations. In such a case, we can expect that the Chinese government will make concessions to facilitate the creation of innovative knowledge-based economy in the emerging EEU. Serious progress in this direction has been achieved by Belarusian leadership. In Belarus recently started big project to assemble Chinese cars (up to 180 thousand per year) which will serve for the

modernization of Belarusian enterprises producing auto details.

Important role in the development of innovative economy, with the assistance of Chinese investment could play technological and industrial parks on the territory of the future EEU. Russia already has a similar experience, Belarus has also entered into an agreement to open one of the largest industrial parks in Europe (80 square km). Potential investment expected – \$ 30 billion, the potential number of new jobs is up to 600 thousand, or approximately 13% of the working force.

Of particular interest in co-operation with China for EEU is the development of modern technologies of alternative energy. China in 2010-2012 became the leader in terms of money spent in this sector, and it has necessary technologies to share.

It can be summarized that the relationship with China is key to the successful implementation of the project of the Eurasian integration. The use of the troubles in China's relations with the United States to strengthen political relations and profitable investment, logistics and

technological cooperation can give a serious impetus to the Eurasian integration and provide stimulus for growth of the economies of the member countries. Obviously there are risks associated with the increasing pressure of growing economy of China, including corruption factor. At the same time, the benefits of increased cooperation with clearly outweigh the possible risks.

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Environmental economics for sustainable development

By Olga S. Shimova

At the June 2012 “RIO+20” Earth Summit, the world leaders confirmed their adherence to the concept of sustainable development of civilization, the conference key theme being the issue of transition to the “green” economy in the context of sustainable development and poverty eradication. According to the UNEP definition, “green” is the economy that leads to increasing people’s well-being and strengthening social justice, with simultaneous decreasing the risks of environment’s degradation. It is environmental economics that has a critical role in the implementation of this concept.

The historiography of environmental economics within the system of economics-related sciences is just a few decades old. However, the beginning of studying relationships between economics and environment goes back to a much earlier period. It was T. Maltus who at the turn of the 18th and 19th centuries for the first time substantiated the limits of human civilization growth due to the nature factor. The formation of the national environmental economics as a branch of economics started back in the 1960-s. Already in the 1970s, an academic discipline under this name started to be taught in a number of the country’s universities, which testified the recognition of its major theoretical and applied importance.

The fundamental research in the field of environmental economics was a response to time requirement regarding the development of methodology and scholarly-methodological provision of environmentally sustainable economy’s regulation. Three stages are identified in the development of the national environmental economics research over the last decades. They have different goals and objectives in accordance with the practical needs: 1) the former USSR central planned economy (1960-1980); 2) the USSR’s last five years (the so-called “perestroika”) economic reforms; 3) modern transition to market economy. The first two stages were characterized by the creation of theory and first experience in practical application of natural resources’ economic estimates, attempts of developing conceptual approaches to the assessment of the environment’s assimilation potential for scientific substantiation of payment for its pollution, research of the economic damage caused by the environment pollution and identifying the environment saving activity’s economic effectiveness, development of theoretical grounds for establishing environmental management’s availability at a price, and so on.

The period of transformational market reforms in sovereign Belarus is putting forward new objectives for environmental economics related, in the first place, to ensuring progress in the field of sustainable development.

In the early 1990-s, sustainable development was recognized as a model of Belarus’s future society, which became an impulse for working out and adopting by the Republic of Belarus, one of the first countries in the world, the national sustainable development strategies (NSSD): for the period until 2010 (NSSD – 1997) and for the period until 2020 (NSSD– 2004). The results of accomplishing the NSSD tasks over the last years testify an absolute positive value of

the above documents. The practical implementation of the tasks found there enabled to stop the production decline and contributed to stabilizing the situation in the home market. In addition, it led to the positive dynamics of major macroeconomic indicators and the environment recovery.

The amount of scholarly knowledge accumulated so far makes it possible for environmental economics to contribute to ensuring an environmental component of sustainable development due to the fact that in condition of forming market relations the economic instruments are becoming a priority in regulating environment-oriented activities.

The improvement, over the recent years, of indicators in the sphere of environmental management in Belarus to a great extent is related to the introduction in the early 1990-s of payment for nature resources and environment pollution. The analysis of the current system of environmental management available at a price shows that its functioning has contributed to the country’s nature preservation activities becoming more intensive. However, the revision of originally low payment rates for a long time was lagging behind the inflation rate, which led to the decrease of funds receipt both for extraction of natural resources by local budgets and for environment pollution by the budgetary environment protection agencies. On the other hand, it did not duly stimulate the nature conservation activities of the economic entities. This requires improving the methodological approaches to the identification of ecological payments due to the economic transformation over the recent time.

In their turn, the changes in ecological taxation should be followed by reforming the tax system, as the nature capital being the major factor of the economy’s development is not performing its critical function in the state tax policy.

Apparently, it is now time to start exploring the market mechanisms of regulating the quality of environment by means of establishing a market of pollution rights, which could become an alternative to the ecological taxation with all its drawbacks. The current system of licensing environmental management in Belarus has created certain prerequisites for it. Testing market mechanisms of ecological regulation in the home market is very relevant for Belarus due to its being a party of the Kyoto Protocol, which will make it, sooner or later, take part in the international market of carbon quotas trading.

The above tasks are just a few among the most relevant directions of research and practical activities in the field of environmental economics.

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Small and medium enterprises in Belarus – status and problems

By Eduard Simchanka

In Belarus SME sector emerged in the early 90-s of the last century. In 1993 it included about 10 thousand enterprises, mainly in form of LLC in construction, industry and trade, as well as cooperatives and farms with 213 thousand employed. By the beginning of 2012 the total number of employed reached almost 800 thousand people. Taking into account changes in criteria for SME classification, the average rate of growth in terms of employment is about 6% per year.

At present SME sector includes *micro organizations* up to 15 person, *small organizations* with staff 16 to 100 persons, *medium-sized* business entities 101 to 250 persons and *individual entrepreneurs* which are doing business as natural persons. The above classification introduced in 2010 by the Law «On the support to small and medium-sized business». Historically this was preceded by adoption of the laws on entrepreneurship (1991) and state support of small business (1996). In 1991 the concept of entrepreneurship was elaborate, and its forms were determined - private and collective, natural person or legal entity, with or without hired labor. In 1996 the criterion of small business based on staff number was introduced - 25 to 100 persons depending on industry.

According to the latest official data in SMEs were occupied 31.5% of employed in the economy (micro - 7.1%, small and medium by 9,6%, individual entrepreneurs - without family members and hired persons - 5.1%). At the beginning of 2012 there were approximately 80,000 SMEs, of which more than 65,000 micro, about 12,000 small and 2600 medium-sized with an average number 5, 38 and 165 people respectively. The number of individual entrepreneurs was about 220 thousand.

Each of the mentioned groups of SMEs has its own peculiarities. Most of the *micro and small enterprises* distributed between trade and services (more than 40% of total), industry (15.5%), business services (12.3%), construction (9.3%) and transport (9.2%). These enterprises is concentrated in the Minsk and Minsk region (more than half, and mainly in the capital), which is approximately one and a half times higher than the corresponding gross regional product. (On contrary, number of medium-sized businesses and individual entrepreneurs for the others five regions correspond to their level of economic activity.) Micro and small enterprises is also characterized by wide - more than doubled compared with the average for the economy - use of external multiple job holders and civil law contractors. Finally, specific only for micro-enterprises feature is low official salary, which is about two-thirds of the country average and which cannot be explained by differences in branch structure.

Among *medium-sized enterprises* the largest number is accounted for of agriculture (29.1% of total), industry (22.6%) and construction (15.7%). About a third of medium-sized enterprises are state owned compared with the absolute dominance of private ownership in other parts of the SME sector.

Individual entrepreneurs have certain benefits at registration and doing business, the possibility of using

simplified taxation system. Their activities concentrated mainly in trade (54.2%), provision of transport and other services (13.9%), construction (12.7%). There is a tendency to limit individual entrepreneurs in attracting hired workers and relatives.

The SME sector (without individual entrepreneurs) generates 22.9% of GDP, with 5.4% of micro-enterprises and 10.3% of small - and medium-sized 7.2% (2011). In general, the productivity of the sector is slightly lower the average for the economy. The exclusion is a group of small businesses where performance above average.

Low growth of SMEs (at the background of their complete absence before transition) and their weak performance (according to the generally accepted indicators) is due to several factors. One of them is the inherited structure of socialist economy. Because of inconsistent policies of structural reforms and privatization, the effect of this factor is largely retained.

If we consider transition period, one can distinguish between influence of *social, economic and business* environment. The *social environment* is characterized by the absolute dominance of the state. For SMEs it manifests itself in limited access to resources, in requirements to fulfill so called forecast indicators, in the mentality of state institutions. First of all it concerns financing, leasing, raw material prices, obtaining licenses, attitude of local, judicial and supervisory authorities.

The *economic environment* is characterized by persistent adverse impact of macroeconomic instability, high taxes and interest rates, economic shocks, changes in economic policy priorities.

The main problems of *business environment* are the lack of the state support and relatively low capacity for self-regulation. For example, the government program for SMSs support for 2013 - 2015 provides annual funding about USD 13m. Regarding self-regulation one can take into account the fact of low proportion of SMEs belonging to business associations.

Unfavorable environment are largely supported by existing power and control institutions and significantly limits SMSs development, hinder greater transparency, efficiency and competitiveness of the sector.

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Status and prospects for development of rail transport in Belarus

By Elena Dadzerkina and Maria Usik

Transport of the Republic of Belarus, is integrated into the international transport system and plays a major role in the performance of the most important sectors of the economic needs of the state - the need to move the product. An important part of the transport system of the Republic of Belarus is a rail. It accounts for about 70% of freight and 40% of passenger traffic. Thus, to improve the efficiency of the economy is necessary to ensure the improvement and modernization of railway transportation.

The main purpose of this paper is to determine the role and importance of rail transport in improve the effectiveness of the economy of the Republic of Belarus with a small analysis of the Belarusian Railways as well as examination of the problems and prospects of the development of rail transport in Belarus.

In the conditions of increasing globalization processes and the involvement of countries in global economy, expanding the scope of railway in the world, the growth of investment in rail infrastructure of Belarus, that is situated in the heart of the Europe at the crossroads of transport corridors linking major economic regions of the Eurasian continent, the challenge of rail infrastructure and service delivery, which conform to international standards.

At this stage of socio-economic development of the Republic of Belarus the activity in the field of rail transport is aimed at upgrading infrastructure in order to realize the advantages of rail transport, the creation of effective, safe and cost-effective transportation to ensure stable indexes of development of not only industry but also country in general.

The understanding of the need to strengthen the mutually beneficial cooperation between the railways, transport organizations, private businesses and society, the creation of conditions in the Republic of Belarus for the investment flows in the rail sector (not only domestic but also foreign, including private), are the most important things for sustainable economic development of rail transport.

Rail transport in Belarus is almost completely under the control of the public association "Belarusian railway", which although is a commercial organization, performs the role that is assigned to it by the country - provide the needs of the state, businesses and individuals in rail transportation, and services. At the same time, the performance of the rail can't be done without support of the state, a special role of which is expressed in participation and financing projects of development and modernization of the rail infrastructure.

The rail plays an important role in economic life of the country. The share of rail transport accounts for about 76% of all freight carried in the country and more than 44% of passenger traffic. It is the most effective, reliable and widespread type of transport, besides it has the necessary infrastructure, which has sufficient reserve and carrying capacity.

The rail transport as a leading element of the transport system of Belarus and plays a dominant role in the future of the economy of the country that can be defined by: need to export goods of mass shipment such as petroleum products, fertilizers, chemicals, building materials, timber; need to import a large amount of resources of critical import; the significant share of currency earnings into the country and tax filling of its budget.

The transportation of goods in transit, which are possible due to its strategic geographical location, is essential for rail complex of Belarus.

The rail transport in Belarus is represented by public association "Belarusian railways" [2, p. 9]. The main objectives of the Belarusian railways is to provide needs of the state, businesses and individuals in rail transportation, work and services rendered by the Belarusian railways, as well as profit.

The main indicators of financial-economic activity of the Belarusian Railways for 2009 - 2011 years are presented in Table 1.

In the last decade there has been a tendency of growth of freight turnover. In order to implement the decisions taken in the framework of the Common economic space from 01.01.2013 Belarusian railways unified the rail tariffs. After unification the delivery of goods by rail over a distance of over 200 km becomes profitable. [3, p.2]

Passenger traffic in 2012 grew up to almost one-third of the total passenger traffic of the country. In 2012 the Belarusian Railways have transported 100,5 mln. passengers (on 13% more than in 2011) [3, p. 1].

The results of 2012 shows that the proportion of the Belarusian railways in 2012 in total freight turnover of transport system of the Republic of Belarus (without pipeline) was 71,1%, and in the country's GDP - about 2%.

The positive dynamics of economic and financial indicators, conduction of balanced transport policy aimed at the development and modernization of railway infrastructure for solution not only transport, but also the economic challenges, says that in the Republic of Belarus for the time of its existence the railway transport played a key role in the integration processes of the country and had an effect on the strengthening of the social sphere, contributed to the economic development of the country. Today, it defines its special strategic importance.

The directions of the development of railway transport

It is clear that in the circumstances of increased competition, favorable geographical position of the Belarusian Railways and its potential alone can't provide sustainable financial and economic situation in the market of logistics services. Therefore it is outlined the main priorities for action in areas, such as: improvement of the legal framework; renovation and modernization of the rail infrastructure; conducting of flexible balanced tariff policy; optimization of existing and establishment of new transport and logistics schemes for delivery of foreign goods; establishment of transport and logistics network; implementation of modern informational technologies; increased international cooperation.

The main advantage of the geographical location of Belarus is that through its territory pass the shortest transcontinental routes, so our railway links its prospects, especially with the development of its transit potential to attract more traffic.

To this goals the main areas of development and modernization of rail infrastructure are: the development of rail infrastructure in the framework of international transport corridors in the country; output from economic circulation an inefficient production facilities; gradual electrification of the rail; modernization of the signaling systems and communication; creation of a single data network; development of technical base of repair of locomotives and carriages; introduction of non-destructive testing and diagnosis of key details of vehicles and other technical devices of rail transport; a system of automatic vehicle identification [4].

The purpose of the Belarusian Railways is to make the industry more competitive, modern and responsive to needs of time.

An important direction in the development of passenger traffic, forming a positive image of the Belarusian Railways is upgrading the station infrastructure. The development of the railway station Minsk-Passazhirsky is directly associated with the development of urban lines in Minsk. In order to increase the capacity of the station and provide a high frequency of trains

urban lines will require the development of plant openings and organization of additional receiving-way by moving techpark.

To sum up we can say that the Belarusian railway is fully performed all tasks that is formed by the government. However, the lack of the necessary financing resources for large-scale implementation of all projects which are planned for modernization and construction of railway infrastructure, is restraining the growth in this area. Despite some difficulties in the implementation of its activities, a Belarusian railway is a symbol of reliability, constant movement and striving for development.

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Table 1 The main indicators of financial-economic activity of the Belarusian Railways for 2009 – 2011

Indicator	Unit of measurement	2009	2010	2011	2011 to 2010
Income from transportation	mln. rub.	4 543 992	5 351 974	10 488 981	196,0
Income from other activities	mln. rub.	537 437	652 731	1 175 491	180,1
Total income from operating activities	mln. rub.	5 081 429	6 004 705	11 664 472	194,3
Spending on transportation	mln. rub.	3 352 278	4 331 651	7 009 216	161,8
Spending on other activities	mln. rub.	423 041	512 064	864 295	168,8
Total operating expenses	mln. rub.	3 775 319	4 843 715	7 873 511	162,6
Profit from transportation	mln. rub.	1 014 973	833 817	3 242 381	388,9
Profit from other activities	mln. rub.	42 133	48 892	145 151	296,9
Profit from sale of operating activities	mln. rub.	1 057 106	882 709	3 387 532	383,8
Profit from operating income and expenses	mln. rub.	35 731	20 840	105 423	505,9
Loss from non-operating income and expenses	mln. rub.	- 227 399	- 312 352	- 905 301	289,8
Net profit for the period	mln. rub.	533 200	313 430	1 778 209	567,3
Profitability on the transportation	mln. rub.	30,3	19,2	46,3	27,0
Profitability of other activities	mln. rub.	10,0	9,5	16,8	7,2
Profitability of sales of goods (works, services) by operating activities	mln. rub.	28,0	18,2	43,0	24,8
The average number of major operations	mln. rub.	77 073	77 803	78 215	100,5
The average monthly salary in the core business	mln. rub.	1 255,6	1 637	2 368	144,7
Investment resources	mln. rub.	920 481	1 234 368		
Own funds for investment	mln. rub.	813 948	728 177		

Source: own study based on [1,2].

This table shows the increased level of profit and cargo, passenger transportation.

Russian startup tour – bringing international experience to Russian regions

By Daria Lipatova, Pekka Viljakainen, Evgenia Mayer and Sergey Blintsov

The latest prognosis shows a warning tendency of 40% decrease in Russian economy growth in all sectors this year. This data is extremely relevant in context of implementing the national modernization strategy. One of its key features is the mechanism of development agencies presented by both profit and non-profit state-funded organizations aimed at filling market gaps in different spheres of national socio-economic development.

Contemporary development agencies present the second wave of such structures created in mid-2000s. Aiming at building national innovation ecosystem, they function in the top priority areas of national economy modernization stated in the Critical Technologies List approved by the President of Russia: security and fight with terrorism; live systems (biotechnology, medical technology and equipment); industry of nanosystems and materials; information and communication systems; green technologies; transport, aviation and cosmic systems; energy and energy saving.

The major development agencies of Russia having a strong international approach are the Russian Venture Company (RVC), Rusnano and Skolkovo Foundation among others. Having different range of tools and services supporting subjects of innovation ecosystem, these agencies are destined to bridge the gaps in their fields. In pursue of unification of their efforts the Agreement on Innovation Projects Financing between 10 agencies was established in 2010. Though sometimes criticized for the bulky structure, the value of a case of unprecedented innovation ecosystem actors coordination should not be underestimated.

The illustration of the development agencies cooperation in action is the Russian Startup Tour (RST) organized by Skolkovo Foundation, RVC and Federal Agency on Youth Development (Rosmolodezh). In 2 months 15 development agencies and partners with the support from the Government of Russia have visited 16 Russian cities from Vladivostok to Kaliningrad gathering 3000 people of entrepreneurial community in regions together and communicating them existing tools and services for fostering innovative ideas into successful businesses.

Not only Russia faces the need to support the entrepreneurial community. Following the RST leader and main organizer, Mr. Pekka A. Viljakainen, Advisor to President of Skolkovo Foundation, it took Finland to face the economic crisis of 2008 and fall of multinational Finland-based Nokia to set up typically new culture of startups in few years raised into 25 thousand people Startup Sauna entrepreneurial community symbolized by super successful Angry Birds and Supercell. Now it is Russia's turn to face the challenge of creating hundreds of thousands of new technology based innovative companies united by entrepreneurial spirit.

“The early stage governmental funding is crucial for the innovative company as the money at the banks is expensive and not easily accessible. We invited all the stakeholders to join us in communicating existing early stage financial instruments for startups”, – Mr. Viljakainen tells the practical idea behind the tour. – “In Russia there are surprisingly many mechanisms available to broaden business. However the “smart money”, when investors contribute to the leadership and quality of the company, is still underdeveloped”, – He continues. – “Considering public financial instruments aimed to cover early stage funding, the target is to increase private funds and private money with the growth of expansion phase”.

Educating young entrepreneurs existing mechanism to finance their business ideas is a natural part of involving them into the business culture of the new type. According to RST co-organizer, Ms. Evgenia Mayer, Head of Partner Department of RVC, development of self-sustainable innovation ecosystem players is needed to form entrepreneurial culture.

“Support of partner projects aimed at developing high-tech entrepreneurship in Russia is one of the strategic areas in our work. Russian Startup Tour marries professionalism of our partners with unique regional expertise to help existing and accelerate new high-tech companies”, – comments Ms. Mayer. “Apparently, the experience of the project confirms us in success of joint efforts of both development agencies and their partners”.

Overall the results of RST show evident regional interest to the topic of building innovative business not only on the level of supporting organizations, but in the very eyes of the representatives new “Digital Cowboys” generation participating in the project.

“We have been working for 4 years now to create a sustainable youth community of innovators”, – states Mr. Sergey Blintsov, Head of Zvorykinsky Project. “Developing the series of events and educational trainings gave its results – today we count more than 10 thousand innovative teams with 50 success stories and total 1 billion rubles investments attracted. Convinced, our effort bringing both Russian and international expertise to the regions have sown right seeds”, – concludes Mr. Blintsov.

Having the size of the country as Russia, to boost the transition from oil-based industrial to knowledge and technology-based postindustrial economy, such organizations as development agencies with the concrete examples of the joint cooperation projects aimed at innovation ecosystem development are needed for a long time. Overall, it does not matter what the brand is – the existing services resulting in concrete success stories are the key.

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Russia

The TRIPADA concept – a road map for concretely turning Russian innovations to local and global benefits!

By Ilkka Linnakko and Tomas Rosin

There is a clear need, on the world markets, for innovations that could boost the industry to be more efficient. Also the globalization put a lot of pressures on the industry to be more efficient, since the competition is on a steady grow. The environmental aspects become more and more important as well, which forces the industry to count their emissions as a cost. These facts are a big booster for industrial Business to Business (B2B) innovations.

Russia has invested a lot in the research of natural sciences. Hence, it is obvious that this scientific research includes a huge number of potential innovations that are just waiting for commercialization. However, the reality has shown that only a tiny fraction of this potential is commercially utilized.

It is a known fact there is a big lack of people, in Russia, who have the skills and the experience to manage technology companies commercializing innovations onto the global markets. However, in Finland, Sweden, Denmark and Germany there are people skilled in the art of entrepreneurship and management of technology companies to penetrate global markets. The Baltic Sea region would, hence, benefit a lot by bringing the innovations and experienced management together to concretely boost the economy of the Baltic Sea region.

The company TRIDARA International Oy has created an innovative model on how to bring the Russian innovators and skilled managers under the same roof. This model is called TRIDARA concept. The TRIDARA concept works as follows:

When TRIDARA International identifies a promising technology it carries out a due diligence on the technology and if everything matches up to the criteria, the TRIDARA team will type up a business plan and attract for venture capital to form a Joint Venture Company (JVC). The headquarters of the JVC will be located within the EU (e.g. Baltic Sea region) and the IPR of the technology will be placed into the JVC. The shareholders of the JVC will be the original owners of the technology (innovators), TRIDARA International (through so called sweat equity) and possible investor(s). The main strategy of the JVC is to wrap the technology into a feasible product portfolio, with strong patents, that brings the best benefits to the customers. The aim is to, take such measures that the marketing and sales commences as fast as possible to get the JVC on a growth curve. This since the main objective is to sell the JVC to an international player (e.g. big industrial entity, which can also be Russian) within six (6) years after startup. To achieve this ambitious goal, the product portfolio needs to gain a positive reputation among the customers as well as the organization of the JVC needs to be efficient and well organized. It should be noticed that the globalization, boosts such tech companies to be developed to become international companies from the very early startup. This means, in practice, that the organization of a JVC will be geographically spread which also will lead to that the Russian innovators can stay in Russia and continue their work but on the pay

rolls of the JVC and they will also, as a bonus, gain a lot of international experience during this period. Russia benefits concretely from the TRIDARA concept by getting more know how in global commercializing, internationally recognized products, gets such know how that there is a shortage of in Russia, gets investments and jobs.

The philosophy behind the TRIDARA Concept is to commercialize Russian B2B industrial innovations, on business basis, with strong entrepreneurship as one of the main guide lines. The earning logic is to make an exit from the JVC's, that is, to sell out the shares. One prerequisite to attract buyers is that the JVC's are transparent and totally free from so called hidden problems, evidently, popping up in a thorough Due Diligence. It should be stressed that TRIDARA International is not a fund or consultancy company but a business accelerator with an own tailor made concept.

TRIDARA aims only to create 2-3 JVC's per year, which is a very small number in relation to the vast amount of potential innovations made in Russia annually.

TRIDARA International have for nearly one year now been looking for an investment in to startup the full scale activities. However, both the private and public investors in Finland has been very cautious, probably, due to the reasons that the operational model of TRIDARA International is innovative and novel and the Russia is still too unknown, and, hence, raises fears. The TRIDARA team anticipated that the Venture Capital in Finland would be very interesting in TRIDARA International since the government of Finland have stated the concrete aim to create 200,000 new jobs in the private sector. Hence, the lack of interest in the opportunity to create new jobs in Finland, based on innovations from a neighboring country, is a great mystery to the TRIDARA team.

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Early stage growth financing is needed in the growing Life Sciences sector

By Tero Piispanen

Biotechnology is on its way to become a major source of employment and welfare in the Baltic Sea area.

As traditional labor intensive work shifts to lower cost countries, the demand for innovation and high technology related workplaces becomes more and more important to the society. Northern Europe and the Baltic Sea region are famous for their effective public healthcare systems. However, the innovations in the healthcare area have not yet led into the formation of many new companies and workplaces in health related industries. Even though some sort of seed financing exists, the lack of adequate early phase risk financing for startup companies has been nominated as the biggest reason why new companies are not established.

In a survey sponsored by the Finnish HealthBIO program, the lack of a local lead investor was the biggest reason why foreign Venture Capitalists have not invested in Finnish life science companies. This is probably true in other countries in the Baltic Sea area as well, since according to the European Venture Capital Association EVCA, only 0.6% of European venture capital was invested in the Baltic and Central Eastern European countries in 2011. Thus the know-how of the researchers is not turned into growing businesses in the area.

Biotechnology starts showing economic impact

Estonia has almost 60 companies operating in the biotechnology sector, with 30 of them being R&D focused biotech companies. Total turnover of the sector in 2009 was approximately 25.7 million EUR, while the R&D biotech companies came up to 17.6 million EUR with their export value making 8.9 million EUR. The average annual growth rate of the R&D biotech companies from 2004 to 2008 was 28.3%. The majority of the companies are active in red biotechnology, in the provision of services.

Denmark has the third-largest commercial drug development pipeline in Europe in absolute numbers. Investment in Danish biotechnology has reached more than 3.8 billion EUR — it is the second largest in Europe. With an export share of more than 90% of total production, Denmark is among Europe's largest exporters of medical technology products per capita.

Also Finland has lately had positive news in the life sciences sector. Earlier this year, chemical industry was responsible for more than 25% of the country's export volume, becoming for the first time bigger than forest industry. Within chemical industry, the export of drugs grew by 30%. And there is more to come: three new drugs of Finnish origin got their marketing approval at the start of 2013. Bayer's Skyla for birth control (developed and manufactured in Finland) and Hormos Medical's Ophena for post-menopausal symptoms got marketing approval in the USA, and BioTie Therapies / Lundbeck's Selincro got marketing approval in the EU. On top of that, Finnish diagnostic companies are growing steadily reaching about 640 billion USD in end user sales, which corresponds to about 1.3% of the world market. The total export of Finnish

health technology companies grew by 22.8% last year, representing the second biggest share of high technology export after telecommunication.

Yet, in Finland there are no dedicated life science seed or startup funds, which could boost the growth of the sector and attract also foreign capital as syndicates. Finnish biotech industry representatives have initiated a public discussion in order to get the government investing again in biotech funds after almost totally abandoning them in the mid 2000's.

Interestingly, the same kind of debate has been going on in Sweden, where Swedenbio has accused the government for not promoting the life sciences sector enough. The government has replied that life sciences are a high-priority field and that it has decided to invest more in research. But what about financing early growth in companies?

Financing gaps exist – new Baltic Sea Life Sciences Fund could be the bridge

In a profiling analysis of investors conducted by ScanBalt's Bridge BSR project it became clear that a financing gap exists in particular in the financing of startups as the first financing for industrial proof of concept.

One way to tackle the early stage financing problem could be to establish a Baltic Sea Life Sciences fund, which would raise its funds from governments in the ScanBaltic area. The fund should have a focus in startups, promote cross border innovation and act as a partner for local seed financiers and typical growth financiers. It could become an effective tool for creating sustainable and highly competitive companies and workplaces for the participating countries.

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Technology transfer between East and West and Russia's economic modernisation

By Sari Autio-Sarasma

The Cold War era froze the concept 'East-West' to signify the division between the United States-led West and the Soviet Union-led East. This is a worthwhile starting point for the analysis of technology transfer between East and West, from the point of view of the Soviet/Russian economic modernisation aims from the Cold War era up to the present day. Traditionally in the Cold War studies, technology transfers between East and West have been seen solely as a one-way transfer of commodities from the technologically developed West to the backward Socialist bloc. These transfers were rather limited because of the juxtaposition and division caused by the East-West conflict and the impenetrable Iron Curtain. This, however, was not the case and not only the knowledge of the East-West transfers, but also the whole picture of the Cold War has changed significantly. According to the new Cold War studies that are focusing on multileveled (intermediate and micro levels) East-West interaction, transfers through the Iron Curtain proved to be active, bidirectional and based on mutual benefits.

The East-West technology transfers were elevated to a new level in the 1950s, when the Soviet Union, during the leadership of Nikita Khrushchev, adopted the western model of economic modernisation. The new model was based on the transformation of extensive economic growth into an intensive one with the help of technological progress (automation). The realization of the new model demanded technology transfers from the West in order to boost domestic innovation and production of automation technology. For the transfer of foreign technology and expertise, an effective system was constructed: The State Committee of Science and Technology (GKNT) became the main organisation for transfers and the scientific-technical cooperation (STC) acted as the main system to acquire needed technology and expertise from abroad. The Soviet STC was an official and approved way to overcome Cold War restrictions such as the US-led high technology embargo (CoCom). Through the organisations GKNT and STC, the Soviet Union knitted the network of the bilateral agreements of cooperation with the Western partners.

Finland and West Germany were the most important technological partners for the Soviet Union in Western Europe. The very first agreement was signed in 1955 between the Soviet Union and Finland. Soon after, the Soviet Union launched its cooperation with West Germany. Both states became important mediators of Western technology to the Soviet Union during the Cold War and after. Since 1957, one of the major partners for the Soviet Union in Finland was Nokia. During the 1970s and 1980s, the STC had transformed into a high technology trade, including e.g. robotics and automated phone exchanges. West Germany conducted active technology trade with the Soviet Union since 1958. In 1971, the cooperation culminated in the STC agreement between GKNT and Siemens, which started a very active computer technology trade from West Germany to the Soviet Union. Finland, West Germany and the Soviet

Union all benefited from transfer and trade, but the cooperation was especially beneficial from the economic point of view for Nokia and Siemens.

After two decades of détente, the Cold War froze below zero in 1980, after the Soviet invasion to Afghanistan. In spite of the growing tension in macro level politics and the tightening embargo, technology transfers through STC continued as normal. The East-West interaction during the Cold War created the process of demand and supply that was determined by the push- and pull-factors on both sides of the Iron Curtain. Since the process was bidirectional - although the commodities and technologies were transferred mainly from the West to the East - it created a new kind of interdependence also between the two blocs. The East-West interaction prepared the ground for wider change - namely the end of the Cold War and the collapse of the Soviet bloc.

The East-West technology transfer is interestingly connected to the contemporary Russia. Former president Dmitriy Medvedev launched a new modernisation plan for Russia in 2009. The plan aimed to boost domestic innovations and high technology production in Russia with the help of foreign technology and expertise. The plan, continuing during Putin's second leadership, is surprisingly similar to the one adopted by Khrushchev 50 years ago. The Soviet Union did not modernise as planned, and it is interesting to see whether the new attempt is more successful. The heart of the Russian modernisation project, the Skolkovo innovation centre, accommodates several foreign and domestic research and development units, a technological university and a cluster of foreign high-technology enterprises. The new hub is expected to boost Russian innovation and high-tech production to a new level in the fields of IT, space technology, nuclear technology, energy efficiency and biomedicine. Several western high technology corporations are involved in the 'forming of the ecosystem of Skolkovo innovation centre' including tried and true partners from the Cold War era: Nokia and Siemens. The participation of US-based corporations such as IBM, Intel or Microsoft in Skolkovo would not have been possible during the Cold War, but what is strikingly similar to the previous attempt to modernise is the way Russia is going to pay for the foreign technology and expertise - with raw materials and energy.

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Cross-border innovation strategies – Russian-Finnish experience

By Nikolay M. Megevich and Simon J. Chernyak

In order to ensure competitiveness and dynamic development Russian state requires a constant search for new economic growth resources and quality of life.

It defines the objective necessity for states and regions economic transition to the innovative path of development. Currently, cogency use of innovation as a basis for achieving of strategic competitive advantage does not require any proof. International cooperation for Russia is a promising form of innovation activity in Russia. The process of innovation development of the territory, as it is known, requires three key steps:

- Analysis of area's innovation potential
- Development of innovative development strategy;
- Implementation and development of area's innovative potential with the help of the strategy as a tool of regional development.

This scheme is formally similar in the border areas, but requires more complex calculations and management skills, as these actions relate to economic and social sub-systems of several states.

The hypothesis proposed by the authors, based on the fact that the innovative potential of the border, notably, as regards potentially depressed regions, is not initially smaller than in the interior country areas, furthermore, having metropolitan status. There are no less Possibilities of "total innovation" in the border areas. However, there are few of classical mechanisms of innovative development in the border regions (especially at the municipal level). In most municipalities the practice of innovative development based on local resources – personal and enterprise investments.

In these conditions, the formation of an innovation strategy needs impartial review of mechanisms and management tools of territorial development and searching of non-typical features. From our point of view, the choice of competitive model of municipal economy in border areas cannot be done without taking into account the innovative potential of neighboring cross-border area. It should be noted that the use of cross-border cooperation as a mechanism for innovation development can be effective only when self-innovation potential is activated.

Taking into consideration the issue of innovation in the border areas, we should recognize specifics of the object. Firstly, there is a different structure of socioeconomic potential of the area. Typically, a set of development options including Innovation is much smaller. This is explained by the key characteristic of the territory - a frontier.

The specifics of socio-economic development in the border areas create certain prerequisites for identifying the principles of border areas innovation development, as follows:

- The principle of interregional interaction with a combination of national and cross-border development;
- The principle of innovation development effectiveness, as regards parts and the whole cross-border region;
- The principle of linking short-term and long-term goals;
- The principle of participation on different levels: state, regional and municipal;
- The principle of intersectoral collaboration;

Initial data for the formation of cross-border innovation system can be based on:

- Macroeconomic forecast of neighboring states and the border areas socio-economic development;

- Analysis of legal backing in innovation sphere;
- Research of direct and indirect state regulation forms of the innovation sphere;
- Research of the status and trends of development of scientific, technological and industrial capacity of countries and their border areas, an analysis of the status and forecast of domestic commodity and labor markets.

In case of successful implementation of unified (cross-border) approaches to innovation development in border areas begins diffusion of innovation. Cross-border diffusion of innovation - innovation diffusion processes in socio-economic, scientific and technical activities. The possibility of effective diffusion of innovations on the Russian-Finnish border determined by the gradient of differences in the levels of socio-economic and political development of the neighboring countries and regions, as well as the mobility of social, economic, technological and other innovations, their ability to overcome the barrier function of the border. In the next step begins the formation of joint innovation strategies. Currently, the Russian-Finnish border significantly associated with the transport and logistics sector. Here is two states (many municipalities) considered as a resource center, key and at the same time specific factor for the formation of cross-border innovation strategy, and no one of them has a monopoly on decision-making.

The main purpose of cross-border innovation system formation is an attraction of innovations from the territory of neighboring State or joint production of innovations in order to create social and economic conditions for the growth of living standards. The development of innovative cross-border strategies between Russia and Finland characterized by large-scale government support. The significant element here was - XIII session of the Finnish-Russian Intergovernmental Commission for Economic Cooperation which took place on March 27, 2013 in Turku. The session discussed topical issues of Russian-Finnish trade and economic cooperation of which approximately half is related to cross-border cooperation. Over 20 joint projects in the field of modernization of national economies were signed within the Programme of Action of the Russian-Finnish economic cooperation. The main feature of this stage in Russian-Finnish cooperation is the fact that an important step for a "technical" support of cross-border innovation strategies was done.

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Russia

Russian innovative ambitions as positive factor for country image in Nordic

By Arkady Ryabichenko

The dangerous Russian bear

Traditionally attitude towards Russia has been negative in Nordic countries. Its main reason is historical ethno-stereotype of the "Russian Bear" as a big, slow and very dangerous animal at times. The Nordic countries usually come out with critics of the Russian regime (Though Finland has historically friendly and good relations with Russia). They blame Russian government on the human rights disturbance (Magnitsky and Khodorkovsky cases) and militarization (Georgian–Ossetian conflict participation and Iskander-M tactical ballistic missiles placing in Kaliningrad Region).

However, the Nordic governments often lead to confrontation with Russia. The most dramatic example is Norwegian expansion to Russian near-border sea zone with overstated ransoms and Russian trawler ships occupation attempts. Denmark and Sweden criticize Russian policy. If these countries were friendlier to Russia, many conflicts could be prevented. Russian-Finnish "children scandals" with Salonen, Rantala and Putkonen families indicated the problems in relation between Russia and Finland. Another reason for the deterioration of the Russian-Finnish relationships is weaponization of Finland.

"Nordic round trip" of the Russian politicians

The situation changed after the Russian president Dmitry Medvedev stated in his program article of 2009 where he emphasizes Russia's choice of innovation development. The national innovation system progress was impossible without cooperation with Nordic countries as "innovate leaders" of the European Union.

The so-called "Nordic round trip" 2010-2011 of President Medvedev and Prime-minister Vladimir Putin was dedicated to establishing innovative links with Sweden, Norway, Denmark and Finland. (Maximal number of meets Putin has with Finland's representatives). Maximum number of the meetings V. Putin had with the representatives of Finland. Potentially this "round-trip" had the aim to improve Russia's perception in North Europe.

After the "Nordic round trip" the degree of anti-Russian rhetoric decreased. President Medvedev who shook Oslo residents' hands scored to the publicists better than president of the USA Barak Obama who earlier had come to the Norwegian capital under the protection of his snipers. The Norwegian prime-minister Jens Stoltenberg said: - Relations between Norway and Russia never had been so good as nowadays.

The pragmatic elite

The main argument which pragmatic Nordic elite representatives supported was an opportunity to enter Russian innovative development sectors.

A lot of positive articles about Russian innovative sector were published in Nordic mass media. Often authors were well-qualified experts. For example, Mats Hellstrom, the former minister of trade, wrote about Russia's achievements in IT in the "Dagens Industri". He marked that there are also innovations in other sectors of Russian economy. One of the leading Swedish experts on Russia Klas Erikson wrote about strong Russia's position in the natural sciences. It is quite understandable that pragmatic interest in business expansion into the Russian market became the main idea of these publications. Frude Mellemvik, the Rector of the Norwegian Business-school at Bodo Regional University, wrote in "Nordlys" that Russian modernization program would open up new opportunities for the Norwegian companies.

Good news for Nordic business was that Russia was ready to use wide range of innovations. And other residents of the North European countries realized that the Russians liked innovations as they did. The "Nordic round-trip" of the Russian leaders changed the perception of Russia in these countries in fact.

Therefore, one of the important effects that Russian state politicians brought about in the sphere of innovation and cooperation with Nordic countries is positive change of Russia's image in the North Europe. The perception of Russia in Sweden, Norway, Denmark and Finland improved and this is the noticeable achievement of Russian foreign policy.

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Is the price of Russian natural gas inflated for the Baltic Rim?

By Vlad Ivanenko

Four countries of the eastern Baltic rim – Finland, Estonia, Latvia, and Lithuania – depend on a single supplier for their consumption of natural gas – Russia. Given that Russia maintains export monopoly on natural gas, the question arises: does this country overcharge the Baltic customers?¹

The bill paid by the region is significant: it spent \$ 3,818 million on gas import in 2012.² Aside from the sheer amount of money at stake, suspicions of non-market pricing have firmed since 2009 when EU observers noticed a persistent spread between the long-term contract prices on Russian natural gas and spot prices on gas set at the European hubs. The suspicions grew to such a degree that the European Commission for Competition decided to open formal proceedings against Gazprom in September 4, 2012. But does a sufficient amount of evidence exist to substantiate the claim of overpricing?

The Commission suspects Gazprom using three anti-competitive practices in Central and Eastern Europe:

- (a) Hindering the free flow of gas across Member States;
- (b) Preventing the diversification of supply of gas and
- (c) Imposing unfair prices on its customers by linking the price of gas to oil prices.³

To prove the claims, one should know confidential pricing formula used by Gazprom. Unfortunately, it requires the authority of the Commission to get access to private documents; however, one contract – that Gazprom concluded with Ukraine in 2009 – was leaked to the Ukrainian media (and led eventually to the conviction of Yulia Tymoshenko, the Prime Minister of Ukraine at the time.) Assuming that Gazprom is consistent in its practices, the Ukrainian contract sheds light on its pricing rules.

This 10-year contract has the following conditions. It obliges the buyer to accept a minimal annual volume of natural gas at the take-or-pay basis. The contract specifies minimal calorific value of the product with its price being an average of prices on two alternative types of fuel – gasoil and low sulfur residual fuel oil (mazout) – delivered to Italy. Finally, the seller prohibits the re-export of natural gas.

Using the referenced prices and calorific values for three fuels, one can show that Ukraine receives natural gas at the price set 23 percent below the price of alternative fuels by their thermal equivalence. Such a discount is inconsistent with the behavior of a monopolist collecting the monopoly rent ruling out an anti-trust probe.

The long duration of the contract and, especially, the take-or-pay clause do discourage the buyers to seek alternative energy suppliers as it will not reduce their expenses. Similarly, the re-exporting ban alludes to market segmentation, which is in concord with monopolistic pricing. The Commission is justified to open proceedings on these two counts and, yet, Gazprom is unlikely to be indicted.

The problem is that these clauses are standard in the dated, but still respectable, Groningen type of natural gas contract. Developed in the Netherlands in 1960s with the

objective to capture foreign markets for Dutch natural gas, the contract sets its price permanently below the price of competing fuels (coal, heating oil, or electricity) to make their consumption uneconomic.

The European energy markets of that time were regionally fragmented compelling the offeror of Groningen contract to adapt prices to regional energy patterns. This approach assured the market capture but created a multitude of prices leading to arbitrage opportunities for some buyers. To preclude buyers' profiteering, the no-resale clause was introduced. As soon as the EU levels energy consumption patterns within the Union, the no-resale clause will stop serving Gazprom interests and will be dropped.

If the Commission fails to find fault in Gazprom practices, can the Baltic countries expect a reduction of their energy bill? A short answer is 'no' as the price of Russian natural gas will remain high as long as the price of fuels, to which it is pegged – crude oil and its derivatives, stays high. But a roundabout way is available. The region considers building liquefied natural gas (LNG) regasification terminals and linking gas networks through inter-connectors, which will allow alternative suppliers to enter the market. However, the cheapest option is not obvious because the success of this approach depends on global factors staying beyond the region's control. Three of them are important.

A rapid increase in unconventional gas production (shale gas) in North America shocked global natural gas markets in 2009; however, its key effect is psychological. The EU expects that Europe may start shale gas production in near future but the continent's quest for shale gas, particularly in Poland, has been, so far, a sobering experience. Will it succeed in the end?

The decoupling of crude oil and natural gas prices in North America created a spread between (higher) contract and (lower) spot prices. EU gas importers believe that the inclusion of spot prices in the Groningen formula will lower the price they pay. But what if the spread is driven by onetime diversion of formerly U.S.-bound contracted LNG cargoes towards Europe?

Finally, observers note that the EU has imported more of thermal coal in last years. Coal is a substitute for natural gas but it is more intensive on greenhouse gas emissions. Does growing coal consumption imply the EU softening stance on climate change?

Answering these new questions require a lengthier analysis than this note permits.

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The opinions expressed here represent the personal views of the author and not those of his employer.

¹ See the Russian Federal Law # 117-FZ "On Export of Natural Gas" dated July 18, 2005

² See UN trade database COMTRADE

³ See the antitrust case "Upstream gas supplies in Central and Eastern Europe", number 39816

Energy development in South-East Europe and the Baltic Sea region – similar problems, similar prospects

By Venelin Tsachevsky

Despite the fact that South East Europe (SEE) and the Baltic Sea region are geographically remote and follow specific paths of development, both are confronted with similar problems and challenges in the energy sector. The majority of the 21 countries located in the designated regions are relatively poor in mineral energy resources and that understandably necessitates significant imports of raw materials, particularly oil and natural gas. More than half of them are entirely dependent on gas supplies coming mainly (in the case of Poland, Greece, Germany, Turkey et al.) and solely (with respect to Finland, Estonia, Lithuania, Latvia, Bulgaria, Republic of Macedonia et al.) from Russia. The exception are Denmark, Sweden and, to a lesser extent, Romania and Croatia.

This is basically the key reason for the high degree of energy import dependence of SEE and the Baltic Sea region. At the start of the current decade it stood at 60% for SEE and around 55% for the Baltic Sea region. In comparison, in 2011 the same indicator for the EU showed an average of some 54%, a figure also considered to be high. The differences between the countries in the two regions are rather noticeable. In the Baltic Sea region this indicator ranges from 81.8% in Lithuania to 11.7% in neighbouring Estonia, while Denmark is “in clover” as the only state, including within the EU, which is energy independent. With respect to SEE, the most dependent countries are Greece and Turkey (69%), with Romania being at the other end of the scale (22%).

Reducing energy dependence is one of the priority goals of the energy policy pursued by the two regions. It is contingent on what the respective policy guidelines will deliver, as outlined in the adopted long-term energy strategies which in some countries cover the period up to the middle of the century. They are increasing and diversifying the production of the country's own energy resources; energy market restructuring according to the market principles; increasing energy sector efficiency in conformity with the environmental requirements; increasing the share of the renewable energy sources (RES) in the energy balance; broadening the energy cooperation within the region and with the other European countries, especially countries in EU, on the basis of the common energy principles, regulations and longstanding aims, including the participation of joint regional and all-European infrastructure projects.

Most of the countries in SEE and the Baltic Sea region have achieved progress in implementing their goals. Over the last years there has been a trend toward lowering the energy import dependence across both regions but the chief reason for that was the slump in the domestic consumption resulting from the economic recession that came about in 2008. The share of RES in the energy balance went up motivated by the target set in the EU energy strategy for a 20% chunk of RES in the gross energy use by 2020. The performance is better in SEE where at the beginning of the present decade the percentage of RES in the gross inland energy consumption was 12.5%, while in the Baltic Sea region it was a bit smaller. Yet, both regions exhibited considerably higher results compared to the average level in the EU (8.7%). However, the gaps between the countries in this respect are sizeable and vary between 8.5% (Serbia) and 39.5% (Albania) when looking at SEE and between 8.2% (Germany, Poland) and 34.5% (Lithuania). The restructuring of the energy balance has also evolved by reducing the share of solid fuels, mainly coal, and shifting to RES, oil and natural gas. The process proved somewhat tougher for those countries which rely extensively on the use of their own reserves, most notably coal: Poland, Germany, Serbia, Bulgaria, Kosovo et al. One of the

critical factors conducive to that transformation is the implementation of the agreements on cutting greenhouse gas emissions.

Special attention needs to be paid to the place of nuclear energy development in the energy policy of the two regions. The overall number of the nuclear reactor in operation is 28, all located in just 6 countries. In the Baltic Sea region there are 23 reactors in 3 countries - Sweden (10), Germany (9) and Finland (4), in SEE the reactors are only 5 – Bulgaria (2), Romania (2) and Slovenia (1). In terms of regional significance, nuclear energy plays a far more crucial role in the Baltic region accounting for around 15% in the total inland production of primary energy, which is twice as high as that in SEE. The future expansion of nuclear energy use looks uncertain in both regions. In a total of 7 countries – Poland, Finland, Russia (Kaliningrad region), Lithuania, Turkey, Bulgaria and Romania – have been announced plans for the construction of 15 new nuclear power facilities. At the same time, due to the grave repercussions of the 2011 Fukushima nuclear disaster the public resistance to the construction of new NPP have stiffened. At the referendum held in Lithuania in the autumn of 2012 the majority of voters rejected the NPP that was being planned. In March 2013 the Bulgarian government cancelled the construction of a second NPP, in this case on financial grounds. In Germany all nuclear power facilities are to be decommissioned by 2022. The implications of such an action, however, might stall the overcoming of the existing energy deficit in both regions.

The pivotal issue in the energy field for the greater number of countries is how to provide the necessary domestic and especially foreign investments. What will foster the process is a more favourable environment created as a result of the recovered financial stability and overcome economic stagnation in Europe which, unfortunately, seems unlikely to happen by the middle of the decade. The regional energy cooperation, regarded as underdeveloped especially in SEE, should be given a boost. To this end the EU will render significant support through the Baltic Sea Region Energy Cooperation, EU Black Sea Synergy, the Energy Community, etc. An incentive for the energy sector will be the realization of more pan-European energy infrastructure projects. The completion of North Stream that benefits a number of countries in the Baltic Sea region has been followed by the start of the South Stream construction, soon to be caught up by Nabucco. The last two are crucial for the energy security and diversification in SEE but are expected to be brought into operation no earlier than the second half of the current decade. Against this backdrop the energy policy goals of most of the states look too ambitious and therefore quite hard to attain.

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On the perspectives of building nuclear power plant in Lithuania

By Gennady Kretinin

During the post-soviet period nuclear power branch of all the Baltic region's republics was represented by the Ignalina Nuclear Power Plant (NPP), situated in the north-east of Lithuania.

It was a powerful source of cheap energy, to a wide extent suiting the demand of the south-east Baltic States economy and population. However under the EU requisition, Vilnius was obliged to shut down the plant on the 31st of December, and then to start its decommissioning.

The idea of building a new NPP was forming while the date of closing the Ignalina plant was coming. Ultimately it was decided to build the Visaginas NPP and to launch it in 2015-2016. Considering the fact that Lithuania was unlikely to carry out this project on its own, it was decided to establish a syndicate comprising Lithuania itself and its nearest neighbours (Poland, Latvia and Estonia), as well as to find a foreign investor. The main Lithuanian principle was not to use Russian assistance while implementing the project.

In 2010-2011 the troubles began. At first Poland refused to take part in the project: the share of the capacities was unacceptable. Moreover Warsaw evolved the building of two its own nuclear plants in the region near the Baltic Sea. Then, unexpectedly the main investor – South Korean company – withdrew from participation in the project.

Japanese company GE Hitachi Nuclear Energy became the new investor, with its technology of building notorious Fukushima-1. All Vilnius efforts couldn't create positive image to the Japanese investor among population and in surrounding countries. In Latvia and Estonia not only objections – why do we need this? – but suggestions to make its own nuclear projects appeared. No one was expressing unconditional consent. The date of possible implementation of the Visaginas project was moved to 2020-2022.

A serious damage to the image of the Lithuanian project was made by the Russian idea of building a NPP on the territory of the Kaliningrad region of the Russian Federation. Lithuanian energy industry authorities could explain objectively neither to politicians of the Republic nor to the population, the advantages of their project and disadvantages of the two times more powerful and raising in shorter time period (2016-2018) Russian project.

Obstruction of the Baltic nuclear power plant could form mistrust of Lithuanian society to the Russian project for some time, which however didn't influence the construction at all.

Meanwhile protest moods against building its own NPP, especially by the company with a huge failure in its construction practice, started growing in Lithuania. As a result, there was a necessity to conduct referendum on the building the Visaginas nuclear plant.

The neighbours' opinions were brought out on the eve of the referendum. Particularly, on the 8th of October 2012 Estonian Prime Minister A. Ansip during the meeting with Lithuanian journalists in Tallinn, formally didn't mind against taking part in the Lithuanian project, but under the condition of positive results of the referendum.

According to the «Vilniaus diena», the Latvian government stated “if the Visaginas project is profitable for Latvia, there won't be any obstacles to take part in this project. But if Lithuanians say “no” to the Visaginas project, the money, which are planned to use for this project, Latvia may use to built the LNG (liquefied natural gas) plant”. Considering that the construction of LNG plant has become a stumbling block between Lithuania and Latvia, this situation will impact on the nuclear project in Visaginas.

Ambiguous relation to the construction of the Visaginas NPP was also seen in the political sphere of Lithuania. Thus, conservatives were strong supporters of the construction, and social democrats who won the elections were standing for taking into consideration the demands of people in the referendum.

The referendum took place on the 14th of October 2012 and the population expressed its negative relation to the nuclear project. For some time the Lithuanian state leadership was taking a break, not commenting the results of the referendum. The position was explainable: there was the formation of the government. Then among the leadership of the country statements started to appear, that the decision of the population during the referendum was of advisory nature, that it was necessary to evaluate the developing situation, that it was possible to hold another referendum. The president and the head of the government paid several visits to neighbours, where they tried to clarify the moods of Riga and Tallinn in terms of the future Visaginas NPP.

In all appearances, this high-level visits weren't successful that much. Anyway Vilnius will come to a decision. Likely, this decision will be positive, because the President D. Grybauskaitė is definitely in favour of the construction. However Lithuanian daily Balsas.lt (28th of January – 3d of February) quotes the President: “the construction of the Visaginas NPP will be delayed over 10-15 years”. Therefore, the terms of commissioning of the nuclear plant with one reactor are shifted to 2023-2028.

Lithuanian observers think that the decision of the problem with the beginning of the Visaginas NPP construction will be postponed till the second half of the 2013. In particular, how does the Japanese investor treat this delay? What will be decided about the financial part of the project? Every delay will lead to the obsolescence of the Ignalina NPP infrastructure, one of the Vilnius's best card to build a new NPP in Lithuania in particular, not in any other country of the Baltic region. Irreparably declines the qualification of the experts in the nuclear field worked in Lithuania. After all in the Lithuania's neighbourhood there are two more NPP project (in Belarus and in the Kaliningrad region) on the stage of the construction. How competitive will be the Visaginas energy even if the Lithuanian project is successful?

One thing is sure. In the nearest future Lithuania has to decommission the old NPP and build a new one. Will the Lithuanian economy be able to bear this charge? The question is rhetorical. To count on support of the EU in building a new nuclear object while it comes short of means to close the old one has no chance to success. Likely, it will be necessary to change something in the external policy to find other resources. Probably in the east.

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Russia

Supply diversification and allocation of bargaining power in the EU-Russia gas relationship

By Elena Paltseva

For a number of years, Russia has been the primary supplier of natural gas to the EU. Russian gas constitutes roughly a quarter of European gas consumption, with 19 of the EU Member States importing gas from Russia. Among these states, the average share of Russian gas in gas consumption in 2011 exceeded 60%, ranging from 1.6% (Belgium) to nearly 100% (Czech Republic, Estonia, Finland, Latvia, Lithuania and Slovakia). This dependency on Russian gas has long been among the main issues of the European debate on the external energy security. The concerns about the EU-Russia gas relationship were further strengthened in mid-to-late 2000s due to “gas wars” between Russia and the transit countries of Ukraine and Belarus that threatened the continuity of Russian gas supply to the EU.

A commonly suggested solution for the EU is to diversify its gas imports. The standard argument behind this proposal is that it would lower the EU’s dependency on Russian gas (and, thus, its exposure to the risks associated with Russian gas imports). However, it is important to remember that the dependency is mutual: more than 60% of Russian gas imports are flowing to the EU. A shift in the EU gas import portfolio away from Russian imports would then impact the allocation of bargaining power in the EU-Russia gas deal. This may diminish the effect of diversification on the security of EU gas supply.

More specifically, the bargaining power may be seen as the best outside option available to the other party in case of disagreement. That is, were the Russian gas supplies to the EU disrupted, how easy would it be for the EU to get an access to an alternative source of gas? The answer to this question would determine the relative bargaining power of Russia. Similarly, Russia’s ability to recover the profits by reallocating gas to other consumers would determine the EU’s “buyer power”.

From this perspective, it is easy to see that there are two conflicting effects of diversification on the allocation of bargaining power. Naturally, the diversification would weaken Russia’s market power, thereby improving the bargaining position of the EU. However, a less obvious effect is that a decline in the EU imports of Russian gas due to diversification would make these imports less important for Russia. This would lower the EU’s buyer power and worsen its gas deal terms. While the ultimate effect is unclear, this argument suggests that the decisions to diversify gas supply sources should also be evaluated from the perspective of the buyer power loss.

Further, in presence of diversification options with different fungibility, such as pipeline gas vs. LNG, the EU is likely to be better off by choosing more fungible alternatives. A (stylized) mechanism is that, in the latter case, the EU may invest into the *possibility* of diversification rather than the diversification per se. In other words, instead of a cut in Russian gas imports, the EU may choose to improve its outside option by e.g. investing in infrastructure to buy and transport LNG (so that it is possible to purchase LNG from alternative providers in case of a disagreement with Russia). Thereby, the EU would simultaneously achieve two goals: by not cutting down Russian gas imports, it would sustain its buyer power; at the same time, by facilitating better

substitutability for Russian gas in case of a (hypothetical) supply disruption, it would weaken Russia’s bargaining position, thereby shifting the balance of power in the gas deal toward the EU.

For example, the EU’s continued support for the Nabucco project (now Nabucco West, as Nabucco is no longer considered commercially viable) has been widely attributed to the concern that Russia would further increase its leverage over Europe by supplying gas through the competing South Stream project. In light of the argument above, the EU may be less worried about the Russian expansion to the South-European gas market. The EU may even benefit from this expansion, as long as it develops a sufficiently strong outside option through an improved access to the LNG market. In fact, given that the current capacity of the EU’s LNG terminals is underutilized, this may also be a cheaper option than backing the construction of Nabucco West.

One important reservation for the suggested argument to work is that it requires a sufficient degree of coordination between the EU Member States. On one hand, “one voice” common energy policy approach have been increasingly important for the EU’s political agenda. For example, the September 2011 European Commission proposal explicitly suggests “to exercise the combined weight of the EU in external energy relations”. Also, recent EU gas market developments, such as the integration and unbundling of internal markets seems to be conducive to the coordination of the Member States’ effort. On the other hand, the possibility for coordination may be undermined by the tensions brought by the Eurozone crisis.

To sum up, the EU-Russia gas relation is characterized by mutual dependency. As a result, gas import diversification may improve or undermine the EU’s bargaining position in its gas deals with Russia. That is, while gas supply diversification is certainly a valuable strategy to improve the security of the EU gas supply, its effect on the allocation of bargaining power in the EU-Russia gas relationship needs to be taken into account in the common energy policy design.

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This article is based on a joint project with Chloé Le Coq (SITE, Stockholm School of Economics). I am grateful for our discussions on this topic.

On interactions between energy markets

By Vladimir Feygin

There are still some disagreements regarding whether energy markets are already fully integrated; most opinion differences are for such regional markets as gas markets. The main point for those who are skeptical is that prices on these markets are not fully correlated as they should be in theory, with price differentials to be equal to marginal transportation costs.

That's true but it is highly probable that major deficiencies in this regard as between East Asia gas markets and EU gas market will be significantly lessen in coming years – we already see more LNG cargos moving from the Middle East (mostly Qatar) to Asia than to Europe (which incentives price increase at the EU trading platforms) and first attempts to organize gas trading in East Asia (which directly or indirectly will force some downturn pricing trend at those markets).

Though prices are not perfectly correlated (and I doubt they will correlate in the foreseeable future) but price relations between markets are becoming very intense. In many cases these are price/volume relations. We marked this above regarding Asia and EU gas markets. We've seen an influence of low USA gas prices to EU gas prices indirectly – through reallocation of the US coal from US power sector to EU power stations,

We can foresee potential appearance of a number of such correlations and influences especially where flexible markets easily reacting to supply/demand balance are involved.

As we know overproduction of the shale gas in the USA had led to a sharp fall in gas prices which made most of the dry gas extraction non-profitable. As a result producers shifted their efforts to wet gas production because byproducts (NGLs) were priced mostly on oil linkage and therefore were much higher than for dry gas. NGLs are very important in North America for petrochemical production as they are more efficient feedstock than naphtha traditionally widely used in Europe. But soon after the above shift NGLs (and first of all – ethane) became overproduced as well comparing to available chemical capacities. So their prices moved down – and this resulted in less drilling activity for total gas production. Now we see an increase of dry gas prices – up to 4\$/Mln.BTU from 2\$/Mln.BTU.

It is yet unclear what reverse impact it will have on the rate of gas utilization in the USA power sector.

On the other hand, most part of NGLs (i.e. LPG and gas condensate) is well transportable and so we can foresee that an excessive volume of these products may start moving from the USA to Europe or other destinations seeking for higher prices. This may lead to dump in US gas prices etc.

These quick and sharp price tendencies' changes are not helping for sustainable energy business because gas and gas components as well as their substitutes are a part of technological and products chains and any transformation of these chains may be substantiated only if they are used for significant time interval when economic correlations are maintained in a similar way.

We know that in the US low gas prices and an excess of NGLs produced have already become a driver for significant shift in industry behavior based on use of cheap hydrocarbons as a feedstock. We do not expect that current rise in gas prices will damage this process but an uncertainty is obvious.

Another very popular subject is a future appearance of USA/Canada gas at export markets. Basic calculations show that, because of costs for liquefaction, transportation, regasification etc. this gas will be available at EU and/or Asia markets at prices not very much different from let say 10-11\$/Mln. BTU. In such a case a critical issue is again market capacity as if these volumes will be absorbed by the growing markets (and – globally gas markets capacity will definitely grow) then US gas export may mostly assist a process of "equilisation" of regional gas prices but not destroying markets.

Looking more broadly we can foresee that increasing NGLs production and lowering prices for NGLs may influence global oil pricing in the downturn direction. The oil production will be more and more linked with use of oil in the transportation sector and less in petrochemicals – so its future will depend on shifts in this sector where gas – jointly with electricity – will be again a competitor to oil products. Petrochemicals will be more directly linked to NGLs use.

This is in good correlation to current vision that global oil production will barely increase – while global liquids production will grow on behalf of NGLs. But NGLs volumes may be less manageable than currently oil production is and therefore prices for NGLs may more easily go down.

So we may expect a sort of global process of interdependence between sectorial and regional use of corresponding hydrocarbons (both basic ones and as process products) in volumes and prices. The danger is a potential uncertainty in this process which may damage investments.

We can expect that new forms of influencing these processes from regulatory side will be used in order to avoid these negative impacts. Some sort of such signals we already watch in the US which let WTI price to be kept for so long and so much below Brent index though in perfect markets it is difficult to substantiate this difference.

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Russia

Russian roulette with gas

By Pekka Hakanen

Times they are changing in North America and you can feel the blow even in the Baltic Sea. The shale gas revolution will soon make the United States independent from import energy. This megatrend has also a major impact in world politics.

Naturally the shale gas revolution has a massive effect to the energy market. The fall in energy prices will affect us all. It is a tremendous challenge to all new form of energy production, but it means pressure to traditional fossil energy production as well. For example, shale gas production can be much cheaper than oil and gas you can get from the Arctic area. Russia has already frozen the vast Shtokman gas field project in the Barents Sea.

The European Union has a very ambitious goal to be a pioneer in green energy. The EU wants to be the light house, which shows the rest of the world a way to energy paradise, where there is no pollution and no shortage of energy. Unfortunately, the world is not perfect you need a lot of fossil energy for the transition time.

The second question is money. It is stupid to think, that Europeans can pay higher energy prices than their competitors.

Energy is not the only reason why Europe has lost its competitiveness. We are older, work less than the Asians and the Americans and our economy has lost its dynamics.

In this situation Russia and Germany have a common interest. Russia has big energy cellars and Europe need fossil fuels to their power stations, which will work as backup power to wind and solar energy.

Only a few years ago Russia planned to export liquefied natural gas to America. Now LNG prices have collapsed in America. The gas stream has changed directions and in the future USA can export LNG to the rest of the world.

In addition, there is a lot of shale gas in Europe too. In Europe, we must very soon answer the question: Have we enough wealth not to use this energy cellar.

If shale gas press energy prices permanently down, it means big difficulties to green energy. Europe and especially Germany has invested enormous amounts of money to wind and solar power.

Of course, everybody wants to use clean energy, but how much for example are new economic powers, like China and

India, willing to pay for it. This is also a key question for companies, which are working in the green energy sector.

Almost all sorts of industries are dependent of energy prices. If energy is more expensive in Europe than in competitive countries, it means a bad headache to politicians. We can see lots of companies leaving the old continent and the rates of unemployment to increase.

The gas pipe between Russia and Western Europe was a political success story in the cold war era. But the times they are changing. There are many economic challenges in both ends of the pipe. The EU needs reasonable priced energy and Russia needs any rouble it can get from energy exports.

Russia does not see any changes in the energy market. Officially, there is no such thing as a shale gas revolution. The rulers of the country live like Tsar Nicolas II before the October revolution.

A tiny creek of the world's energy stream goes up to Gulf of Finland. The Baltic countries and Finland are planning to build a new LNG terminal together somewhere in the northern part of the Baltic Sea.

This project is only a small drop in the enormous ocean of the energy market, but it can be a big step to the European energy policy.

If you can build a new LNG terminal, which is independent from Russia and Gazprom, it will open the door to free competition. The main question is what Russia will do if this LNG terminal comes true?

Russia is still a military superpower and it can do a lot of harm and inconvenience to its small neighbours. But does these kind of actions benefit Russia itself?

Perhaps, Russia wants to play with higher stakes in this game than the others. In the last hand the question is will Russia be inside or outside the free world market. To Russians, future it is a fatal decision. The isolation means that the Russian energy sector, and in fact, the whole Russian economy is not competitive in the future.

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The Baltic Sea Region – the positive steps towards ensuring energy security

By Simonas Klimanskis

The Baltic region is one of the most developing regions in the Europe and has a vision to become one of the most prosperous, innovative and competitive in the world. And energy is one of key preconditions for both the region's development and implementation of its an ambitious vision. Unfortunately, there are several countries which face energy security issues related to a reliable supply of energy sources, a limited access to energy sources from alternative supply and the lack of competitiveness that have a threat to sustainable economic development especially given the depletion of traditional energy resources and the fact that rising consumer's demand should be satisfied by sufficient supply.

These countries are Poland, Finland, Lithuania, Latvia and Estonia. Despite that the first two countries in electricity sector have still sufficient generating capacities and functioning markets, in gas sector Finland, in contrast to Poland, is totally dependent on Russian gas. On the other hand, Poland has a diversified gas supply – about 90 % of its gas import comes from Russia. The country, therefore, is constructing its own liquefied natural gas (LNG) terminal and plans to produce shale gas to further diversify its gas supply and increase competitiveness. Meanwhile Finland is in a worse position as it still considers about such a terminal.

Concerning the Baltic States, these are the most vulnerable in terms of energy security and they were identified as an "isolated energy island". These are countries which are not integrated into the EU energy market, in terms of both electricity and gas sector. For that purpose, in 2009, the European Commission developed the Baltic Energy Market Interconnection Plan (BEMIP), which posits as its goal full integration of the Baltic States into the Western energy market as well as strengthening interconnections with the neighboring EU member states. There are provided several projects like the construction of electricity interconnections "NordBalt", "LitPol link" and "EstLink 2", gas pipelines "Amber" and "Balticconnector" and a regional LNG terminal which would supply gas to the Baltic States and Finland. The aim to eliminate an "isolated energy island" should be achieved by 2015.

Electricity interconnections are under construction and gas pipelines – still under discussion. Concerning the regional LNG terminal which would receive financial support from the EU, the European Commission is published a study which suggests that such a terminal could be built in Estonia or Finland by 2030.

But Lithuania is not waiting this and already is constructing its own LNG terminal, together with the implementation of the third EU energy package, and it will be built by 2014. There are three reasons of why Lithuania is so hurrying: 1) the county totally dependent on Russian gas; 2) it pays the highest price for natural gas in Europe – USD 483 per 1000 m³ – which is imposed based not only economic, but also on political reasons, and gas imported though the terminal is cheaper by 30 %; 2) the country is a major gas

consumer to its population size (about 3 bcm per year) due to the closure of Ignalina NPP and the fact that there are the biggest manufacturer of fertilizer in the Baltics "Achema" which uses natural gas as a raw material. Moreover, Lithuania plans to explore and produce shale gas in order to diversify its gas supply. This all will *make conditions for full control over flows of gas and competition, because it allows to choose a gas supplier offering the lowest price.*

However, one question comes up: should all the Baltic States and Finland participate in the construction of their LNG terminal or develop their own ones as they plan to build them by 2015–2016. Before answering to this question, it should be noted that the date until the regional LNG is to be built does not combine with the date until an "isolated energy island" is to be eliminated. This means that Latvia, Estonia and Finland would remain dependent on single gas supplier for 17 years ahead. But the best way would be to evaluate risk and cost of such a dependency in each scenario and take decisions on LNG terminals. By the way, such terminals could be located at every 50–100 km.

Concerning electricity sector, there are positive steps: in June 2012, the Nord Pool Spot bidding area has been launched, and when Nord Pool Spot bidding area is to be launched in Latvia by 2013 and NordBalt with EstLink 2 is to be in place, Lithuania will take all advantages of trading electricity in a large market of the Nordic Countries. Moreover, it seems that Lithuania would continue the implementation of the project for the construction of the regional NPP in Visaginas, but currently the country is waiting for decisions by Latvia and Estonia on a real participating in this project. The new NPP would ensure security of electricity supply, increase competitiveness and allow full synchronization with the Continental European Network.

In conclusion, countries of the Baltic Sea region still remain different in terms of energy security. The most serious issues prevail in the Baltic States, but provided energy projects and their implementation show that these issues are solving step by step thus creating *the common EU energy market*. Of course, there are also unanswered questions on the participation of the Baltic States and Finland in the implementation of either the regional LNG project or their own ones. But answers are likely to be known soon.

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Energy in Baltics – the last phase of Eurointegration

By Romas Švedas

It seems to be a paradox, but Baltic States are not yet EU Member States in energy sector. Eurointegration process of Estonia, Latvia and Lithuania has started in mid nineties by concluding Free Trade and Association agreements with the EU. Full EU membership in addition to free trade in goods granted free movement of services, people and working force. It seems that three Baltic States became fully pledged participants of the Common EU Internal Market, however, a serious element is still missing – energy. In energy sector three Baltics are called “EU island”, having a very tiny footbridge from Estonia to Finland (Estlink I). Energy systems (electricity and gas) are integrated into ex-Soviet Union system, supply of primary energy sources is strongly dominated by Russia, especially in Lithuania.

Baltic Energy Market Interconnection Plan (BEMIP) is a regional initiative of all Baltic Sea states but, basically, it is devoted for Estonia, Latvia and Lithuania: to establish better interconnections with EU energy networks, to make them part of the EU energy market and thus to get them out of the “EU energy island”. The plan is good, what is left – implementation. So let’s have a look at the progress achieved.

Construction of electricity interconnections are advancing well, though delay with development of New Nuclear Project brought Lithuania into a “nuclear war”, both, internally and externally. Progress on second Estonian-Finish (Estlink II), Lithuanian-Swedish (NordBalt), Lithuanian-Polish (LitPolLink) electricity interconnections is indeed considerable – all the projects have to be commissioned roughly by the end of 2015. Estonia and Lithuania are already participants of Nordic power market (Nord Pool Spot) and Latvia is going to join it without delay. As soon as power interconnections will be completed three Baltics will make an integral part of common Nordic power market with real and transparent competition.

A new nuclear power plant “Visagino atominė elektrinė” (VAE) project is also a part of BEMIP plan. VAE should secure a sustainable electricity supply and ensure energy security of the whole region. The new regional nuclear power plant should play final and decisive role in making three Baltics independent from ex-Soviet Union system.

Geopolitical interests of Russian Federation in the Baltic region are very strong. Russian authorities are thoroughly following and analyzing situation in the region and surely understand perfectly well that in electricity sector the Baltic States are getting out of their control. In order to secure its interest, we should admit, that Russia took a very smart decision – to build a nuclear power plant in Kaliningrad region. Big power generation capacities on the West side of the Baltics have to push three Baltic sisters backwards to the East and will not allow them to leave ex-Soviet Union system. For Kaliningrad needs future power generation capacities are too excessive, there are no external interconnections except of tiny one with Lithuania, commercial model of the project is not clear, therefore this project can be treated as an economic investment for geopolitical purposes. Let’s start building nuclear plant and later we will see... maybe Lithuanian politicians will start having doubts about their own project, or maybe regional partners will disagree – such could be thinking of Russian decision makers. And again, we have to admit, that they are defending their geopolitical interest quite well. In Lithuania, in autumn of 2012, a consultative referendum on the new nuclear power plant took place and the outcome was negative. So nowadays Lithuanian political temperature on the issue of the new nuclear power plant is very high. The Government is looking for the way out of

referendum deadlock and is in the process of considerations on the future of the project. To my mind, there are only two scenarios of future developments:

- a) three Baltic States together with strong strategic investor Hitachi are going to build a regional nuclear power plant and thus will ensure security of energy supply;
- b) in case three Baltic States will not built the new nuclear power plant they will be for another half century dependant on Russia and so will endanger their strategic plan to be synchronously interconnected with power system of Continental Europe.

In gas sector Russian Federation is trying to avoid precedent and is taking preventive measures. Unlike the electricity sector the situation in natural gas sector of the Baltics is quite different – here the progress towards an open market is much more modest. As a result of privatization the process all three Baltic States got into total dominance of Gasprom and to get out of such situation is not an easy task. Lithuanian Government is planning the following measures:

- a) implementation of transmission system ownership unbundling provision;
- b) construction of LNG terminal;
- c) construction of gas interconnection with Poland;
- d) exploration and extraction of shale gas;
- e) exploration to establish underground storage of natural gas;
- f) fast introduction of bio fuel in heating sector.

Gasprom understands that even a small part of these measures will lead to the end of its dominant position. But the most dangerous scenario for Gasprom is that reforms in Lithuania will be taken as precedent and will be followed by Estonia, Latvia and other ex-Soviet Union countries. Therefore Gasprom has decided to take active preventive measures. Recently several meetings with Lithuanian authorities took place where Gasprom, alongside with other proposals, has offered 20 percent reduction of gas price – again, an economic investment for the geopolitical purpose. We’ll see how strong will be Lithuania and other Baltics to stand this pressure and to complete the last stage – energy stage – of their Eurointegration process.

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Lithuania's energy sector – trends and problems of development

By Mihails Rodins, Aleksandr Gaponenko and Inna Dovladbekova

As to the data of Central Statistical Board of Lithuania, rate of energy production in 2011 fell to 81.3%. This decline occurred after the close of the second block Visaginas nuclear power station in 2010. The decline in production has led to a decrease in production of the energy sector in the total GDP of Lithuania. In 2004 the proportion was 3.96%, in 2009 - 3.44% and in 2011 - only 2.85%. Decline in output was accompanied by a decrease of the energy efficiency.

The situation in the energy sector in Lithuania is largely defined the primary energy import and export of waste energy and products made from hydrocarbons (primarily production Mazeikių oil refining factory). Products of the energy sector in 2004 amounted to 2.49 billion litas, import 6.35 billion litas and exports 6.35 billion litas. Thus, power consumption is equal to 2.49 billion litas. In 2011 the situation changed dramatically. Energy production in the country amounted to 3.02 billion litas, imports 25.8 billion litas, exports 17.4 billion litas. Energy consumption as a result equal to 11.42 billion litas. The share of imports in the energy reaches the value of 73.5%. That is, we see a sharp increase in the energy dependence of Lithuania on energy imports. In turn, the country's dependence on imports indicates the absence in it of primary energy resources, and the rapid growth of dependence on external supplies of evidence wrongly selected the energy strategy and adverse external conditions. On the negative impact of decisions in the energy sector for the entire economic complex can be judged in terms of the share of imports in the total amount of energy produced in the country's gross domestic product (GDP). In 2004 it amounted to 9.5%, in 2005 14.3%, in 2008 - 17.8%, in 2009 13.5%, in 2010 20.3% in 2011 - 24.6%. That is, in the seven years the dependence of the economy on imports energe resursov Lithuania increased by two and a half times. Also, the increase in prices of energy supplies has led to an increase in energy prices in the domestic market. Thus, according to the CSB of Lithuania, in 2000, energy prices in the domestic market increased by 12%. Before joining the EU in 2004 was a balance of market and energy prices rose by only 1%. Despite the decline in production and a reduction in total energy demand in 2008-2009., prices increased annually by 13%. In 2010, energy has become more expensive by 7% in 2011 to 12% in 2012 to 11%. The fall in oil prices on the world market was not accompanied by a corresponding decrease in energy prices in the domestic market. This occurred because of the monopoly of energy suppliers in the domestic market, the lack of control by the government, as well as increasing tax rates.

A more accurate picture of the Lithuanian energy can make by analyzing the production and consumption of various forms of energy, reduced to a unified natural indicator ktoe (thousand tons of oil equivalent). In 2005, Lithuania was made in the amount of energy 5366 ktoe, of which 50% gave nuclear power, 1% hydropower, 3% of the energy of chemical processes, 24% of electricity and 22% heat. Volumes of production of solar, geothermal, wind and other alternative energy does not reach 1%. In 2011, has been producing only 1841 ktoe of energy, that is, in real terms its production fell by almost three times. Nuclear power while stopped completely, the share of hydro power

has increased to 2%, and the proportion of the energy of chemical processes up to 13%. Volumes of production of heat decreased by 8%, but its proportion has risen to 60%. Finally, a two-fold increase in the production of energy from alternative sources, but their proportion has remained extremely small - 2%. In 2011, the republic has already imported energy in the amount of 579 ktoe, or 31.4% of total production. From it became a net exporter to a net importer. On the other hand, if in 2005 the energy consumption in the country is 1,591 ktoe, in 2011, the consumption of energy equal to 1,607 ktoe. As can be seen, the energy consumption in the economy of Lithuania from 2005 to 2011 grew by only 1% in real terms. This is a good result, considering that the country's GDP over the years has grown at constant prices by 11.9%, from 20.9 billion euros to 23.4 billion euros. The growth of energy consumption for the production of the gross domestic product in the country was insignificant. According to Eurostat, in 2000 in the Republic spent 576 kg of oil equivalent per 1000 euro GDP production. In 2009, the cost dropped to 445 kg of oil equivalent per 1000 euro GDP. In 2000, energy efficiency in the economy of Lithuania amounted to 345% of the European average (167 kg of oil equivalent per 1000 euro GDP), in 2009 - 315% (141 kg of oil equivalent per 1000 euro GDP). Three times the gap between the average European level of energy efficiency in Lithuania can call it the largest energy problem.

Overall, the data suggest that the energy sector in Lithuania in recent years has shown a significant drop in production and consumption. The decline in production occurred as a result taken at EU level the decision to close the Visaginas nuclear power plant. Lack of energy at this time is covered by the import.

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Global energy markets – the view from Espoo

By David Dusseault

Keeping tabs at the world from my office in Espoo, I can say that we are in an advantageous position. The world's energy markets continue to experience a period of unprecedented promise, change and challenges for companies all along the whole of the economic value chain.

Flexibility is the key. As a supplier of natural gas to our clients, the task facing Gasum is not only to remain relevant as a provider of energy to the Finnish market, but to become more flexible in terms of how we source our gas, the price at which we sell our product and the form in which the gas ultimately is delivered to our customers.

Five new global trends

In the pursuit of tractability, we are following five major trends which will determine how Gasum will position itself in the Finnish gas market in order to maintain and grow our business for the years to come.

1. Gas import volumes fluctuate

Increasingly, major producing countries are faced with a dilemma in terms of the end market for their gas. Russia, Iran and Saudi Arabia are turning inwards developing domestic markets to utilize cleaner and cheaper natural gas in the energy mix. Conversely, thanks to the shale boom in the US, less expensive gas may be available for export if such a policy is adopted by the current US administration. The issue is simple: the amount of volumes that are available on the open market determines the extent to which Gasum is able to expand its supply portfolio on a more competitive basis.

2. Timely investments in infrastructure

To access available supplies, infrastructure is needed. Building the bridge between supplies and consumers is a crucial step to diversifying access. Construction of new facilities for production and distribution particularly in LNG continues apace. For our part, Gasum is "all-in" in terms of identifying the right investments to bring LNG, biogas and pipeline supplies to our customers.

3. Pricing structures change

Subsequently, increases in the volumes will have an immeasurable influence over how gas will be priced. After the Fukushima accident, we have observed that oil-indexed

long term gas contracts are now coming under pressure from alternative pricing models such as those offered on a Henry Hub plus transport from the US to Japanese buyers. The shift in contractual forms is not a question of final price, but that of price formulation: a more accurate estimate of the economic cost for production of natural gas with long term contracts providing the base load pricing and hub based contracts comprising the swing gas in the supply portfolio.

4. Energy portfolios grow more diverse

Occupying the mid-stream in the energy business means that firms need to balance out market risks at the delivery point for supplies and in the consumer markets while striving to improve the competitiveness of natural gas versus other fuels simultaneously. Portfolio creation forms the foundation for competitiveness of natural gas in energy markets.

5. Potential Growth Markets for New Gas

Finally, intensifying competition amongst commodities that were seen as replacement goods has spawned growing opportunities for gas to increase its presence in energy mix. Owing to price discrepancies, particularly with refined oil products in industrial processing, ground transport as well as emissions control legislation in maritime shipping, natural gas has a particularly bright future as a cleaner and more competitive alternative to traditional stocks such as gasoline, heavy fuel oil, and propane.

By diversifying sourcing, pricing mechanisms, and products, companies like Gasum will be able to offer an array of natural gas products for a whole spectrum of consumers tailor made to fit their specific energy needs sustainably, flexibly while at a transparent and competitive price.

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Energy politics in the Baltic Sea Region – new Russian perspectives?

By Nikolay Dobronravin

The energy politics in the Baltic Sea Region have long revolved around the role played by Russia as a major supplier of oil and natural gas. Russia's energy policy was historically Euro-centric, despite the continuous drift of major hydrocarbon extraction centres towards the Far East and to the Arctic.

The situation changed in last few years for several reasons. Shale gas and oil became a reality, meaning that the USA could rely on its own resources once again. Gas and then oil prices were also driven down by the crisis in Europe, leaving Russia more and more vulnerable. As if it was not enough for the embattled exporter, the third energy package entered into force, meaning more openness and competition in the gas and electricity markets.

The gap in the global oil and gas consumption was welcomed by the Baltic states and Poland, interested in the reduction of their energy dependence on Russia. The European struggle against vertical integration in these markets was also supported, as far as the influence of Russia could be diminished.

Russia's vulnerability and mixed reactions

Russia is famous for its tradition of survival under unfavourable circumstances. As the vulnerability of national energy policy became blatant, mixed reactions were voiced by Russian decision-makers and experts. To summarize these reactions, they have included compliance with the third energy package, search for customer diversification and 'business-as usual' approach.

The last way of confronting the challenge, not so rare in Russia's turbulent history, was until recently advocated by Gazprom, which could rely on its export monopoly. In 2012, the company managed to reach price agreements with its customers in Europe. The basic principles such as long-term contracts and 'take-or-pay' were still in vigour, and no real spot market of natural gas has arisen. Last October, upon completing the construction of the second string of Nord Stream, the CEO of Gazprom Alexey Miller looked positive about the future of the third and fourth strings of the pipeline. He said that the company was planning to sign a memorandum in this matter by the end of January 2013.

The plans of the gas giant have not materialize, but it was not a Gazprom's fault. The growing understanding of impending danger which could greatly affect export revenues has resulted in a new set of plans for Russia's energy policy.

Export diversification: 'Look East' energy policy

The Eastern direction of Russia's energy policy is not something new in itself. In 2012, Russia exported 24 million tons of crude oil to China alone, directly by pipeline and through the port of Kozmino in the Far East. Russian oil was also shipped to Japan, the USA and other countries of the Asia-Pacific region. The whole volume of crude oil exported from Kozmino reached 16.3 million tons last year. LNG from Sakhalin was shipped to Japan, Korea and China; other customers have already included Thailand, Taiwan, India and even Kuwait.

The 'Look East' energy policy was highlighted during the recent visits to Moscow by the leaders of China and Japan. The Chinese direction still seems more promising for

Russian oil sector, while various gas projects are of great interest to Japan. Gazprom and China's CNPC signed a memorandum on building a pipeline to be completed by 2018.

All these projects may affect the Baltic Sea Region, if the exports from the Far East turn out to be more profitable for Russia. In 2012, the LNG transport from Norway to Japan via the Northern Sea Route was a sign of future regular gas shipments from the Arctic to the Pacific. However, the perspectives may not be so rosy – enter North American shale gas and oil. The shipment of North American LNG to South Korea and Japan is expected to start in 2017.

Even if the oil and LNG exports from Russian Far East continue as planned, one must be too optimistic to argue that gas price negotiations between Russia and China are going to end anytime soon.

Paraphrasing Sir Winston Churchill: 'We are still in Europe, even if not of it'

The European energy market is too important to Russia in spite of all diversification measures. Europe may be bearish to Russia, but both partners still need each other.

In April, Valdimir Putin asked Gazprom to rethink the Yamal-Europe-2 project. All of a sudden, the idea of building an additional pipeline (up to 15 billion cubic metres) through Belarus to Poland, Slovakia and Hungary. The memorandum of understanding was signed with EuRoPol Gaz, the operator of the existing transit pipelines system, owned by Gazprom and Polish PGNiG. Quite expectedly, the memorandum has resulted in a political scandal in Poland, as the project seems to be aimed at reducing gas transit through Ukraine. As said by Aleksey Miller, no binding documents will be signed on the third and fourth strings of Nord Stream before the Yamal-Europe-2 project is assessed by October this year.

At the same time, gas unbundling debate between Lithuania and Russia is going on. It seems that Lithuania is only interested in price reduction while Gazprom would like to postpone the unbundling of gas transmission network in this Baltic country and guarantee gas transit to the Kaliningrad region.

The most important change in Russia's energy policy can take place soon, if the third energy package is complied with. Gazprom is still holding export monopoly, but Novatek and Rosneft are the major energy companies, and their presence in the Baltic Sea Region will be growing, especially if the gas sector becomes more similar to the already unbundled oil and electricity sectors of Russian economy.

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Russia

Gazprom and the development of spot-pricing on the EU gas market

By Jack Sharples

The EU gas market is currently in a state of transition. Due to declining EU gas production, the share of imports in EU gas consumption is predicted to rise from 67 percent in 2011 to 80 percent in 2030. As imports account for a greater share of consumption, the source and pricing of those imports will also become more significant. In 2003, 90 percent of EU gas imports were sourced (almost exclusively by pipeline) from Russia, Norway, and Algeria. Today, that figure is 75 percent, and falling. EU gas imports are increasingly being delivered in the form of liquefied natural gas (LNG) from suppliers such as Qatar, Nigeria, and Trinidad & Tobago. At the same time, the European Commission is actively promoting greater integration between EU Member States and an increase in internal EU gas trading. The combination of supply diversification and internal integration is slowly resulting in the EU gas market becoming a *market* in its true sense, although the process is far from complete. The question for Gazprom is how to adapt to these developments and retain its current market share of 24 percent of total EU gas consumption.

Pipeline gas supplies have traditionally been delivered under long-term contracts (of more than 5-10 years) with gas prices index-linked to oil prices. This system provided predictability for suppliers and consumers, but also reflected a lack of supply and demand pricing signals and a predominance of bilateral relations between supplier and consumer. However, the development of supplier diversification and cross-border integration means that the traditional bilateralism is being superseded by multilateral, market-driven gas trading: Approximately 35-50 percent of wholesale EU gas imports are now traded at spot prices determined by dynamics of supply and demand, rather than at oil-indexed prices.

Yet the EU gas market remains divided: All of the 19 LNG import terminals currently operating in the EU are located in Western Europe, while the main gas trading hubs are located in the UK and the Netherlands, where spot-pricing is most prevalent. By contrast, in Central Europe, South-Eastern Europe, and the Baltic states, where gas is overwhelmingly delivered by pipeline from a single supplier (Gazprom), long-term contracts and oil-indexation remain dominant.

Following their dramatic collapse in 2008, oil prices rebounded sharply in 2009-12. But the relative 'glut' of gas supplies to the EU market due to increased LNG imports, coupled with weak European gas demand, caused spot prices to remain significantly lower than their oil-indexed counterparts. In response to complaints and threats of commercial arbitration from European energy companies, Gazprom granted a series of temporary price discounts during 2010. However, these discounts proved insufficient for Gazprom's European customers. So, during 2011-12, Gazprom reached settlement agreements with 13 European energy companies in disputes over gas prices: Between

January and September 2012, Gazprom granted \$4.27bn in 'retroactive payments', with a further \$4.7bn predicted for 2013. Such payments are essentially refunds, and have been interpreted as a tacit admission from Gazprom that it overcharged for gas supplies between 2010 and 2012. The idea that Gazprom may have abused its dominant market position is also the focus of a European Commission antimonopoly investigation, launched in September 2012.

Despite the granting of discounts and the launch of the European Commission investigation, Gazprom has consistently reiterated its intention to retain oil-indexed gas prices. This is partly due to Gazprom's continued market dominance in Central and Eastern Europe, although even that dominance is beginning to be challenged: Polskie LNG is currently constructing Central Europe's first LNG import terminal in Poland (due for launch in 2014), while negotiations over potential LNG import terminals in Lithuania and Estonia or Finland remain ongoing. The fact that oil-indexed prices remain higher than spot prices gives Gazprom a financial incentive to retain its current pricing model.

The danger is that, as Gazprom's European customers are increasingly able to import cheaper, spot-priced gas from other sources, Gazprom will lose its market share. The second largest supplier of gas to the EU after Gazprom, the Norwegian Statoil, has already recognised this danger: In November 2012 Statoil signed a landmark agreement with the German utility company, Wintershall, to supply pipeline gas under a long-term contract at spot prices, and announced that it would continue to increase the role of spot pricing in its gas export contracts.

It is likely that Gazprom will follow Statoil's example and switch to spot pricing only when the benefit of retaining its market share outweighs the cost of a reduction in its gas export prices caused by the switch to spot pricing. Gazprom's decision-making in this regard will therefore be influenced by spot prices on the EU gas market, which are by no means guaranteed to remain significantly below oil-indexed prices: While the increase in imports of spot-priced LNG is increasing the competitiveness of the internal EU gas market, it will also increasingly expose the EU gas market to the competition from the increasingly LNG-hungry Asia-Pacific region for supplies on the global LNG market.

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Visa-free travel between EU and Russia might be true in the near future

By Juho Rahkonen

Should there be visa-free travel between Russia and the European Union countries? This question touches the whole union and there is still a long path to go before visa-freedom could be reality. Due to Schengen agreement, it is not up to Finland and Russia alone. However, Finland has the EU's longest borderline with Russia, and therefore the issue is particularly important to Finland.

What do ordinary people think about the issue? Taloustutkimus Oy, a leading Finnish market and opinion research company, conducted a survey about visa-freedom last autumn. The question was asked both Finns and Russians (in the Western part of the country, St- Petersburg region), with a representative sample of adult population. The study in Russia was conducted by Taloustutkimus' daughter company Toy Opinion, which is based in St. Petersburg. In the Finnish side of the border the public opinion is divided: 38 per cent of Finns say yes and 49 per cent say no (the rest are undecided). In the Russian side the opinion is clear: as many as 82 per cent of people are in favor and only six per cent are against visa-freedom.

Taking into account the history-based, negative attitudes that many Finns hold towards Russia and Russians, the result is not as negative as one could have expected. Having said that, there is a significant difference in opinions between age groups: of respondents under 25 years, the majority (56 per cent) is in favor of visa-freedom and 24 per cent resist it. In the age group of 50 to 64 years, only 32 per cent are in favor of visa-freedom and as many as 58 per cent are against it. So it is the baby-boomers and younger middle aged Finns who have the most skeptical views on Russia and the issue of visa-freedom. Younger generation is more open to new possibilities and historic austerities do not weigh that heavy on their shoulders.

The theory of generations, developed by Karl Mannheim, suggests that people are strongly influenced by the social and historic environment they are living in. Formed by the experiences they have had in their early and sensitive adulthood (about 17 to 20 years old), new generations become agents of change.

Given that people's values and attitudes are relatively stable and permanent, it can be predicted that new and more open attitudes are slowly but surely becoming more common in Finland. As younger generations with their open-minded worldviews enter the political scene and older, more nationalist opinions decrease, there should be a great value shift in the society during the decades to come. Such a shift does not happen quickly or dramatically, but rather it is a slow, ongoing process. Thus, the theory of generations implicates that in the near future the Finnish public opinion turns favorable about visa-freedom.

At the moment, the political atmosphere in Finland is not the most supportive for international issues. During the last couple of years, Finland has gained questionable reputation for protracting the integration process of the European Union. In autumn 2011, the Finnish government questioned the

eligibility of two new EU fellows, Bulgaria and Romania, to join the Schengen agreement. Later Finland corrected her policy.

It hardly comes as a surprise that the reasons for such demands lay first and foremost in the internal politics. The landslide victory of the euro-skeptic Finns Party (formerly the True Finns) in April 2011 parliamentary election made other Finnish parties alert. Fear of the Finns party has forced the old parties shift their policy into a more nationalist and euro-skeptic direction – or at least give such an image to the general public. Recently, nationalist voices have risen in many parts of Europe, fueled with economic dissatisfaction in the era of continuing economic crisis.

It is not only a matter of public opinion whether the visa-free travel would be possible. A lot of co-operation between governments and officials is still needed. In the end of the day, visa-freedom is rather a practical question, not as much ideological as it used to be. However, its positive emotional effects should not be undermined.

Several countries near Europe have opened for visa-free travel in the last few years. For example countries like Ukraine, Moldova, and Georgia no longer require visa from EU citizens. The most recent delighting news came in January this year, as Armenia joined the visa-free destinations for EU citizens.

If so many countries near the Eastern borders of Europe are already visa-free, why not Russia? The Great Narrative of our time is globalization and opening of minds and borders. This development is inevitable and it should carry on despite of economic hardships. If the natural integration process of Europe and its neighbors will turn to increasing isolation and protectionism, we should be worried.

When we look back to history we see this is not the first era of globalization. From 1870's to 1930's the world was getting global at a high pace: there was massive immigration and foreign trade was flourishing. This development stopped because of the Great Depression and World War II. Globalization started again after the oil crisis of the 1970's and at least after the end of Cold War, and in many ways it has been a success story. This positive development should not be disrupted, because human interaction is a key to better life. Visa-freedom between the EU and Russia is a part of this big picture, and I am confident it will be reality within the next ten years.

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In search of new mechanisms for state-business interaction

By Andrei Yakovlev

2008-2009 crisis revealed inefficiency of bureaucratic “power vertical” and absence of feedback mechanisms in public administration in Russia. Recognition of this fact gave way to search of new means of state-business interaction. One of them was Agency for Strategic Initiatives (ASI), which was proposed by Vladimir Putin in summer 2011 after a number of meetings with entrepreneurs. As these meetings showed, there were substantial barriers for realization of business initiatives, and state machinery had no incentives for elimination of these barriers.

The ASI was established by the Russian Government as an autonomous non-commercial organization. Mr. Putin is chairman of ASI supervisory board. Declared official goal of ASI is “creation of prospects for self-realization of young ambitious leaders who are able to lead Russia to the front line in the world”. The Agency’s mission includes promotion of projects and initiatives put forward by fast-growing medium-sized businesses and social sector leaders; growth in the number of new leaders emerging in medium-sized business and in social sector, and general improvement of business climate. For achievement of these goals substantial funds were provided to the ASI, and Agency could invite to its staff (which amounted to about 150 employees) a number of qualified experts with business experience. For projects follow-up, ASI invited well-known consulting firms, including the Boston Consulting Group.

What has the ASI managed to do in a year and a half? ASI activity was largely connected with the “One-Hundred-Step Program”, proclaimed by Mr. Putin in February 2012. The idea was to improve business climate and to raise Russia’s position from 120 to 20 points in Doing Business global rating calculated by the World Bank. In the framework of this program, the ASI has launched a “National Business Initiative”, and prepared “road maps” for elimination of administrative barriers in getting construction permits, connecting the electricity, customs regulations, and promotion of exports. In summer and autumn of 2012, these “road maps” were approved by the Government and became obligatory to government offices. The ASI, in collaboration with 11 regions, has realized a pilot project “Standard of business climate improvement at regional level” based on the analysis of best practices shown by regional governments in their investors’ relations. In September 2012, presidential decree included indicators of this Standard into a system of gubernatorial activities evaluation.

Why could ASI be capable in solution of problems which core public authorities failed to solve earlier? Ministries, including the Ministry of Economic Development, which is responsible for business climate by its mandate, are bound with rules of interagency coordination. According the these rules, any “interagency” issue must be discussed strictly at the levels of department directors or vice ministers, which means that the issue should first be “elevated” to this level in one agency and then lowered as an “order”, step-by-step

down the hierarchy, to another agency. Apart of great loss of time for paperwork traffic, this coordination regime means that any complex issue, quite objectively, gets split into a multitude of partial issues, and decision making is made not in the order of entire problem solution but rather on the base of departmental interests.

As opposed to ministries, ASI is not built into formal bureaucratic hierarchy, but owing to its access to Mr. Putin, it has a high status in public administration system. For this reason, ASI representatives can go, avoiding bureaucratic subordination, directly to a concrete official, who is responsible for the issue of their interest in the corresponding agency. Since ASI has no administrative power and lacks any regulatory functions, it meets no specific departmental interests and opens possibility to develop and make complex solutions.

At the same time, this particular status of ASI contains potential weakness in its position as a specific “development institution”. In the absence of administrative power, ability of ASI to influence activities of agencies is determined solely by its closeness to Mr. Putin. However, other influential agents have direct access to Mr. Putin too. So, ASI (which can achieve its goals only in close collaboration with federal and regional authorities and is funded by the Government) objectively has no desire to “strain relations” with most influential agencies. This puts ASI at risks of gradually becoming “fused” with the existing bureaucratic machine.

Nowadays, apart from implementation of concrete projects, the ASI helps to discover effective officials inside the present public administration, to establish horizontal links between them, and also to disseminate best practices. However, ultimate effects of ASI activities will depend on determinacy of Kremlin to appoint and promote top-level officials according to their efforts to invite investments and to create incentives for economic growth, rather than by the criteria of their political loyalty and personal commitment. Whether this turn will take place in Russian personnel policy, will be clear during the following year.

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Russia



The 2013 Cyprus bailout and the Russian foreign direct investment platform

By Kalman Kalotay

In March 2013, as a new episode of the Great Crisis that started in 2008 and whose end is not yet at sight, Eurozone members and the International Monetary Fund (IMF) offered a €10 billion (about US\$13 billion) rescue loan for fellow member Cyprus – representing more than half of its gross domestic product (GDP). Bailout would come with conditions, which will weaken Cyprus' traditional role as an offshore financial centre within the European Union (EU). In the two largest banks of the island on the verge of bankruptcy, only deposits up to €100,000 (US\$ 130,000) were to be saved; the rest would disappear or suffer from a huge discount. As a symbolic measure, depositors might be offered shares in the banks concerned, although their real value would be close to nil due to the bad shape of those financial institutions. While these were already heavy blows, capital controls required to stabilize Cyprus in the short and medium term heralded the effective end of the offshore financial centre of the island.

These developments were bad news for Russian investors, which used the island as the most important platform for their trans-shipped and round-tripped foreign direct investment (FDI). Trans-shipment means FDI destined to third countries while round-tripping denotes projects targeting the Russian market proper with a detour in Cyprus. The phenomenon dubbed Cyp-Rus investment was analysed in detail in the context of trans-shipped FDI to other economies in transition by the Pan-European Institute a decade ago. Since then it has grown in size and in terms of targets of trans-shipment, going in reach to developed economies. The Bank of Russia estimated the inward and outward FDI stocks of the country linked to Cyprus to US\$129 and 122 billion at the end of 2011 (table 1), respectively (it is not by coincidence that the values of the two are so similar). They represented 28 and 34% of the inward and outward stock of the country. These values were five times higher than Cyprus' GDP. However FDI data reported by the Central Bank of Cyprus were way lower, begging the question where the difference can be registered (such as bank account, real estate, portfolio investment, to mention a few possibilities). Official data on portfolio investment are not only of little help but also contradictory (table 1): Russian statistics show asset growth in crisis years while Cyprus data show divestment. As for bank accounts held by Russians, statistics are missing; estimated vary largely, from €5–10 billion (US\$6.5–13 billion, according to the Central Bank of Cyprus) to US\$31 billion (Moody's). In either case, their size would indicate large losses for Russian individuals and firms keeping their assets in the wrong banks (the top two: Bank of Cyprus, whose large depositors face a severe discount in their assets, and Laiki Bank whose large deposits are literally wiped out).

While Russian investors could probably not foresee the degree of measures Cyprus would be forced to engage in, the financial crisis had prompted them to think of strategies not putting all eggs into the same basket. The most salient

trend in this respect is the rise of other offshore financial centres in Russian inward and outward FDI, especially that of the British Virgin Islands (table 1; and to a lesser degree Bermuda and the Cayman Islands). Flow data show large fluctuations, however. The changing relationship between the two top offshore centres is more noticeable in FDI stocks. By 2011, the ratio between the British Virgin Islands and Cyprus rose to an all time high of 44% in inward FDI stocks and 38% in outward FDI stocks.

The Cyprus bailout package can be expected to accelerate the shift of Russian corporate strategies to new offshore financial centres. It is unlikely that Russian firms would change the long-term patterns of their management style, and come on-shore in Cyprus or elsewhere. However the outward FDI dynamism of the Russian Federation may be affected as the potential write-offs related to Cyprus may reduce the free resources available for expansion abroad. Russian firms can switch activities not only to pure financial centres, but also to more mixed trans-shipment hubs such as Luxembourg. To what degree these changes would affect the size and composition of Russian outward FDI is difficult to forecast at this point of time when data series are available only until the third quarter of 2012.

Although the Russian State is in general not in favour of offshore finance, it may be obliged to defend Russian interests. In the case of Cyprus, it already offered a five-year financial assistance of €2.5 billion (US\$3.2 billion) to the country in 2011, which could be extended until 2021 in case of emergency, and may offer case-by-case help to Russian firms that suffer disproportionately from the Eurozone rescue package. However during the depth of the Cyprus crisis it made it clear that it would not engage additional resources and by no means would it replace the EU or the IMF as leading agencies dealing with the macroeconomic woes of the island, nor would it offer any systematic help to the Russian business community engaged in Cyprus.

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The views expressed in this article do not necessarily reflect the opinion of the United Nations.

Table 1. Inward and outward FDI of the Russian Federation by home/host country, 2007–September 2012

		(Millions of U.S. dollars)					
Home/host country	Year	2007	2008	2009	2010	2011	2012 ^a
Inflows							
Total		54'619	75'201	36'336	43'076	55'615	33'080
From EU 27 excluding Cyprus		19'525	21'773	12'199	20'696	27'031	23'660
From British Virgin Islands		3'246	7'341	1'753	2'138	7'196	1'283
From Cyprus	Russian data	10'595	19'555	4'270	12'250	13'569	4'567
	Cypriot data	..	-1'434	197	-611	-120	..
Inward stock							
Total		..	..	378'837	489'256	455'904	..
From EU 27 excluding Cyprus		..	..	111'323	148'686	168'015	..
From British Virgin Islands		..	..	36'599	50'966	56'442	..
From Cyprus	Russian data	..	..	129'930	179'217	128'816	..
	Cypriot data	..	2'587	146	773	785	..
Outflows							
Total		45'897	55'540	43'632	51'886	67'221	37'499
To EU 27 excluding Cyprus		17'992	16'694	11'717	18'003	16'511	8'947
To British Virgin Islands		1'425	3'822	2'305	1'833	4'194	2'646
To Cyprus	Russian data	14'630	8'879	15'391	18'046	22'400	16'110
	Cypriot data	..	466	641	-372	396	..
Outward stock							
Total		..	..	302'188	365'961	361'738	..
To EU 27 excluding Cyprus		..	..	81'093	93'798	110'514	..
To British Virgin Islands		..	..	33'285	38'762	46'137	..
To Cyprus	Russian data	..	..	119'672	153'933	121'596	..
		..	2'206	1'984	1'491	1'905	..
Memorandum items							
Russian portfolio investment flows to Cyprus							
	Cypriot data	..	..	-5'817	-544	-20	-1'060 ^b
Russian portfolio investment stock in Cyprus							
	Russian data	368	1'366	1'877	2'840	4'633	..
	Cypriot data	..	443	1'726	1'517	1'509	..
Estimated GDP of Cyprus at current prices		21'769	25'250	23'474	23'000	24'713	22'446

Source: Author's calculations, based on Bank of Russia and Central Bank of Cyprus data.

Note: Data are calculated by the nationality of the immediate investor.

a January-September 2012.

b January-June 2012.

Russian multinational companies and state capitalism

By Wladimir Andreff

The growth of outward foreign direct investment (OFDI) achieved by Russian multinational companies (RMCs) had the fastest speed in the world from 2000 to 2007, faster than Chinese and Indian OFDI. Russia's OFDI recovered after a sharp drop in 2008. Such a success story did not happen without state interference.

During the Yeltsin era, the privatisation programme established big companies in monopoly or oligopoly situation which swiftly transformed into RMCs. Under Putin presidency, the Russian government has shifted its objectives toward strengthening its influence over the whole economy and promoting OFDI, namely in the service of national strategic goals. In the 2000s, the first objective was reached through a rapid expansion of state-owned enterprises (SOEs) and partial re-nationalisation in some industries. Since 2001, state ownership appeared to be on the rise. Public participation in previously privatised Gazprom increased from 38.4% to over 50%, Gazprom acquired privately-owned Sibneft while state-owned Rosneft acquired various assets of the defunct Yukos. State participation in the stock equity of some RMCs increased, and their strategies were increasingly influenced by Russia's foreign policy. In 2007, seven big state corporations (like Rosnano) were launched with CEOs directly appointed by the president of the Russian Federation. The purpose of these new corporations, gathering activities into big industrial trusts under public control in strategic industries, is industrial modernisation. However, they started internationalising and acquiring technological assets abroad while the pressure of the presidential administration on to them accentuated. Their strategies serve both domestic industrial policy and Russia's foreign policy.

When Dmitry Medvedev, a former Gazprom CEO, was elected President of the Russian Federation, and Igor Sechin, a former Rosneft CEO, was appointed Deputy Prime Minister, tight relationships between the government and its state-owned RMCs rose to the surface. The dividing line between the government and multinational business became more blurred than ever since the dawn of transition. However, the relationships between the state and big business are no longer rooted, as during the 1990s, in state capture by private concerns and asset grabbing. The political influence of those oligarchs who emerged in the 1990s clearly weakened after the Yukos case, and the government taking RMCs owned by oligarchs in a firm hand strengthened the dimension of a state capitalism.

A sort of bargaining model took place in the relationships between the state and RMCs in which the latter benefit from subsidies, tax exemptions and various aids from the government but "in exchange" they have to bear without complaining some duties and additional costs such as a price regulation, frequent administrative supervision and a waste of time in communication with the bureaucrats. Both Russian state capitalism and RMCs have reached a kind of maturity in their evolution and adaptation to a globalisation context in crisis. The Russian government trusts and supports RMCs to become powerful actors in the world markets, namely in

energy markets. RMCs are described as a form of soft power which has replaced the military power of Russia, in particular throughout the "close abroad" whereas Russian political influence abroad is a push factor of Russian investment expansion for instance in Central Asia. The Russian government helps RMCs in Asia and Africa as well.

Now Russia conducts a policy providing support to companies that invest abroad in strategic industries. Since 2007, the government incited RMCs, whatever privately or state-owned, to export more high tech products and invest abroad. It intends to keep an overall direct and indirect control over industries linked to raw materials and natural resources whose major companies are ranked among the biggest RMCs. The hydrocarbons industry and its RMCs are especially turned into a tool of Russia's international relationships, through controlling the network of oil pipelines and gas pipes, which is also a means for a state control over exports. A part of the manufacturing industry is also considered by the state as strategic (aeronautics, shipbuilding, the automotive industry) and is hardly open to free competition while the government sometimes intervenes in RMCs' decisions. The rest of the manufacturing industry which has swiftly modernised (telecoms, telephone) is more open to competition and here RMCs are much less influenced by the state. In the heat of the financial crisis, in November 2008, Vladimir Putin asked the CEOs of big Russian enterprises to discuss with the state administration of their perspectives and future orientation, industry by industry. Indeed, many RMCs undertook their OFDI for the sake of the national economic interest as it was meant by the highest state authorities. State-owned RMCs were often heavily influenced by - or incited to stick to - major objectives of Russia's foreign policy.

Finally, the government took advantage of the financial crisis to spread its grips over some indebted RMCs to which government assistance came from the state-owned VEB which bailed them out; consequently, state administration placed a representative in the companies' boards who has the right to veto any debt or major asset sale. Taking excuse of the crisis to rescue some RMCs, the government sealed deeper alliances with them, now a typical feature of Russia's state capitalism today.

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Joining the Eurozone – Latvia's destiny?

By Morten Hansen

The title of this article may sound somewhat over the top but there is a ring to it. Latvia has relentlessly been working its way towards the Eurozone and at the time of writing, late April 2013, it seems highly likely that the country will indeed meet the Maastricht criteria and join the Eurozone by 1 January 2014.

A short chronology of Latvia's way towards the Eurozone, why the country wants to join, arguments for and against joining and recommendations for economic policy inside the zone are the aims of this article.

Latvia applied for membership of the European Union on 13 October 1995 and became one of the 'Helsinki Six' in December 1999 when accession negotiations were authorized. On 12-13 December 2002, as part of the Copenhagen Council, the country was invited to join the EU, which was followed by a referendum in Latvia on whether to join on 20 September 2003 in which 67.5% of those who voted chose a yes and on 1 May 2004 Latvia became member of the EU. But from a monetary policy angle it is interesting to notice that already on 21 September 2003, just one day after the referendum on EU membership, Bank of Latvia declared that for the country to fulfil its treaty obligations to adopt the euro 'eventually' the Bank announced that it would repeg the national currency, the lat, to the euro by the end of 2004, thus giving the public over a year to get used to this. The lat had been pegged to the SDR since March 1994 and was duly repegged at the end of 2004 at the then market rate and then parity rate of 0.702804 LVL/EUR. In addition, it was Latvia's goal to join 'as soon as possible'. This first meant 2008 which was made impossible by too high inflation compared to the Maastricht criterion, then 2012 which became impossible due to too big budget deficits and the country being in an EU/IMF programme. And now the goal is 2014.

There are indeed many arguments for Latvia joining the Eurozone. It is a very open economy where trade is highly oriented towards the European Union. It is already a highly euroized country – around 90% of borrowing is already in euros and many deposits are in euros, too – euro adoption will automatically remove this asymmetry. The country has also already demonstrated that it can operate well inside the 'friendly straitjacket' of a fixed exchange rate system, just witness the remarkable (but brutal) labour market flexibility following the financial crisis. And what is the alternative anyway? Bank of Latvia has never used the exchange rate as an active monetary policy instrument, having used it instead for inflation stabilizing purposes. In this sense the euro is 'Latvia's destiny', a natural final outcome of a plan set in motion many years ago. An additional argument deserves to be added, an argument that may be hard for westerners to understand but in Latvia many see the euro as further step in terms of integration into the EU and thus a further step away from Russia. Latvia's Foreign Minister Edgars Rinkēvičs put it very well in the Financial Times 23 April 2013 by stating:

"My main message is that Latvia is joining the euro as a geopolitical choice".

And inside the Eurozone the country may finally be able to concentrate on long term development of the economy – during the boom years until 2007 such reforms were largely neglected since the economy was growing anyway while the crisis years of 2008 – 2010 could be characterized with some justification as a series of short-term fire-fighting exercises aiming at stabilizing the economy. Latvia is still the third poorest member state of the EU in terms of GDP per capita. It would indeed be brilliant if, with monetary policy set in Frankfurt and fiscal policy partly determined by the Fiscal Compact, full concentration could be devoted to developing the long term potential of this economy.

I have characterized the Eurozone as a 'friendly straitjacket' but a straitjacket it is so has Latvia learnt from its boom-bust development in order not to see a repeat of this performance?

I mostly think so. The country has adopted a 'Law on Fiscal Responsibility', a local equivalent of the Fiscal Compact which is to ensure that the highly procyclical fiscal policy that exacerbated the boom but also helped to deepen the bust should not be repeated and this is good news indeed but I would like to see something similar, though not as a law, in terms of external competitiveness. Due to an overheated labour market during the boom period, runaway labour costs created high inflation and a sharp deterioration of external competitiveness which was only restored through painful internal devaluation. Such loss of competitiveness must not be allowed to happen again – just witness the immense trouble in Southern Europe following similar losses of competitiveness during similar credit-driven booms. Can that be avoided? Here I might remain a bit sceptical. Latvia has seen notable migration which may rather easily lead to bottlenecks in parts of the labour market and thus increases in labour costs that may harm competitiveness. A more active labour market policy is warranted together with a vigilant eye on competitiveness.

The arguments for joining the Eurozone outweigh the rather few arguments for not joining, however. Latvia should indeed be on its way to its monetary policy destiny, if I may conclude in this rather pompous way.

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Latvia



From enlargement to enhancement – towards a civil security financial instrument of the Baltic Sea Region?

By Timo Hellenberg

Throughout its turbulent history the Baltic Sea has played a role being that of a bridge and a barrier between Eastern and Western Europe. The Sea has carried evolution and spread destruction while digesting the ever-changing regimes.

The modern risks facing the Baltic Sea countries are more complex and intertwined with the civic society, as before. The most potential risk sources are risks resulting from supply of the energy resources, natural and man-made disasters such as storms, environmental degradation and maritime traffic accidents.

The countries in the Baltic Sea cooperation are producing the *civil security* per se. They are also all *consuming* this security while taking actively part in the growing socio-economic interaction of the region. The financial landscape for civil security cooperation (HELCOM, CBSS, projects) are much smaller in the Baltic countries than in the comparably more affluent countries at the north, west, and south-western rim of the Baltic Sea. So even if the interest to enhance the security of the Baltic Sea area would be similar in all contracting countries, the affluent countries will spend more in years to come.

The European Union Strategy for the Baltic Sea Region (EUSBSR) is one of the latest instruments of the European Union in this field. It was issued in 2009, and there are many common projects in the field of civil security with the CBSS. The Baltic Sea Maritime Functionalities (BSMF) is a Flagship Project of the EUSBSR Priority Area on Maritime Safety and Security. It aims to develop information sharing environment for the maritime domain in the coastal countries of the Baltic Sea Region through connecting existing concepts and streamlining them with already functioning operations of national entities as well as showing good practices. However, again as before, the EUSBSR is still not a needed holistic and permanent financial *instrument* but another intergovernmental mechanism.

When considering concrete pooling of a permanent financial mechanism to the Baltic Sea civil security cooperation one needs to acknowledge the growing role of the private sector. It has traditionally had a strong role in shaping and initiating the Baltic Sea security cooperation. One reason is the history which has always changed the existing regimes by leaving the final leverage and responsibility on those people who are directly dependent of the sea and related industries. Today, the private actors are not only initiators of micro level projects (as in 1990s) but also play an essential role in transnational initiatives. The definition of “private” actor is no longer something “to avoid” but to “get involved”.

A positive example of an on-going wider stakeholder cooperation with dimension to Baltic Sea region is the ANVIL Project which aims to map the variety and similarities in Europe’s regional and civil security structures, practices and cultures and investigate how variety affects the safety of Europe’s citizens. The results give policy stakeholders a clear overview over civil security architectures and EU-added value to the debate concerning “not one security fits all”. The ANVIL project is funded by the European Commission within the Seventh Framework Programme (www.anvil-project.net).

So what is to be done in the Baltic Sea Region in order to manage these emerging new risks around civil security and maritime transportations in particular? Rather than losing more time and scarce resources on overlapping national monitoring, training and decision support systems, the Baltic Sea countries should *finally* manage to create one single source financial instrument. This should be done by integrating the existing funding programmes to a holistic funding platform and as such, to boost the permanent system evolution at regional, national and local levels. The starting point would be combining the three essentials - political experience and understanding, pioneering applied and multidimensional research, and most importantly, active participation of the private sector - under the same strategic alliance.

The civil security itself is too valuable resource to be placed with same category with other socio-economic spheres of life. The fact is that with current terms, these civil security projects are initiated on ad hoc basis by private citizens, SMEs and NGOs. The high level declarations and strategies should reflect these initiatives and provide the concrete establishments and financial solutions, rather than following ad hoc tenders agreed at annual summits. Finally, it is easy to be critical and it is even easier to follow the business as usual but for the sake of Baltic Sea citizens and taxpayers, there has to be better progress in the field of civil security cooperation in the years to come.

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Inflation and monetary policy in CIS countries

By Marek Dabrowski

Macroeconomic stability has always been a serious challenge for CIS countries¹. In the first half of 1990s all of them experienced very high inflation or hyperinflation which originated from monetary and fiscal imbalances accumulated in the period of Gorbachev *perestroika*, messy way of dissolution of the ruble area, populist policies and sometimes also from violent conflicts. After the new national currencies were introduced in 1992-1993 and more effective anti-inflationary policies were launched in mid-1990s, inflation moderated to a low two-digit annual level. However, this progress did not receive sufficient fiscal policy support and most of currencies crashed heavily in the period of financial crisis of 1998-1999.

The economic boom of 2000s allowed returning to macroeconomic stability, this time with stronger fiscal fundamentals and backed by rapidly growing official international reserves. Nevertheless, these better fundamentals proved insufficient to withstand adverse consequences of the global financial crisis of 2008-2009: all countries but oil-rich Azerbaijan experienced depreciations of their currencies again. The entire region entered the period of the increased macroeconomic uncertainty even if most countries recorded growth recovery in 2010-2012 and reduced somewhat their external and internal macroeconomic imbalances.

Inflation although lower than in 1990s, remains on a higher level as compared to other regions (Figure 1). Several CIS countries experienced problems with sustainable disinflation to a single-digit level. This concerned, in first instance, Belarus, the worst performer in the region (Table 1). However, Uzbekistan, Ukraine, Russia, Moldova and, for shorter periods of time, Azerbaijan, Kyrgyzstan and Turkmenistan also recorded two-digit annual inflation rates, sometimes approaching or even exceeding 20%.

This rather disappointing inflation performance has very much to do with the absence of firm political consensus around price stability and imperfect institutional status of many central banks which are neither legally nor operationally independent from executive and legislative branches of government. As result all CIS countries run the so-called hybrid monetary regimes under which authorities try to manage simultaneously exchange rates and interest rates/ money supply. Such regimes are inconsistent in terms of the pursued policy goals (some of which are not related to price stability) and non-transparent for broader public and financial markets. Not surprisingly in time of global or regional financial turbulence they become easy targets of speculative attacks as it happened in 1998-1999 and 2008-2009.

The IMF's advocacy of more flexible exchange rate regimes and inflation targeting (IT) brought limited results so far. Only three smaller countries – Armenia, Georgia and Moldova – managed to increase somewhat flexibility of their

exchange rates during the decade of 2000s what was rewarded with improvement of their inflation performance (Table 1). Very recently, Russia follows the same kind of policy change, also with positive result in terms of its lower inflation rate. However, none of the mentioned countries managed to develop IT framework beyond its very initial phase.

The main obstacle on the way to full adoption of the IT strategy is related to the phenomenon called in the economic literature as the 'fear of floating'. Free floating, without any central bank intervention on the forex market, is considered as the risky regime in economies with high dependency on consumer import (which results in high exchange rate pass-through on domestic inflation) and in those with high level of actual dollarization. Both are the cases of the former Soviet Union.

Dollarization can be considered as the legacy of turbulent 1990s and sometimes (Belarus) of more recent devaluation experience (in 2011). In countries which are large labor exporters (Moldova, Armenia, Kyrgyzstan, Tajikistan, Georgia) it also results from high inflow of migrants remittances. In most cases the share of foreign currency deposits in total deposits remains in the range of 40-65%. One should add the widely used dollar cash which is outside these estimates. Russia is the only country where deposit dollarization does not exceed 20%.

As seen from the above analysis the road to full monetary stability and sustainable low inflation in Russia and other CIS economies is still quite long and requires policy effort on many fronts, including more independence of central banks and strengthening their anti-inflationary mission, fiscal stability, financial sector reform and many others. In countries which are evidently delayed in building market economy (Belarus, Uzbekistan and Turkmenistan) more fundamental economic and institutional reforms are badly required.

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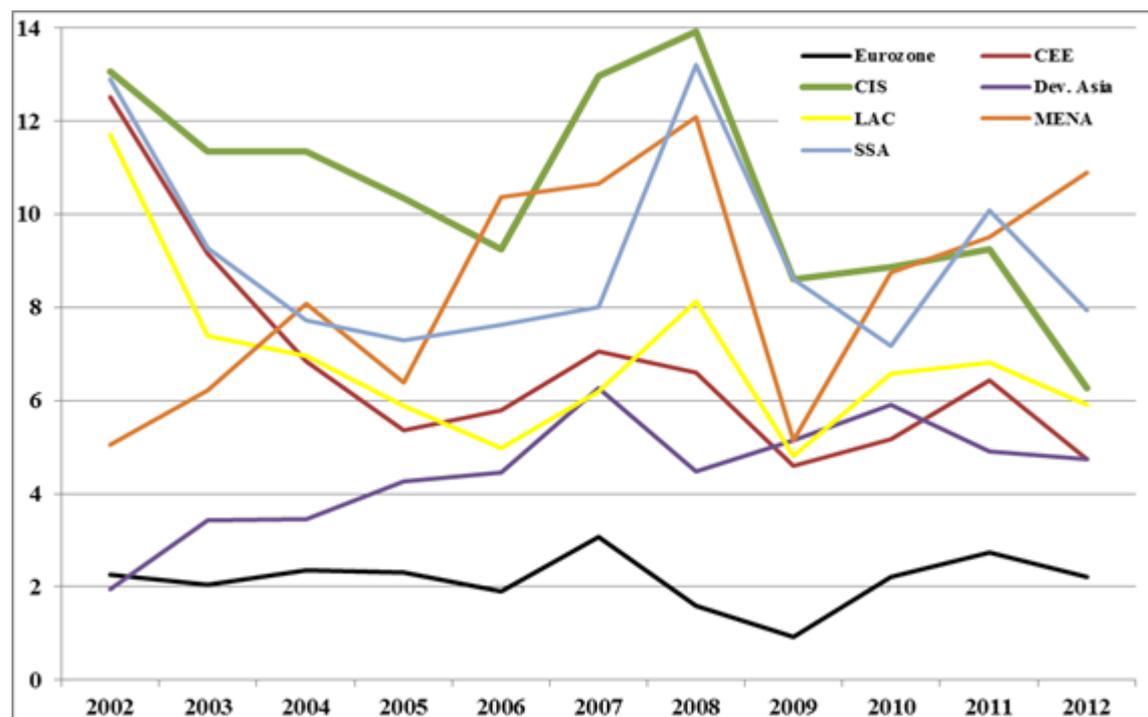
Warsaw

Poland

This article is based on a larger study prepared for the Bank of Finland Institute for Economies in Transition (BOFIT).

¹ In this article 'CIS countries' mean twelve former Soviet republics (all but Baltics). Formally, Georgia left the CIS in 2009.

Figure 1 Major regions: end-of-year annual CPI inflation in %, 2002-2012



Source: IMF World Economic Outlook Database, April 2013.

Table 1 End-of-year cumulative CPI inflation, 2011, comparing to 2000 and 2005

Country	2000=100%	Rank	2005=100	Rank
Armenia	166.3	1	143.4	2
Azerbaijan	222.7	4	176.1	7
Belarus	1043.1	12	342.0	12
Georgia	198.2	2	148.9	3
Kazakhstan	241.0	6	173.2	5
Kyrgyzstan	229.9	5	190.4	9
Moldova	257.8	7	162.1	4
Russia	328.7	10	173.5	6
Tajikistan	315.3	9	190.1	8
Turkmenistan	209.7	3	140.5	1
Ukraine	288.7	8	203.9	11
Uzbekistan	407.0	11	200.4	10

Source: IMF World Economic Outlook Database, October 2012, Author's own estimates.

Corruption line in Baltics – the key differences between key countries

By Erkki Laukkanen

Introduction

Corruption has no unambiguous, universally recognised definition. The starting point, however, is always the abuse of a dominant position for private gain; either one's self, or an associated network. The greater part of corruption always remains an undetected, hidden crime (Johnston, 1996; Transparency Finland, 2012.).

Thus, measuring the scale of corruption is a difficult game: in order to grasp the big picture, several different gauges must be used (June, 2008). Even these only tend to reveal the tip of the iceberg, being based on actual detected cases of corruption (Kaufman et al., 2006; Johnston 2007). This issue was detected in Finland's National Integrity System project too (Salminen et al., 2011).

The best-known corruption index is the CPI, Corruption Perception Index, issued by Transparency International for over 20 years. CPI only measures corruption detected in the public sector. The ratings awarded to each country is based on the information obtained by 7 to 12 international institutions, each of which collect their data through their own means: the citizens in any given target country may not have been asked a thing.

Fortunately, Transparency International also collects data directly from citizens, who must know corruption in their own respective countries better than anyone else. This survey goes by the name of GCB, or Global Corruption Barometer. This rather underutilised survey has been conducted since 2003, excluding the year 2008. In a recent article, I have utilized these data to develop a competing index to CPI (Laukkanen, 2013).

In this article, I focus to Finland, Latvia, Lithuania and Russia.¹ The question is, how do these countries differ regarding detected corruption, i.e. detected by people on these countries. I apply the GCB data to engineer a new integrity index (II) based on the perceptions of the citizens to cover the period from 2004 to 2010. Then I compare the results of II to results of CPI, Corruption Perception Index, and finally I shortly comment the differences.

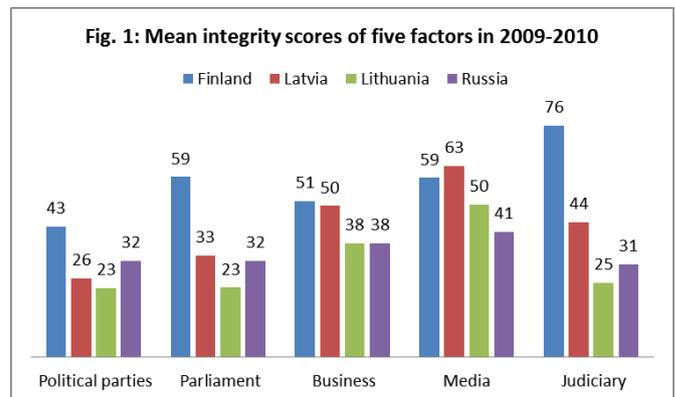
Integrity Index (II) by its constituents

The five contributing factors largely cover both the private and the public sector. These factors are the political parties, the parliament, the business community, the media, and the judiciary. Each factor has been assessed by the respondents on a scale from 1 to 5: not corrupt at all – entirely corrupt. I reversed the numeric scale and expanded it to span from 0 to 100: entirely corrupt – not corrupt at all. Finally, I added the five factors together and divided the sum by five, after which we also had the total index (the Integrity Index or II) ranging from 0 to 100 points.

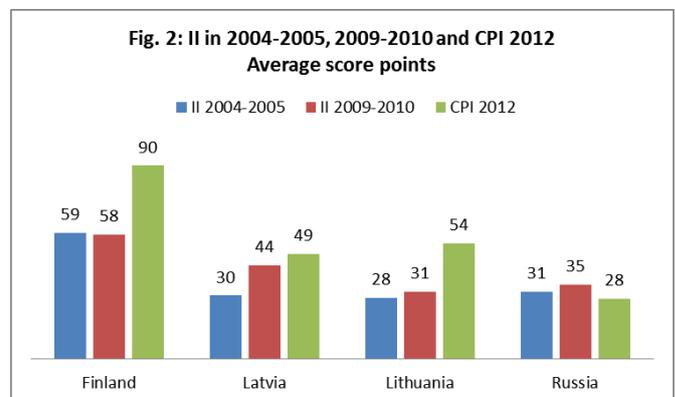
Working in this manner, the Integrity Index is revertible to its original sources, and the variation in its constituent factors may be evaluated in the same fashion as the variation of the II itself. There is an added bonus: the II becomes comparable with the CPI (Corruption Perception Index) after its update in 2012. It is, therefore, now possible to assess the differences between the CPI and the II deducted here. Core information

of the constituent factors and their development may be found in figures 1 – 3.²

As seen in Fig. 1, Finland scores best in all constituents of the II. Especially, Finland's judiciary (76 pts.), parliament (59 pts.) and political parties (43 pts.) score much better than those in comparison countries. Regarding business, Latvia (50 pts.) is very close to Finland (51 pts.), and regarding media, Latvia (63 pts.) scores better than Finland (59 pts.). Moreover, Lithuania (50 pts.) is close Finland too. The data shows that since 2004 Finland's premium vis a vis to other comparison countries has decreased. Besides, the data shows that Latvia has increased its points especially regarding judiciary, business and media.



In Fig. 2, I show the development of the Integrity Index (II) from 2004-2005 to 2009-2010 and CPI 2012, i.e. Corruption Perception Index 2012. Regarding II, Finland's score points have not changed from the mid 2000s to the end of 2000s. In Lithuania and Russia score points have increased some, i.e. 3 to 4 points. But in Latvia score points have increased a lot, i.e. 14 points. And when it comes to CPI 2012, difference to II is significant in Finland and Lithuania: CPI scores those two countries much better than II does. But in Latvia and Russia, II and CPI produce around the same scorepoints, i.e. the differences in score points is "only" 5 to 7 points. Russia is the only country, where CPI produces less points than II does.



¹ Unfortunately, Estonia was included only in 2004, and even then with a quite small sample. Therefore, I had to drop it off.

² Unfortunately, the number of observations for Estonia, Latvia and Lithuania was so small that I had to pool them together to Baltic.

Conclusions

Detected corruption is only the tip of the iceberg, and, therefore, all country comparisons are sensitive to available data and the study set up. In CPI, Corruption Perception Index, country rankings arise from indirect measurements of 7 to 12 international institutions. CPI ranks public sector only. In GCB, Global Corruption Barometer, country rankings arise from direct questioning from the people. GCB asks about private sector too. Therefore it is not surprising that rankings, as well as scores behind the rankings, between the two measurements may differ.

In this article I have utilized the latter way of measurement, i.e. asking directly from the people, to find out how corrupted people find Finland, Latvia, Lithuania and Russia regarding political parties, parliament, business community, media, and judiciary. The results suggest that Finland's position regarding all these five constituents, and especially in judiciary and parliament, is far better than in comparison countries. But, during the 2000s, the difference between Finland and comparison countries has got smaller, and especially so compared to Latvia. In many respects, these results differ from those produced by CPI.

These results may be tentative, but certainly they justify the question, how do we actually differ from each other? Such a question is not to be answered by means of CPI, since it measures only detected corruption and that only in the public sector. However, both measurements are needed. The truth, however, may be somewhere between the two measurements.

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Bumps ahead

By Lars Johannsen

The restructured and recalibrated civil services in the three Baltic states have performed beyond their wildest dreams. In less than twenty years, they have been transformed from being political tools in an oppressive planned economy to being able to manage market economies in open democratic settings. Moreover, administrations have simultaneously been able to negotiate entry into and implement the policies of the EU and NATO. Perhaps only optimists without any sense of realism would have thought this likely twenty years ago.

Despite the success, much still needs to be done, and as the administrations find their feet, it is important to maintain and build capacity and, by careful reform, weed out corruption and political favoritism.

First, the civil service, that is, both the central and subnational level governments, was somewhat bloated twenty years ago compared to other East Central European countries. This could be expected given the Soviet inheritance, the relative smallness of the countries and the sheer magnitude of the process of Europeanization and marketization. However, given the financial burden of footing reforms has been important. In this regard, Estonia has been the most effective. Although the relative wage bill has increased, excess workforce has been sheered, on average, retaining a leaner civil service with a better blend of competences.

Second, the administrative development has been driven by necessity. In the accession process the prime ministerial offices and various EU-integration departments proved to be at the cross-roads of power. In a similar vein, the central banks retained much economic expertise and oversight given the need to secure the new currencies and develop the banking sector. However, the financial crisis and the subsequent belt-tightening have moved the ministries of finance to prominence. The present financial crisis is the third or perhaps fourth in the last twenty years, and it is time to take the long view.

The possible lesson is that the small and open economies are and will continue to be vulnerable to economic shocks. All the more, it is important to improve the in-house capacity of economic, financial and administrative advice and stimulate independent research at universities.

Third, there is a need to cut red tape and corruption to strengthen the market and improve the quality of democracy. A 'helping hand' of the East Asian type is not what is needed but a continuous drive to reduce the burden of red tape. For example, the number of procedures required to start a business or simply to have your firm connected to electricity is still higher in all three countries than, say Denmark, with a slight tendency that Lithuania has the most cumbersome procedures of all.

It is not that the administrations risk becoming 'grapping hands', which is a profound description of the politicized administrations in neighboring countries further to the east, as civil servants in all three countries are equipped with the right moral compass. All surveys demonstrate that civil

servants are well aware that nepotism and bribery circumvent democracy and break codes of good public administration. Indeed, the majority of civil servants support a stronger stand against corruption, including increased penalties for wrongdoers. However, a moral compass only shows the direction. Even if Estonia's favorable ranking, compared to the two southern states, on corruption perception indexes is taken at face value, the sad case is that corruption, favoritism and illicit networking are a problem for all three administrations.

Reducing red tape will lower the demand for expediency money or grease, but it is not a cure in itself for a problem that penetrates the political life. For example, Latvia's former president, Vike-Freiberga, was very outspoken when she lambasted the members of the parliament for their shadowy affairs in 2007.

The three countries have adopted different policies to combat corruption, and while the jury is out with respect to the *best policy*, the probable answer is that an alliance between investigative journalism, active NGO's and a determined government to increase transparency is needed. Developing an *esprit de corps* of the civil service stressing classical values of *servicing* the citizens is much needed in the Baltics as it is increasingly the case in the West following decades of NPM reforms stressing efficiency and effectiveness. Considering the Roman question 'cui bono?', it is, however, difficult to see strong impetus for anything but symbolic reforms. If other issues appear as bumps along the way in the light of the track record of the first twenty years, corruption is the stickiest of all the problems in the administration and in the political life. It is perhaps also the issue with the most serious consequences, as witnessed in the Greek tragedy of the last year.

Finally, administrative reforms have been sponsored by whoever partner is willing to sponsor a project. Thus, 'islands' have been targeted at the mercy of whatever theory or pet project, whether that be NPM, HR, agencification or something else currently in fashion at the partner's end. Eventually, national administrations will amalgamate, bearing their own culture. Until then, expect your meeting with the Baltic administrations to be a very *different experience*, not only between the countries but also within them.

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The chances for reconciliation between Poland and Russia

By Stanisław Bieler

It is worth looking at the chances for reconciliation in Polish-Russian relations from the perspective of the geopolitical change that took place with the collapse of the bipolar system. Previously a Soviet satellite state, Poland became NATO's biggest and the EU's immediate neighbour of Russia. The Polish-Russian border also acts as a line separating the Western world and the post-Soviet area, which, according to Russia, constitutes its zone of privileged interests. It is a natural "axis" of cooperation between large groupings of countries, but also an "axis" of confrontation and competition for influence, benefits and control. In this sense, Polish-Russian relations are burdened with the implications of the strategic conflict that has existed for centuries between the Western world and Russia. All the problems related to Poland's international security, including energy security, are derived from this historical conflict. In addition, there are disputes over the visions of neighbourhood and the burdens of history, which is understood as an instrument of current policy.

The chances for reconciliation in Polish-Russian relations are determined by a rebuttal of three myths based on false geopolitical codes.

The first myth concerns the wrong assessment of Poland's geopolitical situation. This leads to a belief in a permanent German and Russian threat ("German-Russian condominium") on the part of some elites. True, Poland is not an independent player in the international arena. It is unable to develop any strategy that would free it from the influence of its largest neighbours. Thus, the sooner it chooses to engage in joint ventures with them, the fewer illusions it will have about sovereignty and independence. It is particularly important to stop treating Russia as part of the so-called adversarial area. Neither modern Germany nor Russia is a revisionist and belligerent state. Russia does not exhibit any aggressive, warlike intentions towards Poland. They constitute an abstract, imaginary threat. Reverting to Cold War stereotypes does not lead to solving real problems which are faced by all the states and people of the world.

The second myth is derived from anti-Russian phobias and concerns Ukraine. It is about extricating it from the Russian sphere of influence, which proves to be an impossible task. Not only because of the balance of power between Poland and Russia, but also because of the policy of Ukraine itself. The assumption of the convergence of strategic objectives of Poland and Ukraine, which are supposed to share the anti-Russian policy vector, has turned out to be false. That's because Ukraine is a politically ambivalent country (it has repeatedly declared its commitment to a multi-vector policy) and much suggests that intrigues played out between the Western countries and Russia around it do not bring Poland any benefits. On the contrary, it is exposed to losses, as evidenced by Russian economic moves (an embargo, resource transport routes bypassing Poland). Having no possibility to influence the course of events in the East, Polish political centres stubbornly emphasize the necessity to maintain the Ukrainian buffer effect between Poland and Russia. It is a cultivation of confrontational thinking about "containing" Russia, based on suspicion and distrust. It means these centres are nowhere near reconciliation and normalization with Russia.

The third myth relates to the alliance with America, which is supposedly an antidote to Poland's geopolitical troubles in Central and Eastern Europe. But taking on the role of America's "armed wing" is a mistake. The U.S. strategy toward Russia does not correspond to the interests of a country like Poland. According to scenarios drawn up across the ocean, it may seem that Poland is supposed to act more as a "bolt" against Russia than a catalyst for rapprochement. For what is the purpose of a permanent U.S. military base on Polish territory if not to bolt Russia? The military demonstration of a "durable partnership" with Poland by the

United States means that the Polish state is an essential element of U.S. plans for presence in Europe. Thus, understanding the logic of America's imperial expansion, which inevitably collides with similar imperial plans of Russia, only one conclusion can be drawn for Poland: any attempt for its rapprochement with Russia will clash with the functions it has been assigned in the U.S. strategy. The pro-American bias of political elites is a "cornerstone" of Poland's foreign policy, so there is a permanent conflict between affiliations with America and an improvement in relations with Russia. In the long run, Poland's bet on America is doomed to disappointments and failures in the normalization processes with Russia.

Polish political elites are unable to determine their own geostrategic paradigm and put it in the context of a changing U.S. hegemony and the shift to a polycentric world. The awkwardness in explaining Poland's *raison d'état*, for example in the context of the revelation that the highest authorities agreed to assist the U.S. secret services in detaining and interrogating terrorists on Polish territory, shows an intellectual weakness of decisions makers. First and foremost, it is unclear what is the price for Polish interests when it comes to supporting the U.S. ally. It was clear to see in the participation in the Iraq war, now it is clear to see in the participation in the Afghan intervention. Polish political elites, both right-wing and left-wing, by constantly expressing concern over a renewed dependence on Russia, uncritically succumb to American geopolitical visions, related to the encirclement and fragmentation of Russia (the so-called Anaconda policy), and this means, for example, that Polish secret services (in particular intelligence) become hostages of foreign geopolitical concepts (CIA prisons in Poland could be only the tip of the iceberg). It's a wonder that Poland fails to see the dependence and a threat to its national values here.

Rebutting these myths is not easy. They can be, however, offset by new strategic concepts, among them the idea of the "Kaliningrad triangle", resembling the "Weimar triangle". Reconciliation and partnership with Germany and Russia require courage and determination of elites, so as not to give in to concerns and warnings, typical for Polish mentality, that a smaller and weaker Poland will once again become a victim of expansion of the two powerful neighbours. Making a case for this idea, it is worth referring to the optimal use of Poland's geographical location along the European continent's most important transport routes. Polish geopoliticians have long suggested taking advantage of these opportunities, for example in the form of building a high-speed rail line Paris-Berlin-Warsaw-Moscow, or an energy bridge Olsztyn-Kaliningrad. Indeed, the Russian Baltic exclave could be used as an important place for reconciliation between the three nations and the launch of a new, common future.

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15 years of support for cities' urban health planning in the Baltic Region

By Johanna Reiman

Urban health remains a timely topic in the ten countries surrounding the Baltic Sea. The establishment of the Baltic Region Healthy Cities Association in 1998 was part of an effort to support cities belonging to the World Health Organization Healthy Cities programme. The Baltic Region Healthy Cities Association, based in Turku, Finland, promotes health conditions in urban areas in the Baltic Region and supports WHO policies, which concentrate on urban health issues. The WHO Healthy Cities movement supports comprehensive and systematic policy and planning for health. It emphasizes participatory governance and the social, economic and environmental determinants of health and seeks to build a local level movement for health promotion. The Baltic Region Healthy Cities Association aims at increasing the awareness of local governments to make health a central factor in the policymaking process of municipalities.

Since 1987 the WHO Healthy Cities programme has promoted crosssectoral health and wellbeing work. Health in All Policies underlines the importance of bringing health considerations toward the forefront of strategies and actions of cities. Health can and should be promoted in, e.g., education, urban planning and transport as well as the social and welfare sectors of municipalities. Health promotion is a cost-beneficial activity. Members of the Healthy Cities network can learn from each other and exchange ideas and practices.

The Baltic Region Healthy Cities Association has served as a World Health Organization Collaboration Centre for Healthy Cities and Urban Health in the Baltic Region since 2002. The founders of the Association were the city of Turku, the University of Turku and the Social Insurance Institute of Finland. Åbo Akademi University and the Turku School of Economics (now a part of the University of Turku) soon joined as members. The members lend their expertise to the Association's urban health endeavours.

Supporting Healthy Cities in the ten countries surrounding the Baltic Sea has been the core of the Association's work. At present, cooperation is ongoing, e.g., with Russian, Latvian and Nordic cities and networks. In 2012-2013 the Association has also supported Lithuanian and Estonian networks primarily by lectures at conferences and common training sessions. There are now 25 cities in the Healthy Cities network in the Baltic Sea region. The network is growing and Saint Petersburg and Riga are among the applicant cities. When taking into account municipalities in the national networks there are about 280 of them in the Healthy Cities network in the Baltic Sea region.

In the first years of the Baltic Region Healthy Cities Association, sexual health projects were conducted in Estonia and Russia. Other projects have centered on, e.g., HIV/AIDS, promotion of physical activity and tackling non-communicable diseases. At present the Association is involved in a project of the European Union to combat potential years of lost lives in the Kalininsky District of Saint Petersburg. The Association started its first-ever EU 7th Framework Programme's project in December 2012. IROHLA (Intervention Research On Health Literacy among the Ageing population) focuses on improving health literacy for the ageing population in Europe by improving competencies and empowerment of older adults and

providing innovative tools for services. Most of the Association's projects have included actions to combat health inequities which continue to rise in Europe and in the countries around the Baltic Sea. The Association cooperates with health promotion experts from many different countries.

Active communication is an essential part of the Association's work. Regular newsletters are sent and articles are written for both local and international newspapers and journals. Furthermore, the Association's experts are often invited to speak at Baltic Sea countries' national and international conferences and seminars.

The Turku School of Economics, the University of Turku and the Baltic Region Healthy Cities Association organized Well-Being in the Information Society conferences in 2006, 2008, 2010 and 2012. In 1999 the city of Turku and the association hosted a Healthy Cities conference and in 2006 the Annual Business and Technical European Healthy Cities conference in Turku. The 8th WHO Global Conference on Health Promotion will be held in Helsinki on 10. - 14.6.2013 and the Association is involved in its arrangement.

Healthy Cities is a unique concept in which the World Health Organization works directly with cities instead of national governments and ministries. Healthy Cities have remained and continue to develop as a lively ideology. The WHO Healthy Cities programme has created a health-promoting philosophy, leaving the choice of actions to member cities in 30 European countries belonging to the network. Many of the ideas tested in the Healthy Cities network have later been implemented and brought into practice in cities and municipalities and as parts of national legislation. An example of this is the wellbeing report of Finnish municipalities.

We are born with certain genes. However, there are many issues in our preschool, school, work and living places which affect our health. The cities' role is crucial in ensuring that all citizens can live up to their maximum potential. The Healthy Cities programme deals with physical, mental and social wellbeing, giving cities inspiration for cross-sector health promotion.

The difficult economic situation in present-day Europe means that more – not less – emphasis should be put on health promotion. Resilience and empowerment of citizens is one of the key messages of the Health 2020, a European policy framework and strategy accepted by the 53 World Health Organization European member states in 2012. The Baltic Region Healthy Cities Association continues to develop, maintain and strengthen knowledge of health and wellbeing promotion in the cities of the Baltic region.

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Finland



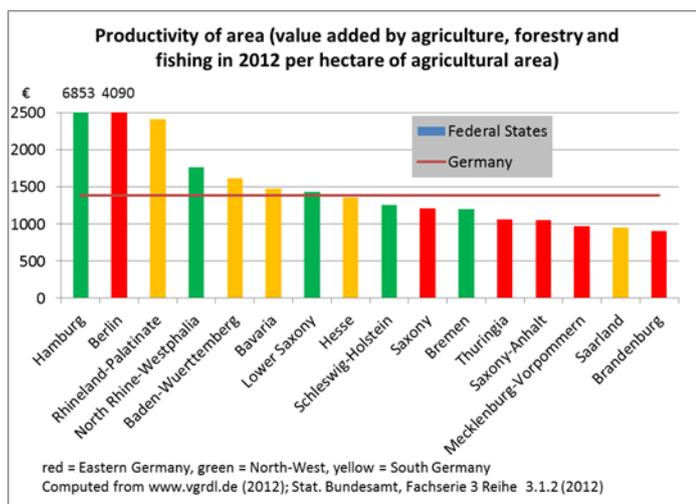
Rural areas of Eastern Germany

By Helmut Klüter

Eastern Germany includes the Federal States of Mecklenburg-Vorpommern, Brandenburg, Berlin, Saxony-Anhalt, Saxony and Thuringia. It is the territory of former GDR which in 1990 was reunified with Western Germany. In Eastern Germany there are living 16 million inhabitants (less than 20 per cent of German population) on 108 thousand square kilometers (30 per cent of German territory). Only 11 of 80 towns of more than 100,000 people are situated in Eastern Germany. Thus, Eastern Germany is less urbanized than Western Germany. On the other hand, one third of all German agricultural area is concentrated in the Eastern Federal States. The average agricultural area in Western Germany is about 46 hectares per unit while in eastern Germany it is more than 230 hectares. That means that agriculture is more industrialised in the East. Soil and technical conditions for agriculture are better in Eastern Germany as more than half of Western German territory is mountain area.

By this Eastern German agriculture is expected to be more productive than Western German. But reality shows the opposite: In 2012 value added by agriculture was 1558 Euro per hectare in Western Germany, but only 1027 Euro in Eastern Germany.

Figure 1 Productivity of area



This is not only the picture of the year 2012 but that of the last two decades. There are several reasons: In Western Germany 86 per cent of the land is owned by small and medium sized family farms. The big agro-industrial firms owning 73 per cent of agricultural area in the East produce mainly cheap mass goods like grain, maize or raps. Most of them are not able to grow expensive fruit, vegetables or flowers because they do not employ enough labor. In the average, in the Eastern Federal state of Mecklenburg-Vorpommern there is working only 1.3 persons on 100 hectare while in North Rhine-Westphalia (Western Germany) there work 4.3 persons. The agriculture of North Rhine Westphalia is mainly based on family labor (69,200 persons) not so much on paid laborers (17,500). In Mecklenburg-Vorpommern there are only 4,500 family persons working in agriculture but 14,900 paid laborers. For a family farmer it makes no sense to leave his family without work. So he tries

to intensify production f.e. by gardening or creating income combination with tourism, direct marketing his products, rural craft and others.

The big agro-industrial business is not interested that much in intensification. They mainly live on subsidies from the European union. The owner of a 1,000 hectare enterprise got 344,000 Euro subsidies in 2012. In Germany most of EU subsidy is spent according to area, i.e. 344 Euro per hectare (average). In 2012 the number of enterprises that got more than 300,000 Euro a year was 1,844 units or 0.55 per cent of all agricultural land owners. They got cumulated 988,323,213 Euro, that means 16.96 per cent of all subsidy money. 952,887,238 Euro of this sum were reserved only for Eastern German agro-industrial business. Being supported by so much money, the business needs not to worry about sensitive plants like flowers or vegetables. The subsidy productivity is much lower in Eastern than in Western Germany. In Western German Rhineland-Palatinate 1 Euro subsidy generated more than 8.88 Euro value added by agriculture (2012). In North Rhine Westphalia it generated 4.60 Euro, but in Eastern Germany only 3.03 Euro. The lowest rate of 2.88 was found in East German Mecklenburg-Vorpommern, the Federal State, in which the agro-industrial business gets more financial support than in any other federal state. The enterprises compensate low productivity by low investment. Thus profit is high enough to buy more land and to get more subsidies. Another instrument to suppress family farms is price dumping. The links between agro-business and food industry are rather tight. By this agro-business does not only attack family farms in Eastern but also in Western Germany. Each year about 7,000 family farms – mainly in West Germany – are closed down.

A second factor fostering the development of huge agro-industrial business in Eastern Germany is lack of technical and political control. As the Eastern German Federal States do not have so much population, not so much industry, no large banking and no financing facilities they cannot afford such monitoring and controlling organizations like in Western Germany. In nearly all parts of Western Germany only agricultural professionals are allowed to buy agricultural areas. In Eastern Germany everybody can buy agricultural land. Investment funds and other non-agricultural enterprises are buying land in great quantities so that the prices for agricultural land are so high that family farmers cannot acquire them. The largest buyer of land is the investment organization KTG Agrar owning more than 27,000 hectares.

The largest seller of agricultural area in Eastern Germany is the Federal privatization agency BVVG. When the agency was founded during the reunification process in 1992 the first target was giving the land back to the private owners that were expropriated during communist GDR period. But soon the Federal Minister of Finance gave the order to sell the land to those who pay the highest prices – i. e. mainly to the former directors of socialist production units, to agro-industrial business and to several investors from Western Germany and the Netherlands.

The effects of this policy on rural areas are destructive. The big agrarian businesses that reduce labor get more public financial support than the rural municipalities. During the last two decades the Federal state of Mecklenburg-Vorpommern has lost 200,000 working places in agriculture. Only 27,000 remained up to 2012. Mass emigration from

rural areas was the consequence. Since reunification several rural regions of East Germany have lost more than 70 per cent of their population.

Though Eastern Germany has better soil and climate conditions for growing plants and cattle the large scale agriculture is not able to supply cities like Berlin or Leipzig with enough food. More than two thirds of ecological clean food has to be imported from Western Germany.

A change in this negative development is only possible if German Federal Government and the EU commission will limit subsidizing agro-industrial structures, i. e. including estates of more than 500 hectares or more than 2000 pigs or more than 500 cows.

Secondly there must be organized a municipal reform. Each municipality must be able to solve the constitutional tasks of administration. Today in Mecklenburg-Vorpommern only 7 per cent of 784 municipalities are strong enough for this.

Thirdly public planning of rural regions has to stop supporting agro-industrial business. The planning authorities should try to diversify production in rural Eastern Germany – like in Western Germany.

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The Interreg IIB BSR programme as a tool for developing a unified transport system in the Baltic macroregion

By Ivan Gumeniuk

In the Baltic region, the intensification of regionalisation processes resulted in the successful development of a special form of international activities – transboundary cooperation, which can be defined as an aggregate of bilateral and multilateral connections between authorities, economic entities, NGOs, and the residents of border regions of two or more countries.

An important objective of transboundary cooperation in the Baltic region is the reduction of socioeconomic disparities between individual countries and regions, first of all, between the “old” and “new” EU member states. Transboundary cooperation is beneficial for all parties. Some regions gain access to new markets for their produce and get an opportunity to involve new participants in the area of their economic influence, others get the opportunity to synchronise their socioeconomic development with that of regional leaders and attract foreign investment.

Transboundary cooperation covers all development areas. One of the key elements is the transport system, which is explained by the essential role transport plays in the Baltic region. One can identify three different functions of transport, which justify such close attention to the problems of its development:

1. *The institutional function.* The Baltic region’s transport system is both an object of transboundary cooperation and a key tool of network cooperation in the region. Alongside the telecommunications industry, the transport system ensures interaction between all participants of the network cooperation.

2. *The regional function.* For many countries and regions of the Baltic Sea, transport is one of key specialisations making a significant contribution into the GRP and ensuring a sufficient employment rate. For them, the development of transport system is a necessary condition for sustainable socioeconomic development.

3. *The global function.* Within the global transport system, the Baltic macroregion encompasses key transport routes supporting global cargo and passenger traffic between European and Asian countries. In such conditions, the qualitative development of the Baltic region’s transport system allows the region to remain competitive in the world arena playing an increasing role in the global cargo traffic. In this case, transport ceases to be an industry of internal competition between countries and transforms into a strategic tool of global positioning of the macroregion.

An important tool for implementing international network projects aimed at enhancing the macroregions transport system is the Interreg IIB BSR programme initiated and financed by the European Union.

Out of 129 projects implemented within the programme, 28 focused on transport problems (21.8%); 29 out of 134 mln

Euros of the total programme budget were allocated to these projects. Transport projects involved the largest number of partners. If, on average, 24.8 partners took part in one project, in case of transport project, the average number of partners reached 27.6.

From the results of transport project implementation, one can conclude that a developed network axis (South Finland – South Sweden – Denmark – North Germany) has formed in the Baltic region; it brings together the most economically developed regions of the macroregion, which participate in all transport projects as principal partners. Their experience was used in the development of transport systems in the other Baltic regions. Another proof is that in only 4 out of 28 transport projects, the principal partner represented one of the “new” EU members (once it was Klaipeda and Gdansk and twice Riga).

The Russian participation in the implementation of transport projects was rather active. Out of 28 projects, 21 involved Russian partners. In the framework of the programme in general, Russian organisations participated in 78 out of 129 projects (approximately 60%), whereas, in case of transport projects, this share is more substantial (75%). Such active involvement of Russian partners suggests that the European countries are perfectly aware of the role the Russian party plays in the formation of the unified transport system in the Baltic region. For Russian region, integration into the unified transport system will help develop a transparent competition mechanism, which will gradually transform into cooperation.

In conclusion, one must emphasise the importance of the Interreg IIB transport project. It relates not only to the results of the improvement of the Baltic region’s transport system, but also to the shared understanding of the need to establish long-term contacts in the field of transport. Such contacts ensure the coordination of development of national transport systems with common interests and promote a strategic understanding of the targets and objectives pursued by the Baltic macroregion – a region that serves as a good example of successful development of network cooperation in the 21st century.

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Promoting business education in the Baltic Sea Region – the case of the Latvian-Russian cooperation

By Anatoly Anishenko and Aigars Rostovskis

Nowadays business education, as a part of the higher education system, is becoming more of a factor, defining economic, socio-cultural and political trends in the Baltic Sea region (BSR).

However, it would be quite difficult to state that the cooperation between Russian and Baltic business schools has resulted in success or has obtained advanced progress. Business education market in these countries is relatively young with a history less than 20 years. Its structural patterns and curricula are mainly oriented towards the US and Western Europe.

Experts believe that Latvia is the most promising Russia's partner in the sphere of business education. First, Latvia has achieved a greater success in this field as compared to other Baltic States. Second, there is a growing 'social demand' because the Latvian-Russian economic relations are booming. Latvia is leading among the Baltic republics in turnover with Russia, which takes the second place in Latvia's foreign trade priorities. Latvia encounters more than 2,600 enterprises registered with Russian equity capital.

It should be noted that the Latvian and Russian business education systems have much in common. For example, they evolved through three similar stages:

1. Post-soviet period, during which education institutions introduced a two-tier system (Bachelors and Masters Degrees).
2. Accreditation period.
3. Introduction of the Bologna Process (BP) principles in full and adjustment to the European educational standards.

There are several factors that could provide interaction between the two educational systems:

- Strong cultural, social, and economic links between Russia and Latvia.
- Both Russia and Latvia have joined the BP that aims at integration and harmonisation of the European higher education system.
- The countries have built similar systems of business education which is based on state universities and private business schools.
- Russia and Latvia have a solid knowledge about each other's higher education systems which have a compatible methodological basis.
- Business education is institutionalized into a competent and relatively independent higher educational sub-system.
- The two countries have a proper international legal framework which is an objective prerequisite for their sustainable interaction in the sphere of business education. The two countries have adopted the EU Road Map of 2005 on the Common Space of Research and Education, Including Cultural Aspects. This allows the two sides to specify the agreement points, in particular to introduce joint or double BBA and MBA degrees and ensure their convergence and mutual recognition.

Russia's cooperation with Latvia (and other Baltic States) in the field of business education develops in two major forms. The first one is an inter-university cooperation. A number of Latvian and Russian universities (mostly from the country's north-western part) have bilateral agreements on academic staff and student mobility as well as on promotion of joint degree programs. From our perspective, joint training programs - especially in such areas as Business Administration, Management, Finance and Credit, Banking,

Logistics, Tourism, Information Technology, etc. – should be primary priorities for the bilateral cooperation. Broad prospects for business education development are opened up by new teaching techniques based on information technologies such as distance learning, teleconferences, interactive education modules, simulations and role games, etc. Stable contacts between universities can - in the long term perspective - ensure cumulative development of the Latvian-Russian business projects, as well as a positive trend in political relations.

Cooperation between the entrepreneurial structures (individual companies, chambers of commerce, SME support institutions, training and re-training centres, etc.) is the second form of the Latvian-Russian cooperation in the sphere of business cooperation.

One of the leading business schools in Latvia Turiba University set up cooperation ties with Russian partners in number of fields including the programs in International Tourism and hospitality management, International economics and International business management. Turiba University has strategic partnership agreement with the Nizhny Novgorod region Chamber of Commerce and Industry.

However, despite the existing objective prerequisites, cooperation in the area of business education between Russia and Latvia is limited to specific sectors and individual cases. Whereas European business schools attract the flow of students from China, India, Turkey and other countries, the number of international students in Russian and Latvian similar educational institutions is not large.

To conclude, Russian and Latvian business schools have accumulated certain cooperative experiences. To make a better use of these experiences and further develop business education in the BSR this sector of the higher education system should be given a priority attention both from the governmental and private actors. A sort of a public-private partnership to promote business education in the region is in a high demand. The sub-regional institutions such as the Council of the Baltic Sea States, Baltic Sea States Sub-regional Cooperation, Union of Baltic States, Baltic Development Forum, etc., can be helpful as well.

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New opportunities for Kaliningrad in the development of Russia-EU relations

By Gennady Fedorov

The 1990s saw an animated discussion on the possible role of the Kaliningrad region as a pilot region in Russia-EU relations. In the early 2000s, Kaliningrad scholars put forward the idea of the region acting as a special “development corridor” between the most developed core regions of Russia and the EU neighbours of the region.¹ However, the favourable geographical potential for implementing such function has not been fully untapped. It is explained by certain cooling of the relations between the parties in the 2000s. Moreover, by 2013, the Kaliningrad has achieved certain success in the development of Russia-EU cooperation; the intensity of mutual connections is comparable only to that at the Russian-Finnish border.

The best results have been obtained at the Russian border with Poland, where local border traffic was introduced in the framework of a Russian-Polish agreement signed in summer 2012. It gives the residents of the whole Kaliningrad region an opportunity of multiple visits to the adjacent Polish regions, including Tricity (Gdansk-Gdynia-Sopot), Elbląg, Olsztyn, and the famous tourist centres of Mikolajki and Mrągowo with specially issued documents (cards). The reciprocal tourist flows have increased significantly, although Kaliningraders visit Poland predominantly for shopping purposes and the Polish Russia for cheaper petrol. However, the education, recreational, and business tourism does develop simultaneously; prerequisites for the further development of cross-border cooperation in manufacturing and the social sphere are being created; the relations between people living astride the border are getting warmer.

Despite the assurances of both parties and the need for a similar Russian-Lithuanian agreement, a positive decision has not been reached yet. However, the economic ties between Kaliningrad regional enterprises and those operating in the neighbouring Polish and Lithuanian regions have been developing successfully. In the structure of foreign investment that was made in the Kaliningrad region in 2011, Poland ranks second (following the pseudo-foreign investment from Cypress), Lithuania third. In the mutual trade between the Kaliningrad region and foreign countries, Poland ranks fifth and Lithuania seventh.

Russian accession to the WTO is a factor that can contribute to the development of export orientation of Kaliningrad production. Such change in the orientation of the current import substituting industry based on the customs privileges ensured by the law on the special economic zone in the Kaliningrad region is emphasised in all regional development strategies drawn up in the 2000s.

The current restructuring of regional economy is aimed at a broader use of the internal specific factors of regional development. It will help mitigate the impact of the changes to the law on the special economic zone in the Kaliningrad region to be introduced in 2016 – the abolition of customs preferences determining the prevalence of import-substituting production in the field of manufacturing against the background of a low value of marginal product in the region.

The strategy approved in 2012 does not only stress the development of tourism, the amber cluster, and other industries using the special internal resources of the region. The development of automotive cluster suggests a substantial increase in the added value generated in the region. Special attention is paid to the development of tourism. The construction

of the first unit of the Baltic nuclear power plant of a capacity of 1.2 GW is expected to be concluded in 2016, that of the second unit of the same capacity in 2018. The regional government finances the development of equipped industrial platforms that are expected to attract investors. Significant funding for the development of industrial and social infrastructure (including the preparation for the 2018 World Championship football matches) will be received from the federal budget in the framework of a new state programme for the socioeconomic development of the Kaliningrad region adopted in the end of March 2013. Such measures will help create an economy independent of the customs privilege regime of the special economic zone operating since the early 1990s. A need for such actions is determined by the 2016 abolition of privileges stipulated by the 2006 law on the special economic zone.

The development of cooperation with the neighbouring EU countries is suggested by all regional development strategies. The development of international industrial cooperation leads to the formation of new spatial forms of international economic integration. Cooperation is developing in the framework of five Euroregions with the regional participation. The foundation for the tripolar Tricity-Kaliningrad-Klaipeda system is being laid at the moment, as well as that for the Gulf of Finland growth triangle, whose concept was formulated by the Finnish professor Urpo Kivikari. The introduction of local border traffic (visa-free) regime between the Kaliningrad region and the neighbouring Polish regions in mid-2102 will contribute to the development of mutual connections. There is a need for a similar Russian-Lithuanian agreement as a step towards a visa-free regime between Russia and the EU.

The meeting between the President of Russia and the students and professors of the Kaliningrad Immanuel Kant Baltic Federal University on April 1, 2013 in the presidential residence of Novo-Ogaryovo showed that the federal authorities count on the university to contribute to the development of different areas of international cooperation between Russia and the EU. The university is actively involved in the development of connections with Baltic partners, student academic exchange, and research on the problems of international cooperation in the Baltic, including those in the field of education and innovations. The studies emphasise the advantages that can be gained by Russian and the Baltic partners in the course of further development of all areas of cooperation.

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¹ I.e. the modification of regions of the development corridor type identified by J.Friedmann, 1966. See: Klemeshev A.P., Fedorov G. M. From an isolated exclave – to a “development corridor”. Alternative development strategies of the Russian exclave on the Baltic Sea (Engl.). Kaliningrad, 2004.

Possible strategies for the Kaliningrad region 2013

By Vladimir Balobaev

The Kaliningrad region is the westernmost point of Russia situated on the Baltic Sea coast between Poland and Lithuania. With Prussian history and retaining some pieces of architecture, the region was connected to continental Russia only through the Lithuanian Soviet Republic, and developed in the same way as many other Soviet cities. But after the USSR collapsed, Kaliningrad became from one side partly open for foreigners, but from the other – disconnected from Russia (Lithuania became an independent state). The exclave was put into very special circumstances – the region, with approximately 90% of the world amber deposits and many resort possibilities, became divided from Russia and had to find its way and strategy for development in the new conditions. The process of seeking an optimal strategy is still ongoing.

The long period after 1991 and before 2004 (when Poland and Lithuania joined the EU) was rather contradictory, with many possibilities accompanied by even more difficulties. Opened to foreigners after more than 40 years, Kaliningrad attracted a lot of tourists from Germany and many infrastructure projects too. With the financing from European funds and programs many projects were realized. Kaliningrad of that period had no chance besides trying to 'catch at a straw', as many straws as possible. As a result of many different processes, a Special Economic Zone law was implemented in 1996, but other attempts to give Kaliningrad a development vector did not succeed.

In modern Kaliningrad we see a very similar situation when authorities do not know what to do exactly and try to cover all possible scenarios. Instead of trying to find the 'chief' scenario, they are still trembling between many variables.

One of possible scenarios proposes to transform the current Special Economic Zone into a Free Trade Zone, where all citizens of Russia will be able to buy goods for personal use at reduced price and bring them back to Russia. It will increase cash flow and mobility, budget payments from taxes, and the possibility to develop two-in-one recreational and shopping tourism in the Kaliningrad region. This scenario seems very productive, but not very likely.

Another unlikely scenario is to make an export-orientated industrial zone with tax privileges for companies in the Kaliningrad region. It could bring new companies from EU countries to settle their production in the region with qualified and quite cheap labor. This scenario is not probable, because it requires many changes at customs, which Russian authorities do not like.

One more popular scenario is Kaliningrad as a 'bridge' between Europe and Russia, but different political actors understand this 'bridge' in their own ways. Some experts speak about tourism, another about building a common marketplace. Both views require a visa-free regime for incoming mobility. Many experts think it is not very difficult to eliminate visas for incomers (i.e. EU citizens), but in that case, authorities need to decide what to do with Kaliningrad citizens, because if it will be only a one-sided decision, social conflicts can occur.

Moscow expert Vladislav Inosemtsev in his article 'Island Kaliningrad' claimed that all these scenarios will find support in Kaliningrad society, but Kaliningrad society is much dissociated and polls show that public opinion about the future of the region has not been formed yet. On one hand people want to live in clean and ecologically-safe region, earning money from recreational and historical tourism, but for many reasons, tourism in Kaliningrad cannot be the only strategy to win.

In 2007 a strategy of regional development for the Kaliningrad region was announced, prepared by regional authorities and experts. This strategy was prepared during George Boos' term and some of these ideas were brought to life (projects for building a new large port in Kaliningrad gulf and yacht haven in Pionersk), but in 2010 the new governor Nikolay Tsukanov was appointed by the president. He started the process of preparing a new regional strategy from the beginning, continuing the endless chain of attempts to find the proper regional strategy. A new 40 million rouble strategy from the McKinley agency, announced in 2012, recommended as usual developing the amber production sector, tourism and IT-technologies.

In April 2013 the Governmental Program for Kaliningrad Region Development until 2020 was signed by prime-minister Dmitry Medvedev. However, this program is only prescriptive and does not give a view on how and in what direction the region will develop in the nearest future.

Regional experts count around 50 different scenarios and plans for Kaliningrad's future which were announced and discussed after 1991. Many of them were rather similar and almost all were about how to modify Kaliningrad's negative sides (isolation, exclave etc.) into positive (advantageous geographic position, crossroad of cultures) and gain something visible from this. Most of these projects remained on paper. Speaking about strategies, experts agree only on one point – Kaliningrad needs a new program or strategy for regional development, which will be focused on special rules for economic management in the region, special custom and taxation law and integration in the regional economic system.

The year 2013 will show in which direction the region will move in next years, it will show – whether this Governmental Program for the Kaliningrad Region Development until 2020 matters or not, and in general – whether the scenario has been chosen or the search is still ongoing.

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