



**VALDIS DOMBROVSKIS**  
Ukraine – defending  
our values



**ALEXANDER RUMYANTSEV**  
Russo-Finnish relations  
about to turn 95



**HENRIK LAX**  
The Åland regime  
after Crimea



**BRE**  
REVIEW

# BALTIC RIM ECONOMIES

The Pan-European Institute publishes the Baltic Rim Economies (BRE) review which deals with the development of the Baltic Sea region. In the BRE review, public and corporate decision makers, representatives of Academia, as well as several other experts contribute to the discussion.

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VALDIS DOMBROVSKIS

# Ukraine – defending our values

Expert article • 1868

**A**s recent events show, instability in our neighbourhood can quickly and dramatically affect our daily lives. I am of course referring to the situation in the Middle East and North Africa but, equally importantly, the situation in our closest neighbourhood - Ukraine. It is imperative that we do not divert our attention from ongoing events in Ukraine.

The EU economy has only recently returned to growth, overcoming what was one of the most severe financial crises in its history. After an immense effort to stabilise the financial sector, consolidate public finances and introduce structural reforms, the Union is now focussed on unlocking investment, increasing productivity and accelerating the process of convergence to ensure that today's growth is not only maintained, but indeed strengthened, in the future.

However, even when all the right conditions are in place within the EU, external risks will remain and this may endanger future economic prosperity. In all fairness, we do not live in either a political or economic vacuum. Developments in our neighbourhood could potentially be the source of serious external shocks. Almost five years of the civil war in Syria and long-standing political instabilities in Africa have led to hundreds of thousands of refugees crossing EU borders in search of international protection and hope for a safer life. This means that close engagement with *all* key EU neighbourhood partners is vital to ensure that they are both economically and politically stable. Ensuring economic and political stability would allow a country to withstand aggression, be it military aggression or targeted propaganda or cyber-attacks, which are becoming increasingly prominent.

Ukraine is undoubtedly one of the EU's closest partners. Today, Ukraine is coping with significant negative economic and social consequences of political actions of the past. Since almost two years, the EU has been actively supporting Ukraine's reforms process, including with extensive macro-financial assistance, grants, EIB loans, subsidy re-investment programmes, and humanitarian assistance. With a total of the €7 billion that has already been mobilised for Ukraine - out of a total €11 billion support package - this is the largest EU financial assistance ever granted to a non-EU country in such a short time.

EU support, however, does not amount to the financial assistance alone. As of 23 April 2014, the EU unilaterally removed customs duties on Ukrainian exports to the EU, granting it preferential access. The annual value of this support measure was nearly €500 million in tariff reductions. As a result, this has gradually started re-orientating Ukrainian exports towards the EU. In 2016, the Deep Cooperation Free Trade Agreement between the EU and Ukraine will finally be in provisional application, bringing Ukraine and the EU even closer together.

Over the past eight months, Ukraine has made impressive progress on reforms, despite the conflict at its eastern border and its particularly difficult economic situation overall. This reform effort is

already bearing fruit, allowing Ukraine to weather one of the worst recessions it has ever experienced. After recording more than a 17% decline in GDP at the beginning of this year, Ukraine is expected to return to growth already towards the end of the year - for the first time since 2013. At the same time, it was possible to broadly stabilise the local currency – hryvnia – following the turmoil earlier this year. Stability of the currency also enabled moderate inflation in the country. In a nutshell, what we are now witnessing is the turning point for the Ukrainian economy. The country is gradually, but steadily, setting off on a recovery path. It is therefore essential to continue the reform course to make this recovery more sustainable.

A lot has already been achieved. In the area of public finance management, for example, external audit and transparency of public procurement have been strengthened, and progress has been made in reforming the financial sector. More, however, still needs to be done, particularly to fight corruption, reform the Ukrainian civil service and complete energy sector reforms.

The agreement that Ukraine successfully negotiated with its private creditors will give the necessary breathing space for the country to introduce the remaining reforms, without pressure from its creditors. In parallel, the international financial support programme, to which the EU contributed an unprecedented level, alongside the International Monetary Fund, should address the immediate financing needs of Ukraine.

By successfully completing reforms and combatting deep-rooted corruption, the Ukrainian Government can live up to the expectations of those calling for a reformed Ukraine at Maidan in February 2014. With our support, and that of our partners, Ukraine should transform into a reformed, democratic and growing economy.

With signs of economic stabilisation appearing in Ukraine, we can also start thinking about the future strategy for rebuilding Ukraine after the conflict, putting in place the necessary infrastructure and returning Ukraine to a sustainable growth path. Only a strong and prosperous Ukraine can engage with its neighbours on an equal footing, effectively fighting aggression.

Even more urgently, Ukraine must become a safe country once again. The conflict in the East makes the recovery extremely difficult, as the insecurity is taking a toll on its budget and, more importantly, its people. Ukraine needs a return to peace urgently and the only way to restore peace is through full implementation of the Minsk Agreements. The burden to comply lies on both sides. We expect full involvement and commitment of Russia to a swift and successful resolution of the conflict in the East of Ukraine. It is not time for political arbitrage when it comes to the fate of a country and its people.

The EU's decisive stance on Ukraine has had a negative economic impact on some Member States. The Baltics and Finland, for example, were most heavily affected by the Russian retaliatory measures introduced last year on EU exports of agricultural and food-products.

The country is gradually, but steadily, setting off on a recovery path. It is therefore essential to continue the reform course to make this recovery more sustainable.

Expert article • 1868

For the Baltic milk producers alone, Russian retaliatory measures on EU exports of dairy products translated into more than a 20% reduction in demand. This was one of the triggers for extraordinary support provided by the Commission to milk producers several months ago. Overall, according to the European Commission's estimations EU GDP dropped by 0.1% due to the Russian crisis and Russian sanctions.

With the tragic events in Paris, the refugee crisis, and the crisis in Syria, our attention is naturally focused there. It may therefore seem that the political focus is moving away from Ukraine. I would, however, like to reassure our Ukrainian partners: the EU's fight against terrorism and actions to tackle migration issues will not diminish our deep and strong involvement with Ukraine. Because the EU's continuous

support to Ukraine is not only a strong commitment to our closest neighbour and its people, it is also a strong commitment to defend in Ukraine our own core values – that is the values of freedom, democracy and respect for human rights. ■



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# BALTIC RIM ECONOMIES

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MARJU LAURISTIN

# Reforms in Ukraine pave the road to Europe

Expert article • 1869

**A**t the moment when Europe is overwhelmed by refugee crisis and shocked by the horrible terrorist attacks in Paris, it is nevertheless important not to forget about Ukraine. The threats to security and peace in Europe created on the Eastern border of EU by the 'hybrid war' launched by Russian armed groupings in Ukraine should not be undermined. As it was said by the Chairman of EP Delegation to Ukraine Mr Andrej Plenković after the meeting of the EP Delegation to the EU-Ukraine Parliamentary Association Committee held in Strasbourg on 25 November: 'It is our duty to keep Ukraine high on the EU agenda and to make sure that the EU policy remains firm and united in exercising solidarity with Ukraine, supporting the peaceful reintegration of temporarily occupied and annexed territories, and bringing Ukraine closer to the European family- in accordance with the clearly expressed political will of a majority of its population.'

The strategic solution for the Ukrainian crisis lies in the successful European integration of country in the framework put in place by the Association Agreement between Ukraine and EU a year ago. By now this agreement has been ratified by all parliaments of the EU Member States. But this is only the first step on the long road of Ukraine to become a democratic, peaceful and prosperous European country, like it was envisaged by Ukrainians who demonstrated on Maidan two years ago. Ukraine is still partially occupied, hundreds of thousands of families in the Eastern Ukraine are suffering through deep humanitarian crisis, Ukrainian economy is on downfall, democratic institutions are still fragile and Ukrainian media are criticized for the lack of full freedom. Besides the need for far-reaching economic and political reforms, the most difficult political and social challenge for the forthcoming years lies in the need to consolidate the nation, to integrate the multi-ethnic population of Ukraine, to bridge the historical and ideological gap between the mentalities of people from the Western and Eastern parts of Ukraine. This gap has been cruelly used by separatists and amplified by the traumatic experiences of the 'hybrid war' and anti-Ukrainian propaganda campaign launched by Russia. To solve its difficult problems, Ukraine needs understanding, patience, help and political support from European Union, especially from those member states, who understand and share its geopolitical concerns.

Progress in the reform policies in Ukraine is under constant scrutiny in the European Parliament's EU-Ukraine Parliamentary Association Committee. During their visit to Kiev on 4-5 of November representatives of this Committee have met with the representatives of Ukrainian Verkhovna Rada, with Prime Minister Arseniy Yacenyuk

and with President Petro Poroshenko. During these meetings the Committee has witnessed a strong desire of Ukrainian authorities to continue on the path of reforms and modernisation of the country. The European Parliament is following closely the progress in the reform process in Ukraine, including constitutional and electoral reforms, as well as decentralisation, anti-corruption activities, justice and public administration reforms. The aim is to help Ukraine to go on with the integration to Europe and to achieve economic and political stability inside the country.

We expect that during the next year Ukraine will be able to take remarkable steps towards this aim. Meaningful help for Ukrainian economy could be expected from implementation of the Deep and Comprehensive Free Trade deal between Ukraine and the EU from 1 January 2016. On 25<sup>th</sup> of November the EP Delegation to the EU-Ukraine Parliamentary Association Committee had a working session with President

The strategic solution for the Ukrainian crisis lies in the successful European integration of country in the framework put in place by the Association Agreement between Ukraine and EU a year ago.

of the Venice Commission, discussing the constitutional amendments tabled on decentralisation and judiciary. Decentralisation is a crucial step on the road to the modernisation of the country, as well as in the context of the implementation of the Minsk Agreement. It will be important for the Verkhovna Rada to reach the necessary qualified majority to pass these amendments in second reading. Despite the criticism concerning the pace and depth of the reform policies and the pertaining shadows of corruption, it seems that the Ukrainian political elite is at the present moment recognizing the need for common efforts, in order to push the constitutional reform through. Without confidence in the progress of democratic reforms there will not be sufficient grounds for maintaining strong international financial and political support for Ukraine. And last but not least, Ukrainian government and parliament will be hopefully ready to the end of this year to adopt the full package of laws necessary for the implementation of the visa liberalisation action plan. Introduction of a visa-free regime between EU and Ukraine will bring tangible results to Ukrainian citizens and contribute to further pursuing its European perspective. ■

MARJU LAURISTIN

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JENS NILSSON

# Social economy – a key role in renewing the Nordic welfare model

Expert article • 1870

**W**hen neoliberal experiments fail to tackle unemployment, inequality and social cohesion, old ideas should be replaced by new ones. It is time to highlight the Nordic welfare model and point out a new direction for renewal. A new architecture of the welfare model should involve citizens' contributions to a sustainable liberal market economy. The Nordic countries have an opportunity to act at the EU summit that will discuss the potential of social economy in December.

In the wake of the global financial crisis in 2008 we need to rethink the political economical system. International institutions such as IMF and OECD are acknowledging the failures of neoliberal policies as the world is experiencing increased inequality between people and states. The economic gaps we are facing today are leading to social unrest, which is hampering sustainable and economic growth. In this context, contemporary theories tackling economic inequality and global injustice seem to be having more to say in the political discourse.

It is possible to think differently. Experience shows that economic equality is good for both growth and job creation. One must always have a social agenda when striving for economic development - this is what leads to sustainability and prosperity. There are possibilities to create mechanisms so that the market economy serves the people. There is no zero-sum game between freedom, liberal market economy and social justice and solidarity. On the contrary, they are each other's preconditions leading to a win-win situation for jobs and the people.

If all are able to benefit from economic growth, consumption can be sustained benefiting enterprises, people and the public sector. However, it requires continuous dialogue and negotiations between social partners. It also requires that the elected representatives are able to dispose the redistribution mechanisms based on systems for taxation and public insurance. Additionally, it requires mutual trust amongst people and the welfare system.

It is therefore essential for the Nordic welfare model to renew itself. During my time as mayor of the city of Östersund in Sweden, when we began analysing citizens opinions of the city, there was one thing that stuck out; people were mostly satisfied with the local governance but not with their own influence. I have witnessed similar results from other contexts and see a need to act.

For me it is just as easy and difficult as that; people need to take active part in producing and maintaining the welfare system. It is not enough to pay taxes and demanding your rights – as a citizens you must also do your duty. This is where the potential of social economy needs to be unlocked. Social economy is defined as a third sector among the private and the public sector that includes enterprises and organisations such as cooperatives, mutuals, associations and foundations. Common to these organisations is the principle "people over

capital" with the main purpose to serve members and public interests rather than maximising profit. These ideas have existed for over 100 years and point out sustainable ways to organise the economy even in the future. As a third sector, social economy is very well intersected with the liberal market economy. Business and enterprises within the sector are competing with private companies in local and regional markets. They have proven to be very competitive within various sectors such as health and education, insurance and banking services and tourism.

The social enterprises have also proven to be professional, modern and efficient. Furthermore, they have other comparative advantages that the private sector lacks: they are founded under the primacy of democratic governance where one member has one voice. This creates mutual trust and added value in doing business leading to a win-win situation for the enterprises and the society. Additionally, what distinguishes them from doing business as usual is that they always reinvest financial surplus in their businesses in order to serve their social mission. Instead of short-term profit objectives, the social economy enterprises prove to have a stabilising effect on the market economy which institutions like OECD requires. New social innovations within the sector have also shown to remedy social and economic complications in the wake of the financial crisis.

During the European Council in December, the member states will carry out conclusions on social economy. If the conclusions will result to progressive wordings as I predict they will – this will strengthen the key role that the sector plays for reciprocity in the welfare system and for the economy. This is what the Nordic welfare state model needs right now – if it wants to pave the way for a sustainable future not for the few, but for all. ■



Photo: Socialdemokraterna

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ALEXANDER RUMYANTSEV

# Russo-Finnish relations about to turn 95

Expert article • 1871

**O**n 31<sup>st</sup> December 2015, ninety-five years will have passed since diplomatic relations were established between Russia and Finland. Looking at the path that they have taken, we can affirm that relations between us are now supported by a solid foundation of long-term good neighbourliness and co-operation worked out over these difficult decades.

Now when the situation in Europe and globally as a whole is far from simple, Russia and Finland should take particular care not to allow the state of the economy to negatively affect relations between us. Such an understanding was confirmed this year by the heads of the two states, who have engaged in business-like confidential dialogue in the form of bilateral meetings and of regular contact by telephone. The first contact between the Prime Ministers since the change of government in Finland has taken place – so far by telephone. The ministers of foreign affairs have already established reliable co-operation, having managed within six months to hold two fruitful working meetings – in New York and Oulu. Departments, regions, companies and public organisations in Russia and Finland are continuing traditional co-operation at many levels. Cross-border programmes are advancing, aimed at the implementation of a variety of tasks around the Baltic Sea and Northern Europe, including within the framework of regional organisations – the Arctic Council, Barents Euro-Arctic Council, the Council of the Baltic Sea States, and the partnerships of the “Northern Dimension”.

We see in such mutually advantageous co-operation a necessary prerequisite for the development of production, scientific and technical, cultural, social and humanitarian activities in the North-West regions of Russia and friendly Finland.

We are used to considering multilevel economic ties as the traditional basis for Russo-Finnish good-neighbourliness. The trend from growth to a recession in recent years has been conditioned by a whole set of reasons, both political and economic – the slowing of growth rates in Russia and in Finland, the EU policy of sanctions and the measures that we have been compelled to take in response, the dynamics of the exchange rate, and the fluctuations in demand for basic goods in mercantile turnover.

According to Russian customs statistics, trade between Russia and Finland for 2014 has declined by 14.7%. In January-August 2015, it amounted to 6.5 billion USD, a decrease of 42.5% compared to the same period of the previous year. We expect that the volume of trade between our countries for 2015 will total just over 10 billion USD, which will evidently be the lowest figure in a decade. This situation is reflected in the entire spectrum of bilateral relations, including contacts between people, who have always been one of the bases for our co-operation. Tourism is suffering, to a large extent owing to the recession – according to data from border services, crossings during

the first ten months of this year have decreased by 21% compared to the same period in 2014.

The gravity of the situation must not be underestimated. However, we think that there are no grounds for pessimism about our prospects. In the opinion of many Russian experts, in 2015 the dynamics of the Russian economy reached their “lowest ebb”. Our country is adapting to the changing circumstances of economic life, there are signs of stabilisation and gradual adaptation to new, lower prices of hydrocarbons and changing rates of exchange. We can see good opportunities for the development of mechanical engineering, agriculture, the chemical industry and a string of other sectors.

It is obvious that, in these conditions, Finnish business is acting as pragmatically as it can, based on its own interests and those of its

From our point of view, deepening integration within two regional associations – the European Union and the Eurasian Economic Union, will be an important feature of bilateral co-operation in future.

partners. No efforts are being spared to foster production co-operation and to find opportunities for future business, principally in telecommunications and information technologies, robotics, biomedicine, “clean” technologies and power-saving. We appreciate such an approach and are prepared to help optimise the conditions for Finnish entrepreneurs in Russia, to promote mutual trade and investments.

From our point of view, deepening integration within two regional associations – the European Union and the Eurasian Economic Union, will be an important feature of bilateral co-operation in future. We are counting on constructive dialogue on the long-term goal – the formation of a united economic and humanitarian zone from the Atlantic to the Pacific Ocean based on principles of equal indivisible security and broad co-operation.

Russia sets great store by the continuation and deepening of friendly relations with Finland. The importance of reciprocal efforts in this direction is conditioned by the interests of Russian and Finnish regions, business and ordinary people in contacts and joint projects, and simply in good relations. Thanks to mutual respect and a common desire for co-operation, the Russian-Finnish border is today in many respects a model example of beneficial co-operation. Our entire history shows that there is no alternative to precisely such a policy in our relations. Russia will be following this principle in future, too. ■



**ALEXANDER RUMYANTSEV**  
Ambassador of the  
Russian Federation in Finland

HANNA WESTERÉN

# The opportunity of a lifetime for coastal and island communities to make a difference

Expert article • 1872

I've been involved in politics for over ten years; for several years at the local level and nowadays also on the national level, representing Gotland County in the Swedish parliament. As the years go by, the revelation grows within me: the future is a joint venture. We are one, but seldom do we act as one. I have hope for the future, but some days also a sheer amount of pessimism. We address challenges, but are we serious when presenting potential solutions?

I have grown up on Gotland, my father's family has lived on the island for generations. I wish for the same for my future children and grandchildren. The island would flourish immensely with a greater population. Among other things. When working with Baltic Sea issues on the local level, but also when programming the new edition of Central Baltic 2014-20 I often had discussions on how to make our islands and coastal zones more attractive, achieve a growing population. One of the core tasks ought to be opening our societies for new citizens, no matter origin. The island and coastal societies are often small and often adequate places for quick integration into society, labor, studies and social life. Give these societies a chance to contribute! There's so much to be achieved between humans, sometimes with some necessary initial help from authorities.

In this moment our world is facing disaster. An amount of refugees not experienced since WWII is fleeing for their lives, hoping for life in peace and safety. Most of them are offered shelter in the neighboring countries, such as Lebanon and Turkey, but thousands do also take the step and travel for Europe. A dangerous path, not least when crossing the Mediterranean Sea. The refugees come to Europe to seek shelter, a human right that is announced by most democratic states around the world. Knowing this, it's sad to experience the debate climate in the European Union, the actions taken to shut people out.

Gotland County has no winner record in receiving refugees. We are much more able than the actual number states. But we do have a history of opening our society, our homes to new people. And now: in this very moment, we're so ready to do it again. The Swedish government recently informed itself of the housing capacity of the Swedish Counties and the reply from Gotland was quick. Over 4000 beds can be at disposal on short notice. Do I have to say that I'm proud? Proud over the immediate response, over the signs of solidarity, of the will to help.

At the moment the EU member states face the refugees' need of shelter in different ways; some say NO, some YES, some maybe. Not a very reliable or sustainable standpoint. We must take common action to end all wars, but meanwhile: the people suffering from those wars, must be our common responsibility.

Sweden is a rich country, I know, and we must do our fair share - and more - to offer shelter for those fleeing for their lives. Although we can't and shall not do it alone. The capacity among the Baltic Sea states is grand. And this is not a challenge optional to face. It's here. Now. First of all we must face it for solidarity reasons. To prove that we still agree upon our common rules of conduct and human rights. But also for survival reasons. In the long run this is what the European Union needs, with an ageing population and sinking nativity. These people are the colleagues of tomorrow, our future carpenters, doctors and relatives.

For Gotland this is an opportunity not to be missed. First of all: for solidarity. To be able to look children and grandchildren in the eyes be-

cause we tried to make difference when the world was on fire. But also because in reality we'll need these people, as much as they need us now. So, my wish for this Christmas and the others to come: let's turn the perspective. The current discussion seems to be very much about keeping the numbers down, if possible: shut out. For me, islander as I am, me and my fellow citizens' thoughts ought to revolve

much around the strategy to make these people stay on our islands, help us make these paradises flourish even more.

When this article will be published, Gotland is hopefully on the verge of welcoming our new islanders, mainly from the devastated countries of Afghanistan and Syria. Hopefully we'll not have experienced arsons and threats against the planned sites of shelter, but can gladly welcome them to the county of Gotland, were we have chosen to live our lives, and were we also hope that several of them will find their new permanent home. The ongoing wars is a common failure, the consequences of them can be the opportunities of a lifetime for small societies, eager to make a difference for others, as well as for themselves. Gotland seizing this opportunity is not only humanitarian. It must also be considered to be a very clever strategy to build a more sustainable future in the Baltic Sea region. Hopefully several islands and coastal regions reach the same conclusion. There's no other way than a common effort to face the common challenge, and turn it in to a possibility for growth and prosperity. ■

The island and coastal societies are often small and often adequate places for quick integration into society, labor, studies and social life.



HANNA WESTERÉN

County of Gotland  
Member of Swedish Parliament  
Sweden

HENRIK LAX

# The Åland regime after Crimea

Expert article • 1873

The annexation of Crimea was a definite wakeup call telling us that Russia has turned down the European Security Order and assumed a policy of open confrontation in its relations with the EU and the US. The political environment of Finland had changed. Russia's unwillingness to respect international agreements and its provocative military posturing in the Baltic Sea area give us cause to update our evaluation of "the Åland regime".

Is it under threat now? Is there a demand for measures to consolidate it?

This regime is based on the demilitarization and neutralization<sup>1</sup> of the Åland Islands, an autonomous region of Finland. It is governed by the 1921 Convention relating to the Non-fortification and neutralization of the Åland Islands adopted by the League of Nations. In the 1940 Treaty between Finland and the USSR concerning the Åland Islands, Finland has pledged not to fortify the islands and not to put them at the disposal of the armed forces of foreign states. Russia has succeeded the USSR as a party to this treaty but is not formally tied to the 1921 Convention and its guarantees endorsing the neutrality.

In accordance with the 1921 Convention Finland has assumed the responsibility to defend the neutrality of the zone should it "be imperilled by a sudden attack either against the Åland Islands or across them against the Finnish mainland". It was also foreseen that Finland could ask the High Contracting Parties<sup>2</sup> for help in defending the status of the islands against being violated. This matter, however, was to be referred to the Council of the League of Nations which does not exist any longer.

The nature of warfare and military technology has changed substantially since 1921. Hybrid warfare integrating non-military elements eventually supported by military actions of high speed and precision in an escalating conflict characterise the threats of today. How and at what stage could and should Finland repulse "a sudden attack" by pre-emptive measures in these circumstances?

Edward Lucas (The Coming Storm – Baltic Sea Security Report, CEPA June 2015) points out the strategic importance of Gotland, Bornholm and the Åland Islands with regard to NATO's possibilities to reinforce the three Baltic republics in case of a military conflict with Russia. He also makes a strong plea for a de facto coordination and combining of the defence capabilities of the NBP9 countries (Nordic, Baltic and Poland) to create a forceful deterrent. The evolving Finnish-Swedish model for unified military cooperation could serve that purpose too.

Given the solidarity clause and the framework for Permanent Structured Cooperation enshrined in the Treaty on the European Union (TEU Art. 42.6-7), I have the following suggestion: it might be investigated whether these provisions could offer a solution in making it possible to substitute the disbanded Council of the League of Nations

<sup>1</sup> A legal regime which prohibits military operations in a defined geographical area in armed conflicts.

<sup>2</sup> In addition to Finland, Denmark, Estonia, France, Germany, Great Britain, Italy, Latvia, Poland and Sweden are adherent/ signatory parties – Russia is not.

in case Finland decides to call for active defence of the neutrality of the Åland Islands by the parties to the 1921 Convention. These are all EU members.

There is no minimum number of Member States required to set up Permanent Structured Cooperation as opposed to Enhanced Cooperation (Art. 20). The decision shall be taken by the European Council and is one of the few areas in the Common Security and Defence Policy where decisions are not made unanimously but by qualified majority voting.

Combining the armed forces of EU member states as well as other measures reinforcing the guarantees for the neutrality of the Åland Islands would require political will and determination. A prerequisite for such an understanding would be a common perception of the crisis and the threat among the EU member states in the Baltic Sea area.

There is an obvious demand  
for an assessment of the  
Åland regime in the next  
Report on Foreign and  
Security Policy to be passed  
by the Parliament of Finland.

In his opening speech at the National Defence Course 10.11.2014 the President of Finland Sauli Niinistö referred to a Russian proverb saying: "kazak beryot chto plokho lezhit" 'A kosack will grab whatever is not firmly fixed to the ground'. He also said that every one of us in Finland is responsible for our common security and urged us "to take care of issues and actively cherish the things we view as important".

Two weeks later the legislative assembly of the Åland Islands debated a policy paper on their demilitarization and neutralization. The perceptions of the crisis expressed in that debate diverged dramatically from the one represented by the President. The least to be expected from the inhabitants of Åland, if they want to promote their case, is to show an open mind to enhanced cooperation with the civil authorities in mainland Finland.

There is an obvious demand for an assessment of the Åland regime in the next Report on Foreign and Security Policy to be passed by the Parliament of Finland. There is also a demand for serious dialogue and confidence building between the national Finnish authorities and the regional ones in Åland. A common perception within Finland of the challenges is a *conditio sine qua non* for receiving any positive contributions from the neighbours in the Baltic Sea area. And yet, it might be more appealing for the signatory and adherent parties of the 1921 Convention to invest in the Åland regime, if Finland and Sweden were their allies in NATO - but that is another matter. ■



HENRIK LAX

Member of the European Parliament  
2004 – 2009

ELISABETH NAUCLÉR

# The neutralization of the Åland Islands

Expert article • 1874

**T**he Crimean war in 1854 partly took place at Bomarsund fortress in the Åland Islands. Russia was defeated by France and Britain, which resulted in the peace agreement in 1856 signed in Versailles. Russia was forced to accept that the Islands, though still in their possession, should not be fortified.

“Åland” is an archipelago consisting of more than 6.500 islands in the middle of the Baltic Sea. The water is shallow and difficult to navigate. Notwithstanding who were in control of the islands, they constituted a military threat to all the neighboring countries. If in Russian hands they were a threat to Sweden and if in Swedish hands a threat to Russia. The idea of introducing the demilitarization as a confidence building measure aiming at reducing the threat in a region was genius. Nowhere in the world had demilitarization been used to create confidence in a larger area that was not on the frontline where fighting had not taken place.

It could be viewed as an experiment, and it was not foreseen how the respect for the regime should be safeguarded. In the military strategic planning the demilitarized area was, and has ever since been, viewed as a problem. In 1921 when the League of Nations solved the legal dispute between Finland and Sweden resulting in autonomy for Åland, it was also decided that a conference should be convened to discuss the military regime of the islands. It had become clear, that an area, with military restrictions, and where no fortifications were permitted could not be defended against the enemy with traditional territorial defense methods. The enemy therefore had to be made part of the solution, and the solution was neutralization. The signatories to the Åland Convention agreed that in case of war they should all respect that no war actions were to take place in this territory, like hospitals are in accordance to international law excluded in case of an armed conflict. The neutralization has later been interpreted as a regime that is not only binding for the signatories, but has to be respected by every state as part of the customary law regulation of the Åland Island’s military status.

Finland should, in case the neutralization was not respected, alert the League of Nations for them to decide on necessary measures, and defend the neutralization. Sink mines could be used awaiting the decision. The organization was supposed to have the power to uphold the respect for the regime with the help of the member states. Finland followed the obligation to inform as long as the League of Nations existed, and even after that, but now turning directly to the signatories.

Russia was a party to the agreement on demilitarization, but not member of the League of Nations in 1921 and therefore not a signatory to the neutralization. The demilitarization has been confirmed by Russia at several occasions, but never the neutralization.

The demilitarization plays an important role in the Åland political life. It is clear that Finland cannot build any fortifications or bring in troops, but what else? The politicians have traditionally united been defending the demilitarization and carefully looking after the implementation and interpretation of the Convention in peacetime.

We have not been planning for war, and therefor has the neutralization not been a topic. There are only a few demilitarized and neutralized territories in the world, and only one being demilitarized, neutralized and autonomous, and accordingly little to make reference to. It is common that neutralized is confused with neutral. Neutralization is something completely different. If Finland would be a warring party Åland would not be neutral, but still neutralized.

The tense situation in our adjacent area, has sparked discussions on defense cooperation in the Baltic Sea, and the need for new defense alliances, including threat to the Islands, and how the military could defend the islands, but with no deeper analysis of the neutralization and its implications. In these discussions nothing has been said about the asset of being in possession and control a neutralized area. The expensive military equipment could be used somewhere else where better needed if the respect for the neutralization is upheld with diplomatic means in an international context, but so far all too little has been done to focus on what the regime implies, not even on the European level are these issues discussed. Recently even senior politicians in the islands have avoided a deeper analysis, making reference to it as a military question, which has never heard of earlier.

The focus has to be not only on the demilitarization but on the neutralization as being the only important factor in a critical situation. The Finnish, as well as the Åland authorities must increase the efforts to shed light on the implications of neutralization and the necessity of a deeper understanding of the concept. Only if we have a broader understanding and recognition on an international level will the military recognize it as an asset in case of war. Asked to comment on all the theoretical threats and possible interventions against the islands President Niinistö answered that it will not take place, and I fully agree with him. But we can only have confidence and real security in the future if the concept of neutralization again and again stressed and recognized in all international discussions and negotiations, and what is most important to be considered as an asset. Silence and negligence is the worst threat to the regime.

This should be one of the most important objectives of the Contact Group between the Ministry of Foreign Affairs and the Åland Government. ■



**ELISABETH NAUCLÉR**  
Director General to the  
Åland Government (1999-2006)  
MP (2007-2015)

LARS STRANNEGÅRD

# The power of education

Expert article • 1875

**W**e live in a knowledge society where education is increasingly important. The prosperity of a country is based on knowledge, and I am confident that investing in education and research is the best way to enhance a country's competitiveness. In this context, knowledge is key.

One decisive factor for a country's development potential is the ability to develop talent. The Stockholm School of Economics (SSE) is a small business school with sister schools in Riga and St. Petersburg, but relative to our size we have a substantial social footprint. We are ranked as the top business school in the Nordic and Baltic countries and produce knowledge that society deems relevant.

## A business school for society

The relevance of the knowledge we produce derives from our conception of the business school as a school for society, seen through an economic lens. We are a real-life, real-business academy where we develop insights, where new role models take shape, and where each student relies on equal measures of innovation and analysis. Within this conception of a business school, we try new things in order to learn new things.

A business school for society, and a business school of the future, requires much more than improving the bottom line. Economic growth is a means to an end but not an end in itself. Growth can help us lead more meaningful lives, meet global challenges, and create more opportunities in places where too few opportunities exist.

Our programs encourage students to build a foundation of values and master the tools they need in order to achieve their goals and follow their hearts. As a school for society, we hope that this mix of values and tools will foster a deeper sense of meaning in our graduates in the contribution they make to the societies and communities they will live and work in.

## An international impact

Our school is ranked by the Financial Times as the top business school in the Nordic and Baltic countries and plays an important role in the development of tomorrow's leaders. Our alumni play key roles in business, organizations, government, culture, and politics. Consequently, our school has a significant impact on our societies, and our mission is to enhance that impact.

Our globalized world is closely linked to digital advances. Globalization and digitization depend on one other. In this context, the internationalization of business schools is a must. A business school that is not international is no longer relevant.

Internationalization occurs in many ways, such as through exchange programs, research collaborations and especially through the great diversity of nationalities among faculty and students. It is also increasingly common to have strategic partnerships across borders as well as double degrees from schools in different countries.

## Partnerships important in a competitive world

We are also seeing a substantial increase in the number of business schools – there are now more than 13,000 business schools around the world, according to the European Foundation for Management Development (EFMD). Competition is ever more intense. Yet even though competition is increasing, it is necessary to create strong partnerships, both regionally and worldwide. Quality is more important than quantity in SSE's partner relations, so we limit the partner univer-

sities in our worldwide Student Exchange Program to 60 of the world's most renowned business schools.

The Stockholm School of Economics founded its sister school in Riga (SSE Riga) in 1994 and its sister school in St. Petersburg (SSE Russia) in 1997. All three schools offer programs that are highly regarded both nationally and internationally. In Stockholm we offer bachelor's and master's degree programs and PhD, MBA and executive education

programs. In Riga we offer a bachelor program and executive education programs. In Russia we offer an Executive MBA and executive education programs. SSE also has strong partnerships in Finland with the Hanken School of Economics. The aim is to enhance knowledge-building in these countries – by learning from one other. Education and research become a way to conduct diplomacy, and to develop civilization and prosperity.

In the digital, knowledge society of the future, education and research will be tools for competitiveness, international trade and, ultimately, peace. ■

In the digital, knowledge society of the future, education and research will be tools for competitiveness, international trade and, ultimately, peace.



LARS STRANNEGÅRD

Professor, President  
Stockholm School of Economics  
Sweden

LAILA KILDESGAARD

# Bright Green Island – from vision to realisation in 10 years

## A vision for Bornholm, the Danish Baltic Sea island of around 40 000 inhabitants

Expert article • 1876

In 2007, a number of key players went for a 48 hour boating trip around Bornholm. The aim was to discuss and come up with proposals for a new vision for the island. Inspired by the scenery the title of the vision became “Bright Green Island” which has since then been the marketing platform for Bornholm.

This article describes the idea behind the marketing platform, the challenges in the process and the possibility to rethink the strategy into soft areas like food and ecology, increasing the public support.

Bright Green Island is a vision to become a 100 % fossil-free community by 2025, and to create local sustainable solutions which then again create local growth and jobs. At least 50 initiatives have been taken, such as climate and cleantech strategy, energy fairs, green building including education, local planning and authority treatment. The ambition to be a green and sustainable island was integrated into the local and regional development plans.

Each measure itself does not make a sustainable island. What makes the difference is when the initiatives are coordinated, which is only happening now in 2015 – 8 years after the vision was formulated. Now the municipality, the local power plant, the central heating system and the waste management plant have joined to present a draft for a common energy strategy. This strategy is based on the experiences the partners have had working together on developing a new common energy strategic model calculation. Only now the results of the overall Bright Green Island strategy start to show even though all the partners have contributed individually up until this point.

If we continue as so far planned we will only reach halfway of the vision by 2025, with 47 % of the energy supply based on renewable energy sources, transportation sector as it is now, central heating extended, more straw heating plants will be developed and climate screens improved.

If we instead modernise our electricity sea cable to Sweden, convert buildings outside our central heating structures to heating systems based on 50 % wooden pellets and 50 % heating pumps, rebuild our power plant to consume wooden chips, increase the use of solar cells and combine offshore windmills with windmills on land, Bornholm will have a 100 % fossil-free energy supply by 2025. Hereby we will have reached our vision.

A final decision on the draft is expected to be taken before end of 2015, after the current public consultations. Eight years from vision to action. After our last local elections in 2013 the new Council decided to give the vision / brand of Bright Green Island a new chance, and a food project became a part of the brand. This project has revitalised our green ambitions. Within 18 months, the share of organic food items has increased from 6 % to 60 % in our local public food production.

With the conversion to organic food and the increased focus on local products we have got a new opportunity to introduce more children to food dishes made from the bottom, but also to give our elderly people the joy of smelling and tasting food from their own kitchens.

The project included training the staff, mainly having short term educations and thus benefitting from an infusion of professional pride and consciousness. They learned entirely new skills and experimented with the food, for examples they have made sandwiches from cabbage, made chips from a traditional pudding based on beer and rye bread as well as making Spaghetti Bolognese from offal. They have also learned how to reduce food waste as this is an important part of keeping the new organic scheme within the budget.

Going forward, we will continue the work to minimise the gaps in the value chain from soil to table – and to manage expectations between kitchens, food producers and suppliers. It takes a continuous effort due to our local situation with many small producers, and it requires a close dialogue with the Farmers Union, who represents the local producers.

The Regional Municipality has analysed our sourcing of food items today and estimated which types of products we expect to need in the years to come. We have matched our demand with the food products which are produced today by our local farmers: The conclusion is that there is a good match between supply and demand, but we have also identified a need for increasing the production of vegetables on the island of Bornholm. At the same time we are estimating selected food product segments ‘sustainable price level’ – and which food products do have a richer potential for local sale, when we consider the quality, CO2 emission and job creation.

The conclusion is that you need several years of patience and leadership to succeed. The conclusion is also that in times with a focus on so-called ‘co-creation’ it is important to see concrete results of the vision in order to engage the whole community. ■



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Executive Director  
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ANASTASIYA KUZNETSOVA

# Economic development of the Kaliningrad region

Expert article • 1877

**D**ear readers of the Baltic Rim Economies! Let me offer you a brief description of the economic situation in the Kaliningrad region.

In 2014, the Kaliningrad region showed outperforming growth rates in the economic indicators as against the average Russian rates.

The industrial-production growth was 8.7% (in the RF –1.7%) which was achieved due to an increase in the manufacturing activity by 11.2% (the figure in the RF –2.1%).

The volumes of executed construction works grew by 17.6% (the average RF volumes dropped by 4.5%), and the growth in the residential construction amounted to 75.7% (the figure for the RF –14.9%).

An increase in the Gross Regional Product, according to provisional estimate, was approximately 0.7% which is in line with the growth of the Russian economy on the whole.

Under current conditions, the task of the Government of the Kaliningrad region is to support the development of import substitution, to promote the establishment of favorable investment environment, also within those support measures taken by the Government of the Russian Federation regarding the Kaliningrad Oblast.

One of the most remarkable examples of the implementation of our activities in the area of import substitution is the agriculture.

In 2014, the growth of gross agricultural output against the level of the year 2013 was 109.1% (the average RF rate –103.7%).

The grain production increased by 30% as against the last year's rate and amounted to 430 thousand tons which was the best performance in the past 25 years. The average yield of grain and pulse crops in the region is 39.1 hundred kilograms per hectare (ranking 1st in the North-West Federal District, and ranking 9th in Russia).

In the past 4 years, the agricultural industry has been returned 112 thousand hectares of idle cropland.

In accordance with the adopted programme for the development of dairy cattle breeding, a number of investment projects were implemented in the dairy sector. The milk production per cow on farms grew up to 6642 kg (ranking 5th in the Russian Federation).

The supply of local products to the region's population is increasing. The region population's demand for unprocessed and processed meat is 67.4 thousand tons. In 2014, 68.8 thousand tons was produced which means that the meat produced in the region is enough to satisfy the demand at the recommended level.

The definitive possibility for the growth of output of animal farming products in the region is based on the intensive development of grain production.

A task was set to double the production of agricultural gross output within three years and to provide the food processing industry with local raw produce which is feasible owing to the retention of measures of state support.

A second important area of import substitution is the coastal fishery. The regional Government supported a major modernization of the local fisheries.

This resulted in quotas drawing having increased from 60% in 2010 to 85% in 2014. This year the catch quotas will be taken up in full and it will be necessary to press the issue of their increase.

The coastal infrastructure and that of the fish processing sector was upgraded with our support. The main aim of fish processing within the region is not to trade in raw produce but to process every kilo of fish creating added value and new jobs.

A third important sector which we have been supporting for years is tourism. As time has shown, the choice of this sector was right. In the past four years, the volume of inbound tourism has increased more than twofold. The doubling has been achieved due to a number of measures of state support: the federal centre adopted the decision about subsidizing the air fares, the scheme "visa at the border" for foreign visitors has been introduced, and we are actively helping the Oblast's tourism business in promoting it at various exhibitions.

New hotels are being opened. The infrastructure is developing. Soon, a new point of attraction for the tourism sector will be the tourism and recreation area with a gambling segment close to the village of Kulikovo.

The supported indicated sectors are the apparent points of growth for the regional economy. Besides that, the regional Government directs all the efforts to improving the environment for doing business, both in financial and non-financial terms.

The main task is to make the authorities and business work together, and we have all the necessary conditions for this. The Kaliningrad region is situated at the intercrossing of cultures and territories, that is why the promotion of new markets and technologies is suitable for us.

We are ready to work and to become a pilot region for certain new markets, which will act as an example and show a possibility of attracting both domestic and foreign investment, of collaboration between international organisations and improvement of the socio-economic relations. ■



ANASTASIYA KUZNETSOVA

Minister of Economics  
The Kaliningrad Region  
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TARJA NUOTIO

# Southwest Finland – at the heart of the Baltic Sea?

Expert article • 1878

Located in the south-westerly corner of Finland with 470,000 inhabitants, the province of Southwest Finland has a rich history, diversified nature, and diverse business structure. Our traditional strengths are agricultural and industrial production. We lean on our strong, high-quality education offering, we are proud of our unique archipelago, and bilingualism is a resource. The people of Southwest Finland are proud of their roots and region for a good reason.

Globalisation, economical fluctuation, and the changes in the geopolitical situation have presented challenges to Southwest Finland, too. Are we ready for the change? Are we working actively in order to maintain our position and the vitality of our province?

## Approachable gateway of the Baltic Sea

One of the goals in the Regional Strategy approved in 2014 is to be an "approachable gateway of the Baltic Sea". It means not only regional accessibility and good traffic connections, but also intellectual accessibility and a positive, open and collaborative operating environment.

Industrial activities in Southwest Finland have quickly grown international, and e.g. shipbuilding industry, a long-time cornerstone of the region, is blooming again through the German company Meyer, the pharmaceutical industry has strengthened its position, headed by another German company Bayer, and the automotive industry benefits Uusikaupunki by manufacturing Mercedes-Benz cars. The internationalisation of the operations gives us the obligation to maintain and develop smooth road, sea and air traffic connections via both Sweden and the Baltic Sea to the rest of Europe.

We are also obliged to participate actively in work for the Oslo–Stockholm–Turku–Helsinki–St. Petersburg development corridor i.e. the Northern development corridor, and emphasise the importance of this central transverse and genuinely international zone. The goal is to create a green and intelligent zone that also attracts international players and will form one of the key connections between the EU and Russia. The importance of the zone has been acknowledged at European level, and it is included in the official TEN-T network. We truly believe that a transverse connection zone with a variety of activities is needed, and in our opinion it does not compete with the other growth corridors, but rather strengthens Finland's overall position as part of the European system. We believe that the Finnish government also supports our view and names this Northern development corridor an operationally and logistically significant growth zone. We already have the international support for this.

## We can't make it alone – partnership and co-operation are key factors

The economic recession emphasises the importance of working together. We need co-operation and partnerships across organisational, regional and national borders. One of the main objectives of the Regional Strategy is to make partnership a permanent way of working in which common targets are set together for building the future of the province.

Through various co-operation projects, our region has managed to create functional relations with many different players. The active participation of universities and other organisations in, for example, EU's research programmes has created more intellectual capital and financial resources to the region, as well as genuinely increased the internationality. The Regional Council supports this development work by providing information about the available financing opportunities and helping in forming international project consortiums.

One good example of international co-operation is the EU's cross-border programme activities. The Regional Council of Southwest Finland acts as the managing authority of one cross-border programme, the Central Baltic Interreg programme. Through this programme, some 116 million euro will be allocated to the implementation of different co-operation projects between Sweden, Estonia, Latvia, the Åland islands, and mainland Finland. The funded projects diversely support accessibility, the development of SME's, vocational education, as well as improving the state of the environment.

International co-operation comprises more than just project co-operation, drafting of co-operation agreements, or participating in seminars. Another important form of operations is active participation in the key networks for the region. The Regional Council of Southwest Finland is a member of the Committee of Maritime Peripheral Regions (CPMR), which is an extensive and active policy development organisation. The committee strongly promotes the interests of European maritime regions, and is a highly regarded player in the cabinets of the European Commission and Parliament. A regional point of view in maritime policy, accessibility of regions, cohesion policy etc. are important themes of this network organisation.

So are we at the heart of the Baltic Sea in Southwest Finland? In my opinion we are, but it requires continuous active focusing on extensive co-operation and networks, emphasis on partnership, renewal of ways of working, and especially belief in our own work and strengths. That way we can genuinely support the role of Southwest Finland and its municipalities in the constantly changing operating environment, and consequently the well-being and competitiveness of the municipalities and the region. ■



TARJA NUOTIO

Regional Development Director  
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ADOLF WYSOCKI

# ”All change, please?” – the need for innovation and a new perspective

Expert article • 1879

The Baltic Sea Region (“BSR”), however diverse as to its current level of development, is distinguished by its high competitiveness from other highly developed regions of the world. That said, the BSR remains peripheral and heterogeneous - in the sense of available potential and growth opportunities in the midst of a global economic crisis - experiencing a certain degreed economic turmoil. Europeans want to be global trend setters but at the same time wish not to lose their sense of cultural identity and autonomy.

Detailed SWOT analysis for the BSR carried out in 2005-2006 by the European Commission laid the foundations for various programs and forms of support for the BSR countries, looking closer to home, with a development period in Poland taking place between 2007 and 2013. An important feature of the European Commission’s program is to strive towards sustainable development with the aim of continually improving quality of life in the region for more than 85 million of its inhabitants. Recession, an uncertain global economic outlook, and an increased imbalance between supply and demand indicate that a viable equilibrium will be not achieved until 2017 or, perhaps 2020, an outlook well substantiated by the Kondratieff’s long-term cycle.

With that in mind, what do deliberations on 21<sup>st</sup> century Poland actually entail? They must mean serious conversations about creating an innovation-based, competitive economy, the development of digital, intelligent national specializations, and systematic improvements in quality of life, with a particular focus on rural areas.

The majority of Polish economists are consistent about one focus point, namely, that Poland’s economy must become more competitive to prevent the country falling into the so-called “middle income trap”. As such, we must switch to a model of development based on innovation.

Companies need to strive to achieve a competitive advantage through new or improved solutions, products and services. They should make better use of results from research and development (“R & D”). Increasing R & D activity is the main task, especially in the context of the availability of substantial EU funds for this purpose. Poland has in this context identified 19 national “smart” specializations, grouped into five distinctive areas including natural resources and waste management, innovative technologies, and industrial processes. There are opportunities out there for those who seek them out.

Nevertheless, strengthening social cohesion and economic competitiveness requires stronger links between stakeholders. In order to assist in achieving such goals, an agreement on bilateral co-operation between the West Pomeranian Voivodeship and Helsinki-Uusimaa Region was signed during the 2<sup>nd</sup> International Maritime Congress held in Szczecin on 12 June 2014. Organized by the City of Szczecin, the “*Scandinavian Days*” event – inaugurated in April 2014 and held for the 2<sup>nd</sup> time in April 2015 – created a forum named „*Energy of positive changes*” with the aim of mobilizing the local community to establish bilateral contacts with companies from the Nordic region. The

prestige of the forum was bolstered by the presence of the ambassadors of Denmark, Finland, Norway and Sweden who participated in various discussion panels and meetings.

Equally important has been the establishment of a new Scandinavian Studies learning module at the University of Szczecin’s Faculty of Philology in October 2014.

Academia aside, Finnish entrepreneurship is well represented in the West Pomeranian Voivodeship with Cargotec/Hiab as its leaders.

Looking ahead, Poland’s Presidency of the Council of the Baltic Sea States (“CBSS”) – scheduled between July 2015 and June 2016 – creates further opportunities to deepen mutual relations between BSR states. Acting in its capacity as CBSS President, Poland intends to focus on possible areas of cooperation concentrating on three new long-term priorities of the CBSS agreed in June 2014, namely, sustainably, regional identity, and security.

Former Republic of Poland President and Nobel Prize winner, Mr. Lech Walesa, who was one of the guests of The Baltic Sea Cultural Gathering conference at the European Centre of Solidarity held in Gdańsk in September 2015) stated:

„*The world needs not only new structures and programs, but also new thoughts on how to proceed further on.*”

After witnessing 25 years of system transformation in Poland, and with the benefit of hindsight, one could say that a chance to introduce more staggered reforms which would have mitigated the hardship endured by many ordinary citizens may have been missed.

That said, public polls continue to show that the majority of Poles declare that they loved the personal freedom they gained after 1989, the freedom of choice of workplace, the freedom to travel anywhere in the world, the freedom to choose the place they want to live in, and the freedom to decide their fate. With freedom understandably being held in such strong prominence it is unsurprising that Poles are currently keeping a close eye on developments around the world and, specifically, a stone’s throw from Poland’s Eastern border.

With that in mind, the current generation must, through its actions, confirm its understanding of its responsibilities for the long-term future of the region. They must be part of the drive towards ongoing competitiveness within the BSR and, to go back to the title of this article, innovation must surely lie at the forefront of those efforts. ■



ADOLF WYSOCKI

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ANU FREDRIKSON

# The Arctic – a possibility for future sustainable growth

Expert article • 1880

## The Arctic Momentum Is Now

The world is increasingly eyeing up the Arctic. The European Union is preparing its joint communication on Arctic policy. The work done by the most important Arctic actor, namely the Arctic Council, attracts increasing attention.

Arctic affairs are high on the agenda also in North America as the United States has taken over the Chairmanship of the Arctic Council after Canada.

The story of the North has traditionally been that of vast areas, great distances and skillful human survival. However, it has the potential to become the story of wonderful opportunities, responsible actions, and good cooperation. Much of the interest towards the Arctic (at least coming from outside the Arctic states) can be explained by economy. Prosperous Norway provides a good example: the fastest economic growth in the country takes place in its High North.

Norway has now started to harvest the fruits of its early investments in the Arctic (or High North, as the Norwegians prefer to call it). Smart investments pay off and create new opportunities.

The Arctic potential is not just local: the opportunities are so vast it has the potential to become the next growth area on a wider scale. The European economy is still trying to pick up the pace after the financial crisis. By investing smartly – and this doesn't exclusively mean financial investments – The European Union could find important future growth potential in its northernmost parts.

## From Words to Action, from Plans to Reality

What is needed in order to cash in on the expectations? Again, I'd like to use the example of Norway: since the start of the strong focus on High North and the creation of a High North policy approximately 10 years ago, the country has invested in knowledge, infrastructure, research and innovation – all backed up by political will.

Infrastructure might well be described as the Achilles' heel of the Arctic. Developing infrastructure in the lands of vast distances and harsh conditions provides a challenge in itself – and isn't exactly free of charge, either. However, the cost of building Arctic infrastructure should be seen as a strategic choice. Infrastructure can act as a catalyst for creating growth, industrial development and economic opportunities – just look at the history of railroad building!

The inhabitants of the Arctic are its greatest resource. Investing more in them is always a good idea. By strengthening knowledge and the basis for new, innovative ideas, we can create the platform upon which the future Arctic activity can be built.

## Arctic Opportunities

Unlike recent news might indicate the Arctic is not just about oil and gas. The potential of the blue economy is expected to be huge. Just in Norway, the value of the marine industry is expected to increase

fivefold by 2050, up to approximately 54 billion euros. The production of seaweeds, fishing and fish farming, subsea oil and gas plants, wind farms, and mining on the seabed are just some examples of the future opportunities offered by the blue economy.

Pristine nature, fantastic natural phenomena such as the north-

ern lights, and the uniqueness of the Arctic help attract a growing number of visitors to the region. Tourism has been identified as a significant factor in the future economic development of the High North. Maritime transportation will most likely continue its growth as the Arctic opens up for growing tourism and transport of goods. Small and medium-sized enterprises already have a significant role as an employer in the local communities. Some of these will

become the big players of the future.

## Play by the Rules

With the opportunities also comes great responsibility. The fragile Arctic nature requires clear and strict regulation. To ensure the sustainable development of the unique nature and to safeguard the traditional livelihoods of the indigenous people we need to make sure we get it right, not just done. It is essential that all economic activity that takes place in the Arctic takes into account economic, social, cultural and environmental impacts.

Policy and business efforts should be anchored to the local communities. The Arctic is not simply a raw material reservoir to be exploited. It is home and the basis of livelihood for those living there.

## See the Light?

Ambitions are good to have, but only if you also manage to deliver results. To be able to harvest the full potential of the Arctic and for the Arctic, we need the courage to think strategically and invest wisely – whether it is knowledge, time or money we are talking about. And in doing all this it is essential that we keep one thing in mind and act accordingly: everything we do should be done sustainably. In the era of economic downturn in Europe and elsewhere, we need a guiding light to find our way out. Though we are in the middle of the darkest time of the year in our High North, there is light. Do you see it? ■



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HANS JØRGEN KOCH

# Bridging the Baltic with electricity

Expert article • 1881

**E**xactly 100 years ago, Denmark and Sweden were joined by the first international undersea power cable. Later this year we will see a historic joining of hands between the Baltic, Nordic and European electricity systems.

Both the 700 MW NordBalt interconnector between Sweden and Lithuania, and the 1000 MW LitPol interconnector between Lithuania and Poland will start operation at the end of 2015. This almost triples Baltic interconnection capacity with Nordic and European systems.

Lithuania and its Baltic neighbours will go from being an energy island, just off the coast of Russia's electricity system but far from the shores of Europe, to being an energy crossroad, connected to the Russian, Nordic and European grid systems.

Much has been made of the role of gas in Baltic energy security. Lithuania's Klaipėda floating LNG gas terminal began operation one year ago. With enough capacity to cover the gas demand of all three Baltic States, it has brought with it a great increase in energy security, sorely needed after the closure of Ignalina nuclear power plant six years ago.

The diversification of gas sources for the Baltics was necessary and had very positive effects. However, the outlook is now one of oversupply and the Klaipėda terminal is unlikely to run at full capacity. The terminal led to a reduction in Russian gas prices and Estonia has recently indicated plans for its own terminal. Furthermore, a gas pipeline between Lithuania and Poland could begin operation in 2019.

Investment in excess gas capacity may be necessary from an energy security perspective, but it is inefficient from an economic perspective. In contrast, investments in electricity system integration between Baltic, Nordic and European systems are less likely to experience these issues. Differences between electricity markets and constant variations in supply and demand mean that electricity interconnectors have a better chance of running at full capacity. This balancing results in huge efficiency gains across the system as a whole, and is why grid interconnection is of such high priority in the EU's Energy Union initiative.

In the longer term, the Baltic States have an opportunity to put to use their significant resources in biomass and wind, potentially moving away from gas and oil shale. This is reflected in the Memorandum of Understanding signed by nine Baltic Rim countries in June this year, expanding the scope of the Baltic Energy Market Interconnection Plan (BEMIP) to cover areas such as renewables and energy efficiency.

Such a development is already underway in the Nordic countries, where renewable energy buildout is expected to create a surplus of clean electricity that can be exported to Continental Europe. The tight

integration of Nordic national grids is evident today through large unidirectional flows, such as that from Sweden to Finland due to delays in new Finnish generation capacity. But perhaps more importantly, through rapidly fluctuating bidirectional flows, such as that between Denmark and Norway, where Danish wind is balanced by Norwegian hydropower. The Nordic grid has helped the region achieve a carbon intensity of electricity of around 100g CO<sub>2</sub>/kWh, where the world needs to be in 25 years if it is to stay within the 2-degree target.

The economics of electricity markets tell us that the buildout of Baltic interconnectors will likely be a solid long-term investment. The greater the penetration of variable renewables such as wind, the greater the value of interconnectors between electricity systems.

The long-term outlook of the BEMIP is full Baltic integration with European energy markets and we are well on our way. In February, the European Commission reaffirmed the 10% interconnection goal as part of the Energy Union initiative. This means that countries should have interconnector capacity equal to at least a tenth of domestic generation capacity. The Nordic EU members of Denmark, Finland and Sweden were 44%, 30% and 26% respectively in 2014. The Baltic countries as a whole were at 4% before the second Estlink cable between Finland and Estonia in 2014, around 10% today and will be significantly higher with NordBalt and LitPol in operation. This indicator does not count Baltic connections with the Russian system, which runs asynchronous to the European system. True integration with European electricity markets will be possible between 2020 and 2025, when the Baltic States switch to synchronised operation with Europe.

As important as integrating electricity systems is integrating knowledge systems. Nordic Energy Research is the joint research funding body for energy under the Nordic Council of Ministers. Our experiences with involving Baltic and North-West Russian researchers in our Nordic networks have been both long and fruitful. We will continue to have a Baltic focus in our coming research funding programmes and advisory work for the Nordic Ministers of Energy. ■



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TAPIO PEKKOLA

# Nord Stream 2 – building upon experience and securing Europe’s energy supplies

Expert article • 1882

**T**he quest for reliable energy supplies is an ongoing challenge for utilities and energy companies in Europe. Against the backdrop of rising demand for natural gas in the EU, declining domestic production and the ensuing increased requirement for imports call for additional reliable, long-term supply options. For this reason, a new group of shareholders led by Gazprom decided to join forces on the Nord Stream 2 project in September 2015. The pipeline will build upon the experience gained with the existing Nord Stream Pipeline, providing security of supply and at the same time being environmentally friendly and economically viable.

The feasibility study conducted by Nord Stream AG in 2012 confirmed that extending Nord Stream with one or two additional pipelines was possible from a technical and permitting perspective. The Nord Stream 2 twin pipelines will stretch for some 1,200 kilometres across the Baltic Sea, connecting the Russian coast with Germany’s coast near Greifswald. They will have the capacity to deliver 55 billion cubic metres (bcm) of natural gas per year directly to the EU – for more than 50 years. Completion of the two new pipelines is envisaged by the end of 2019.

At the moment, natural gas makes up one-quarter of the EU’s primary energy consumption. With the EU looking to cut its CO<sub>2</sub> emissions by 40% compared to 1990, the only cost-effective and sustainable way to achieve this goal will be to reduce the use of coal and increase the share of natural gas in the EU energy mix. In light of the CO<sub>2</sub>-efficient qualities of natural gas, building a new natural gas import route will not only serve the purpose of meeting increased demand, but also help the EU reach its climate goals.

Parallel to the rising demand, indigenous gas production in Europe is in an accelerated decline, most dominantly in the North Sea. The United Kingdom, Germany and the Netherlands are all facing a decrease in production. Therefore, the overall gas demand in the EU over the coming decades can only be met by increasing imports. The EU is in reach of numerous suppliers which can help fill the import gap.

The need for commercially sensible supply options calls for additional gas supplies from Russia, as existing European supply sources will not be sufficient to fill the gap. The experience of the Nord Stream Pipeline has shown the advantages of additional reliable long-term supply options via pipelines.

Nord Stream 2 will complement existing infrastructure as a competitive additional supply option, providing a direct connection between the largest natural gas reserves in the world in Russia’s North and European markets. It will strengthen the EU gas hubs and contribute to the region’s security of energy supply.

In addition to increasing security of energy supply, Nord Stream 2 can draw upon the positive track record of its sister project implementation – on schedule and within budget. The privately financed

investment will provide a major economic stimulus for many sectors of the European economy: steel, engineering, construction, pipe-laying, logistics, environmental surveys and monitoring. The new gas supply infrastructure requires no subsidies and will be constructed at no cost to the EU taxpayer.

Nord Stream AG set the benchmark for the transparent, safe and sustainable management of the environmental and social issues associated with the implementation of a state-of-the-art pipeline project. Extensive monitoring programmes have demonstrated that the Nord Stream Pipeline did not cause any unforeseen environmental impact. Construction-related impacts were minor, locally limited and predominantly short-term, and transboundary effects have been verified as being insignificant. The results of previous surveys and the experience gained will help to ensure that Nord Stream 2 will meet the same stringent standards.

Nord Stream 2 AG is in charge of the future project development and will continue the permitting and survey work which Nord Stream AG initiated. Building on this heritage, Nord Stream 2 will strengthen Europe’s energy security in a safe, environmentally sound way and under sensible economic conditions. At the same time, it will contribute to further developing the mutually beneficial, five-decade energy partnership between the EU and Russia. ■



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# International gas projects of Russia in the context of changing economic paradigm

Expert article • 1883

People are endowed with a variety of congenital and socially built talents that determine their destiny and path of life. In lucky cases talents may be historically relevant and recognized by contemporaries, but may also be devaluated and lost in changing times. However, most adhere to their destination due to or in spite of the circumstances. In many ways, the same phenomenon is observed in the life of countries whose "talents" are based on a unique combination of natural and historical factors that shape their material, intellectual and spiritual culture.

Nature has given Russia impressive significant reserves of energy resources, including natural gas. Russia holds the world's largest natural gas reserves, 1/3 of the total proved volumes and 30% of world gas production. This gives gas sector a strategic importance and attracts powerful economic and political actors in Russia and abroad despite well-known connotations of "blessing or curse" and discourse concerning painful dependence of the country well-being on instable raw material markets. Estimated change in world oil/gas prices by  $\pm 10\%$  (increase / decrease) leads to an increase / decrease in the Russian GDP  $\pm 1.5-2\%$ . The current situation demonstrates both problems with dramatic clearness. But way out from the raw trap is still not obvious.

International gas projects of Russia (more than 50 in total) - eloquent symbol of the country's role as a commodity giant of the industrial era with its still dominating mass production and consumption. More than 20 projects provide extraction and delivery via 175 thousand km of pipelines (mainly from remote areas of Western Siberia) one third of gas produced in the country to customers abroad. Several projects already deal with involvement of new fields in continental shelf and Arctic.

Most of the projects are implemented in the field of dry natural gas, less - in LNG, and invisibly small part in non-conventional gas, including shale gas (firstly extracted in the USSR in 1953). International gas projects are carried out by two dozens of the Russian companies (more than 90% of them are private) with a sound dominance of the "Gazprom" producing more than 77% of the Russian gas. As a rule, each project has 1-5 major foreign partners from the group of leading oil and gas MNCs, as well as a considerable number of stakeholders. By nature gas projects have evident economic character, but the in most of cases political dimension is unavoidable. The current price competition and political pressure increased risks and losses - "buried in the ground" investments, canceled or "frozen" contracts.

Traditionally, the Russian gas projects have been focused on neighbor close and economically prosperous countries of **Europe**. During the last decades the Russian gas sector was strongly integrated with the companies of interested countries and in fact played as a congruent part of European economy, while staying outside the EU legal field. At list this consideration was shared by many experts and general public in Russia (partly abroad) and grounded an idea of future "all-European economic space".

European gas directory was constantly supplemented with other projects around the vast Russian border, first of all in **Asia** - in the former Soviet republics, as well as in Japan, China and Turkey. The role of the Asian directories began to grow in recent years mainly due to the **Chinese market** capacity and the interests of the government in diversification and security of raw materials' supply. Existing enthusiasm cools the fact that China turns towards expected "calming down" dynamics and a "new normal". The country also has the world's largest reserves of gas from unconventional sources. So far they were slightly evolved for reasons of economic feasibility; however, its activation will limit the Russian gas projects in the future.

Historically Russia was committed to dozens of smaller cooperation projects **worldwide** - in Vietnam, Algeria, Iraq, Libya, Bolivia, and Venezuela. Serious preconditions for cooperation were built with partners in Argentina, Brazil, Bangladesh, Egypt, Pakistan, Iran, Sri Lanka, Uruguay, the Dominican Republic, Tanzania, Mozambique, Myanmar and other countries. It now appeared that efforts to establish partnerships in different regions seem justified.

Geographical variety doesn't reduce an importance of traditional relations. As shown by the "Nord Stream-2" the role of Europe remains crucial, despite "squeezing" and structurally transforming demand for energy, known controversies with Energy Union, difficulties of negotiating with some partners and certain incoherence inside EU.

The phenomenon of strong commitment to the resource sector in Russia is based on combination of two main internal and external factors - resource-driven economic paradigm (fueled by strong and often "greedy" and corruptive economic interests) and external demand for energy. According to respectful international institutions, the XXI century was supposed to be the "golden age of gas" with growing projected demand at least until mid-2030-s. More than 2.6 billion people in developing countries still used for heating and cooking traditional biomass, and 1.3 billion people have no access to electricity. The role of natural gas is difficult to overvalue in context with still very actual

Expert article • 1883

interpreting of the MDGs into SDGs. The current refugee crisis and other signs of violent outbursts of despair from inequality and injustice clearly manifest what it means to procrastinate in UN Goals achievement.

Resource blessing opens known opportunities for Russia, but impose a long list of threats, including the most crucial - disproportions in the structure of the economy and its poor readiness for the future tectonic shift - transition from industrial civilization to a post-industrial era.

Long-term and widespread decline in material production, re-thinking of basic development indicators (especially, growth), virtual projects and "paper» commodities, movement of society towards sharing economy and the reduction of material production and consumption - these are just a few of those issues that world dramatically face. A large number of hardly projected and unpredictable processes ("black swans" and "wild cards") which contemporaries do not want or

cannot explain in the framework of industrial mentality, cause confusion and resistance, increasing competition and aggression. All these need new paradigm of development, preempting the future and reacting in a moment. However, Russia hardly coping with the inertia moves in wake of its "talents" in spite of circumstances and painful experiences. The future will show whether this makes sense for all of us. ■



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# BALTIC RIM ECONOMIES

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NURŞIN ATEŞOĞLU GÜNEY

# The future of EU's energy supply security?

Expert article • 1884

**T**he European Union is still the largest energy importer in the world. Relations between the West and the Russian Federation became extremely tense following the annexation of Crimea by Moscow and the situation has yet to improve. Currently, one third of the gas consumed in the EU today comes from domestic resources while the remainder needs to be imported from four external gas sources. At the moment 30 percent of Europe's gas supply comes from Russia, but when Russia behaves aggressively this 30 percent becomes a serious energy security issue for Brussels. Energy supply security across Europe has generally improved since 2009 and from the perspective of energy security developments Europe has observably overcome the previous East-West divide. Most countries located in this geographical region are making real progress in this regard, with the countries geographically situated in northwest region of Europe having become almost immune from any likely gas interruptions that may come from Russian aggression. On the other hand, the North-South gap in overall energy supply security still remains real. The EU energy supply security once again became an issue following Crimea's annexation in 2014 and then again in response to Russian's hybridization of war mostly in the eastern parts of the Ukraine. The international community has witnessed how Russia, in retaliation, has responded to the EU/USA sanctions following the annexation of Crimea. Moscow initially declared the postponement of South Stream and then employed the various instruments at her disposal to divide the 28 members of the EU especially in regard to the energy issues associated with the Western Balkans. Under the current deteriorated relations between the West and the Russian Federation, and due to the continuing geo-political competition between the two sides, the south-eastern countries because of their vulnerabilities in the field of energy supply security were destabilized along these competitive geo-political parameters. Starting with the 2006 Green Paper the EU has researched ways of overcoming their dependency on the gas supplies from Russia. However, the Europeans have not yet succeeded in managing energy security collectively and have to date only pursued half measures. The latest effort in the EU is the Energy Union, an ambitious initiative to overcome the vulnerability to the Russian gas monopoly, especially in eastern and southern Europe through diversification. It is a positive step forward that the Paper has now emphasized the strength of diversification and documented that the Union will develop a strategic energy partnership with both production/source countries as well as transit countries in this process.

## Europe was lucky this winter but what about the future?

Energy experts in general are convinced that EU will continue to be dependent on Russian gas imports until the mid-2020s. Fortunately, the EU seems to be in advantageous position in overcoming energy security disruptions that might arise from any new Russian gas cuts at least in the 2015 winter. This is due to multiple challenges that Russia is currently facing. It is certain that the recent sanctions originating in the West had a negative impact on Moscow's economy and led to the devaluation of the ruble. Moreover, the low prices of oil coupled with the mild winter conditions of 2014 coincided with the introduction of energy-saving programs across Europe causing a dramatic drop in gas consumption in Europe. All in all, these factors have combined to challenge Russia sufficiently to cause Moscow to exercise restraint in using the gas supplies as a lever in foreign policy.

Most of the major western nations in the EU are currently at lower risk. The progress that has been made in the energy field so far in the eastern and south-eastern areas however has been slow and has become complicated by. What is more important is that the current tense relations between the West and Russia seem to be feeding more instability into the main contours of the southern-eastern Europe's energy supply security matrix and because of this uncertainty some of the alternative options for gas supplies have now become irrelevant. Currently, the EU and the EU Commission are attempting to address the challenge of energy supply security by concentrating on several options. In our opinion, the EU, in order to reduce its dependency on Russian gas supplies should start by accelerating its own common energy market needs approach by increasing the number of interconnectors, reverse flows and so on while strengthening the Southern Gas corridor and enlarging its capacity. All in all, the Southern Gas Corridor, including the TANAP, TAP, ITGI, IGB, ITB, seems to be the best available diversification option before the EU and one that can bring benefits before the end of 2020. ■



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# Belarus – sovereignty decreasing?

Expert article • 1885

Preserving the sovereignty of Belarus is a frequently used element of the official discourse of President Aleksandr Lukashenko. Since coming to power in 1994 he has been successful in ensuring the continuous flow of various Russian economic subsidies that helped him keep up his authoritarian system, and has given only minor political concessions in exchange. However, recent developments indicate that in terms of security and defense the sovereignty the president intends to preserve is becoming increasingly limited.

In order to assess the sovereignty of Belarus vis-à-vis Russia, hereby the Westphalian sovereignty model of Stephen D. Krasner is used. In his authoritative work *Sovereignty. Organized Hypocrisy* Krasner defines Westphalian sovereignty as the state's ability to exclude 'external actors from authority structures within a given territory.' The sovereignty of a state may change along or against its own will. The first element is defined by Krasner as an *invited* decrease of sovereignty (for example, when a state signs an international agreement), while if sovereignty is compromised against the will of the state, Krasner calls it a *violation by intervention*. According to him, 'Westphalian sovereignty is violated when external actors influence or determine domestic authority structures.'

Concerning security and defense policy, until the mid-2000 Minsk was remarkably successful in putting the burden of its own defense on the shoulders of Moscow, but without getting its sovereignty fully compromised, or by maintaining at least a certain level of interdependence.

In the framework of the so-called Union State, a bilateral, close intergovernmental cooperation forum of Belarus and Russia, Belarus got its air defense system integrated with the one of Russia. However, as the Union State is built on consensual decision-making, Minsk managed to maintain political control over the defense implications of this cooperation. Hence, in the Krasnerian sense this compromise of sovereignty qualifies as an invited one.

The situation has been somewhat similar in the defense industry. Belarusian defense industry has been structurally dependent on the great Eastern neighbour: Russia is the source of its cheap raw material supplies as well as its main buyer and its outlet to the world arms market. However, Russia is also dependent on Belarusian defense industry companies in a number of key fields. One of them is, for example, the Minsk Wheeled Tractor Plant that is the sole producer of the wheeled chasses used in Russia's road-mobile missile launchers. Though Moscow tried to set up its own production line, the effort was unsuccessful due to technological reasons, thus the dependency

on Belarus prevails. Therefore, Moscow cannot use the dependence of Belarusian defense industry against Minsk without getting its own interests harmed.

The main indicator of a negative change in the security and defense-related sovereignty of Belarus is the planned new Russian air base to be opened reportedly in 2016/2017. Russia continuously had military installations (*voyenniy obyekt*) on the territory of Belarus; however, those were not operational bases (*voyennaya baza*), but an early warning radar and a radio-electronic station. Though the idea of Russia opening a military base has emerged a few times in the past two decades, Minsk has always been successful in turning down these attempts, thus keeping its territory free from permanently stationed Russian combat troops.

However, since the eruption of the Ukrainian crisis Russia has started to push Minsk much harder for opening a proper military air base on Belarusian territory. Though Lukashenko has been resisting and questioning publicly the necessity of the airbase, Moscow may still realize the project by using its political and economic leverages over Minsk. Besides its strategic importance for Russian military, the airbase project probably also serves the political purpose of hampering the efforts of Belarus to normalize its relationship with the West. The reason is that due to its proximity to the Baltic States, the Russian forces to be stationed in the base will constitute a primary threat for the NATO.

All in all, by setting up a military airbase in Belarus basically against the will of Minsk – i.e. by forcing the Belarusian leadership to finally give its consent – Moscow has been clearly violating the sovereignty of Belarus by *intervention*. This means that the two decades long era, when Minsk was able to successfully bargain with Moscow over issues of security and defense is clearly over. If the new Russian base becomes operational, there will be no way in which Minsk could stay out of the possible negative consequences of a further worsening Russia-West relationship. ■



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# Russian policies not adapted to the effects of climate changes in northern Russia

Expert article • 1886

Russia will experience global warming to a greater extent than most other countries with an increasing number of disasters linked to floods, droughts, wildfires, thawing permafrost and other climate influenced events.<sup>1</sup> For example in 2010, central and western Russia suffered its worst heat-wave since records began, causing increased mortalities, widespread forest fires, drought and ruined crops.<sup>2,3</sup> Extremely heavy rainfall in 2013 caused the river Amur to flood vast areas, the worst in 120 years.<sup>4</sup> A study suggests that climate change probably caused this flood disaster.<sup>5</sup>

In northern parts of Russia, the rate of climate change is faster than what ecosystems will be able to adapt to.<sup>6</sup> The air temperature is expected to increase by twice the global rate and cause substantial loss of permafrost by 2100.<sup>7</sup> There will be increased runoff in rivers and flooding in the North and droughts in the South by 2030.

Climate-induced changes in permafrost areas will be detrimental to almost all types of structures, pipelines, roads, railways and buildings, in northern Russia.<sup>8</sup> The Arctic Ocean could be ice free in 30–40 years and the very large deposits of trapped methane in the seabed or in wetlands will be released due to thawing permafrost and increasing the rate of global warming.<sup>9</sup> Rising wetland methane emissions is associated with the sea ice retreat.<sup>10</sup> The security situation in the Arctic

region is changing due to competition among countries for control of the area's riches and the Russian Armed Forces is increasing its presence there.

Russia's policies on climate adaptation and mitigation lag behind those of most countries and several policies contradict its climate change commitments.<sup>11</sup> The post-2020 climate plan intends to reduce emissions by 25-30 per cent compared to 1990 levels which in reality means an increase of its emissions about 40-50 per cent above current levels by 2030.<sup>12</sup> The Russian leadership's attitude has gone from denying the existence of climate change to seeing it as a means of promoting Russia's role in international affairs to achieve diplomatic policy gains in other policy areas.<sup>13</sup> ■

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MATTHEW KOTT

# Becoming more “European” – in the wrong way

Expert article • 1887

Since regaining independence from the USSR in 1991, the dominant political narrative in Latvia has been an aspiration to “rejoin Europe” or “become European”. Although much progress has been made over the past quarter century, it is not always the best Europe has to offer that is adopted.

Major events can stimulate abrupt fluctuations in public opinion. The ongoing crisis of refugees from the Middle East and Africa has, for example, caused seismic shifts in several European countries. Even if almost no refugees have come to Latvia, much less sought asylum there, the public opinion has also been affected – negatively.

On 4 August 2015, the discourse of the far right in Latvia – which, with the National Alliance in the government coalition, has always been present in the public sphere – became less post-Soviet and more in step with that of the far right elsewhere in Europe. That day, a number of marginal organisations, ranging from self-proclaimed “anti-globalists”, to neo-fascists inspired by interwar Latvian forebears, staged a protest outside the Cabinet of Ministers against EU plans to distribute 250 refugees from Greece and Italy to Latvia. Individual politicians from the National Alliance supported and took part in the demonstration.

This protest, although it only gathered a hundred participants, marked a sea-change in Latvia’s far right discourse due to the symbolic language used. The slogans and symbols on the protesters’ signs included the same mix of Islamophobia and white supremacy familiar from northern and western Europe. For the first time, the crossed-out mosque symbol popularised by the “Pro” and Pegida movements in Germany was used in Latvia, along with slogans about perceived Islamisation. Using Islamophobic tropes, migrants were presented as a threat to the economy, the social order, and being terrorists, as even a threat to national security. One protester’s sign even welcomed refugees to Latvia – Swedes fleeing from the chaos and destruction allegedly caused by immigrants in the restive suburbs of Swedish cities.

In addition to this symbolic language borrowed from the “counter-Jihad” milieu, the protesters also expressed crude white supremacist ideas. Letting in refugees was equated with “genocide of the White peoples”. A famous depiction of a Latvian woman in folk costume was modified to show exaggerated “African” features – with a caption asking, if this was how Latvians wanted their grandchildren to look. Far right discourses that previously attacked Russians as civilizational “Others” now embraced these Slavic brethren due to the new threat from Blacks and Muslims.

Such discourse is highly novel for the Baltic context. The post-Soviet Baltic far right remained stubbornly focused on hating Jews and Russians, leaving them increasingly out of step with their European colleagues, for whom Turks, Somalis, and Muslims in general were seen to be more of an immediate threat. Over the past decade,

far right groups in Europe have been increasingly gravitating towards Russia as the true defender of Europeaness and the White race, thus leaving the Baltic far right isolated. Earlier this year, a conservative Estonian politician also publically expressed that the future of the “White race” was threatened by immigration, signalling the coming change in Baltic far right discourse.

Islamophobia has heretofore had little traction in the Baltic states. In Lithuania, the centuries old local Tatar community are not suspected of disloyalty even by most ultranationalists. In Estonia and Latvia, the Muslim communities that appeared in the nineteenth century were tiny and seen as more an exotic detail. In the breakup of the USSR, the Balts even expressed solidarity with the Chechens in their struggle against domination by Moscow. Recently, however, the Latvian Security Police has kept the post-Soviet Muslim community under surveillance for hints of radicalisation.

The anti-refugee rhetoric now seen in Latvia is also ironic from an historical perspective. Latvians have also been refugees: 250,000 fled the Soviets in 1944/45. A previous wave of Latvian political exiles, after the failed Russian Revolution in 1905, even contributed to the stereotype of the refugee-as-terrorist, thanks to the Siege of Sidney Street in London, 1911.

The freedom of movement offered by EU membership has led to 200,000 residents of Latvia emigrating in search of a better life. Hence, there is definitely room for refugees who also seek a better life in a democratic EU member state. Despite its self-image as poor, Latvia belongs to most clubs for rich countries, and hence has an obligation for solidarity with those in crisis. Having sent Aminata, who is of mixed Latvian, Russian, and *Burkinabé* descent, to Eurovision this past year, there is still reason to hope that this new “European” narrative in the Latvian far right will not become the dominant one in the general public discourse in Latvia. ■



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# Recent development in emigration from Russia

Expert article • 1888

**B**efore discussing emigration trends from Russia outside the territory of the former USSR, some remarks about the nature of data should be made. In 1990s in the Russian statistical reference books the number of emigrants was determined as the number of persons who were granted permission for departure outside Russia for their permanent residence abroad.

In the beginning of 2000s this source of information has disappeared, since exit permission from the bodies of Interior ministry was no longer needed. From the end of 1990s the main data source about migration flows are the permanent residence registration readings, collected on migrants' arrivals and departures by the Federal Migration service. However, since that time the criteria of determination of the foreign migrants were several times changed. As by the most recent (2011) update, the emigrants are not only those, who were removed from their registration, but also those who had temporal registration in Russia for 9 months and more.

As an international practice shows, the quality of immigrants' registration is much better than the one of the emigrants'. Foreign citizens arriving to another country for permanent residence are registered in censuses and sampling surveys; they are entered to the registers of local population and foreigners, as well as to the other administrative information systems. Thus, many countries have data about flows and stocks of the immigrants, their social-economic and demographic characteristics. Due to that, while determining the number of migrants from Russia, it is better to apply the statistics of their hosting country.

The former USSR was a closed country, the "doors" of which were getting open for a short time under the pressure of certain historical circumstance. In 1986 2.1 thousand people moved to Germany for their permanent residence, and a bit over 200 persons moved to Israel. After the fall of the "iron curtain", the emigration from the Soviet Union sharply increased. Taking into account its volumes and structural features, the emigration from the Russian Federation could be divided into two waves: 1990s and 2000s. All together during the period of 1989-2002 by the data of the Russian ministry of Interior affairs, 1265 thousand persons had left for the remote foreign countries for permanent residence. This data is not accurate, since it does not include those who emigrated without official permit of the Interior ministry. As by the foreign statistics, the estimation of the outflow from Russia was at least 1.6 million persons. Distinctive features of the Russian emigration of 1990s were its geographical destinations and ethnical composition. Over 90 per cent of all emigrants moved to three countries: Germany/Israel (mostly as repatriates) and the USA (over half as refugees). By the Russian data most of the emigrants (nearly 60 per cent) were the Jews and Germans.

By the mid-2000s the emigration outflow substantially went down, among other reasons were the exhaust of repatriation reserves (of the Jews and Germans) and reduction of various migration programs for the former Soviet citizens. By our estimation based on the foreign sources, in 2003-2013 over 600 thousand Russian citizens moved abroad for their permanent residence. The Russian data is very different. First of all, it significantly underestimates the volumes of emigration outflow. Thus in 2011-2013 by the information from 14 countries, the general emigration outflow from Russia was 8.6 times larger than by the Russian data. Secondly, the Russian statistics does not fully reflect the geography of the modern emigration.

In particular, they do not show the significance of such centers of attraction for the Russians as Spain, Italy, Canada, Finland, Austria and France. The character of emigration has also changed; it became economically motivated, while immigration policy of the hosting countries forms professional-competence/language/integration selection rules for the emigrants. Today there are relatively more young, educated and rich people among emigrants, than in 1990s.

Totally, over 2.8 million Russian-born people reside outside the former USSR. Among them over 60 per cent - in Germany, USA and Israel. Many of the emigrants keep the Russian citizenship. As by the consular registration data, there are nearly 120 thousand of such persons on the USA, over 130 thousand in Israel, and nearly 570 thousand in Germany. Many of those people keep their apartments, businesses and even jobs in Russia.

The emigration from Russia continues, however its potential has significantly declined as compared with 1990s. In 2013/2014 the National Research University Higher School of Economics conducted survey among 6.5 thousand of the graduates of the Russian universities. Only 5 per cent of them answered, that they are planning in the nearest future to move abroad and mainly with the purpose of education and work. ■

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# Japanese investment in Russia

Expert article • 1889

**H**istorically, Japanese-Russian investment relations have gone through several stages of development, which were characterized by different organizational forms and level of intensity. The investment cooperation was developing in forms of natural resources concessions in 1920-1940s, compensation agreements in 1960-1980s, joint ventures in late 1980-1990s etc. However, most of the investment projects used to specialize in resource development, particularly timber and fuel in the Russian Far East. This region has always played an extremely important role in the development of economic relations between the two countries. The Sakhalin projects, which are conducted through the international cooperation with participation of Japanese companies under the Production Sharing Agreements, represent the largest proportion of investment cooperation between Japan and Russia. 30% of the Sakhalin 1 project belongs to the Japanese SODECO consortium and 22.5% of the Sakhalin 2 project belongs to Mitsui Sakhalin Holdings B.V. and Diamond Gas Sakhalin (a subsidiary of Mitsubishi) with 12.5% and 10% respectively.

Recent decade has seen several new trends in the development of Japanese-Russian investment relations. First, they included the fast and continuous growth of the investment inflows: during 2005-2014 investment stock (all types of investment) increased about 17-fold (from 567 mln USD to about 9,8 bln USD) while direct Japanese capital stock grew almost 7-fold (from 175 mln USD up to 1,2 bln USD). One of the special features of Japanese investment in Russia is that direct investment account for only about 13% on the total Japanese capital in Russia. Most of the investment stock is represented by other investments (the borrowing or lending of funds between direct investors and subsidiaries, branches, and associates—including debt securities, suppliers' credit, loans, trade credits, financial leases etc.) that mainly relate to the oil and gas projects in the Far Eastern regions, first of all, to the Sakhalin projects.

However, recently in addition to the dominant Sakhalin projects, manufacturing sector became increasingly attractive for the Japanese largest TNC's that entailed another trend - major shifts in terms of structure and technology of FDI inflow. The share of FDI inflow into manufacturing industries of higher technological complexity and capital intensity increased from 13,6% to 51% in 2005-2013.

Moreover, the regional distribution of Japanese FDI has become more diversified; in addition to the traditionally attractive regions of Moscow and the Far East, investment cooperation with the Central, Volga and Ural Federal districts has developed intensively. Top-list of regions attracting Japanese FDI in addition to Moscow city, Sakhalin and Primorsky Krai (70% FDI in 2013 combined) includes Lipetsk region (9%), Moscow region (7%), Tver' region (5%), Ulianovsk (3%), the Republic of Buryatia (2,4%) and St. Petersburg (1.3%).

Intensive production facilities establishment began in 2005-2006 when the "pioneers", Toyota and Nissan, decided to set up production plants near St. Petersburg. Following them other Japanese automobile producers such as Isuzu, Mitsubishi Motors, Mitsubishi Fuso, Komatsu and Mazda as well as related component and material produc-

ers such as Asahi Glass, Yokohama Rubber, Ishikawajima-Harima Heavy Industries, Daido Metal and Sakura Kogyo have also begun to open their plants in Russia. Automobile production has become a core industry for Japanese direct capital, and implies an increase of FDI inflow into related industries (cluster development), the growth of the technological level of investment.

However not only automobile sector attracts Japanese capital in Russia. The chemical industry is represented by Sojitz, Mitsubishi and Marubeni, electrical engineering – by Panasonic and Sony, financial and banking sphere – by the largest Japanese banks such as Tokyo-Mitsubishi UFJ, Mitsui Sumitomo, the Mizuho Corporate Bank and the Toyota Bank. Telecommunication is represented by the largest joint ventures - projects by KDDI-Rostelecom (a fiber-optic communication line between Nakhodka and Joetsu) and NTTCom-Transtelecom (a fiber-optic cable between Nevelsk and Ishikari). Two plants, jointly established by Sumitomo and Terneiles in Primorsky Krai are amongst the latest timber processing investment projects in the Far East region. And this list is far from exhaustive.

Recent tensions in international relations and economic crisis in Russia could not but affect the business of Japanese companies in Russia: most of them suffer from ruble devaluation that make their products less competitive on the market; problems with raw materials, components and equipment import and processing of payments on international transactions. However, the majority of the Japanese business representatives admit that despite the crisis and market shrinking Russia remains an attractive investment destination, and believe that current market instability is temporary and expect the market to recover and grow. ■

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# Integration processes in the former Soviet Union

Expert article • 1890

The experience of more than 15 years of integration in the post-Soviet space activities demonstrates the process viscosity, yet that is largely determined by the market nature of the trickle-down process, over-reliance on the development of inter-State ties. While operational objectives operational links between manufacturers, trade associations, business entities often is decided not by economic operators of the market, and the various ministries and departments. Real integration of national economies can move only through direct economic relationship of enterprises and organizations of the countries-participants of the Eurasian Economic Union, which would undoubtedly contribute to the formation of a common market.

Geo-economic features of the countries - former republics of the USSR, the cultural community of peoples and other socio-economic and natural features give the Eurasian Economic Union, the possibility of intensive development and deepening of economic integration in the common economic space. Organizational-legal registration of the economic unification of the states of the Eurasian Economic Union is fully integrated into the concept of multi-level and multi-speed integration and in no way contradicts the prospects of development of cooperation within the Eurasian space, including the Customs Union has already drawn up.

What, in the future, see the integration prospects of cooperation of member countries Eurasian Economic Union:

1. The need for liberalization of trade in services. The challenge is more than complicated, since domestic regulations also deal with individual countries of the Commonwealth.

Formation of a single unified multilateral free trade in services at the present time because the General Agreement will require a large number of seizures, harmonization of sensitive assignments, and, of course, will be the source of the increased number of conflicts and contradictions. It certainly will reduce the value of the machinery, which is not desirable.

Trade in the framework of the Eurasian Economic Union, it is advisable to adjust the format of bilateral mechanisms, which will include separate markets of individual countries, represents the common interest of all States of the Eurasian Economic Union.

2. The second integration development direction of the Eurasian Economic Union is a legislative provision of migratory flows of labour, monetary, financial and investment cooperation among the countries of the Eurasian space.

The alleged agreement for the regulation of labour migration should encourage a further influx of skilled professionals and workers in the national economies of the CIS States and include legal format in migratory flows in the Eurasian region, taking into account the real needs of the domestic labour market, a Eurasian Economic Union.

In the monetary sphere of multilateral cooperation should be geared towards reciprocal liberalization of financial markets, the unification of the currency legislation, increased use of multicurrency in trade between countries of the Eurasian Economic Union, as well as the establishment of the system of collective payment mechanisms (the currency of the collective action).

Regulation of investment transfers will require the establishment of an interstate regulatory framework that ensures an adequate level of legal guarantees and motivation to launch cross-border investment activity in the Eurasian Economic Union.

3. The third direction of the development of integrative countries of the Eurasian Economic Union is forming a common energy, transport and agricultural policies, the implementation of which would require fundamentally different approaches to energy, transport and agricultural spheres.

Due to the fact that transport corridors were formed on the basis of common rules and standards in Soviet times, and they are also the main interstate transport routes, it is important to provide an environment of unrestricted use, adapt transport networks and border crossings to the requirements of increasing the speed of movement of commodity flows and passengers between the countries of the Eurasian Economic Union, improve the reliability and security of transport infrastructure.

The most sensitive area for countries of the Eurasian Economic Union will remain agrarian. Including and because the main flows of agricultural products and foodstuffs is intraregional. In this sphere of interaction should be artery-technological nature, involving the joint development of infrastructure of the food market (construction of refrigerated storerooms, wholesale markets, terminals, etc.), national distribution networks, forming the consolidated balance of resources and use of basic agricultural products and food, the formation of a system of regular between exchange trading, e-commerce development. ■

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# Resource curse and Russian economy – current situation and challenges for the future

Expert article • 1891

Today it is quite common to believe that crisis in Russia has started much earlier than the end of 2014. In fact it is foreign policy events which have brought to the surface the internal problems which have been accumulating in Russian economy over the long term, including the “fat” 2000-2007 years. Indeed, the last few years has been seeing a curious pattern: on the one hand, world oil prices remained at a fairly high level up to the end of 2014 (with an average of 102 US dollars per barrel for the period from 2010 to 2014). On the other hand, economic growth has been slowing down (from 4.5% to previous year in 2010 to 0.6% in 2014; the official forecast provided by the Ministry of Economic Development of the Russian Federation for 2015 is -3.9%) after the crisis of 2008-2009 despite the high level of world oil prices.

The end-of 2014 collapse of oil prices resumed the discussion on how the Russian economy would operate under extremely unfavorable foreign trade terms (i.e., cheap oil). Favorable terms of trade after economic overheating in 2008 allowed us to keep low positive growth rates. However, even if oil prices surprisingly turn back to very high (100 dollars per barrel and above) level, this would not give such a boost in growth as in previous years. Let us try to understand what is the reason for that, and whether Russia has a chance to go the other way and avoid the problem of the so-called “resource curse”.

Usually a heavily oil dependent economy has always a temptation to use windfall revenues and do not invest in economic diversification and institutional reforms which could promote high sustainable growth rates in the long term. Indeed why an economy should make such investments if during the period of low oil prices it can use its reserve fund accumulated earlier under more favorable terms of foreign trade?

Creating a reserve fund itself is not a wrong or harmful step itself. Moreover, accumulation of windfall revenues in sovereign wealth funds is a key recommendation of the IMF to resource-rich countries in order to protect their economies from the volatility of world oil prices. In economic theory this strategy is called the “bird-in-hand” rule<sup>1</sup>. The baseline strategy of using the windfall of exhaustible natural resources is an alignment of costs between young and old generations following a well-known permanent income hypothesis. According to this hypothesis windfall revenues are considered as growth of wealth and the corresponding consumption expenditures are smoothed over time.

<sup>1</sup> See, for example, Ploeg, F. van der (2010). Natural Resources: Curse or Blessing? CESIFO Working Paper No. 3125, Category 9: Resource and Environment Economics; Collier, P., F. van der Ploeg, M. Spence and A.J. Venables (2010). Managing resource revenues in developing economies, IMF Staff Papers, 57, 1, 84-118, etc.

This approach, described in 1957 by M. Friedman<sup>2</sup>, is based on individual's (in our case – government's) desire to maintain a uniform consumption pattern in the long term, regardless of the time structure of income. In the first year, an individual believes that the growth of her income is temporary and saves a significant part of this additional income. If in future years the income remains at a high level, an individual adapts to this level and starts consuming more and, thus, her savings rate decreases. Thus, Friedman's idea is that consumption depends on the long-term average earnings in all future periods (called permanent income) rather than on current income.

For emerging economies, which are facing lack of capital, high interest rates and imperfect capital markets, a different strategy is more preferable<sup>3</sup>. Poorer countries should use the growth of consumption in favor of present generations instead of transferring most of the revenue growth to future generations (in accordance with the rules described above). In this case economic development is due to a combination of investment in the national economy (including infrastructure, structural reforms, etc.) and investment aimed at reducing external debt and, thus, lowering interest rates. In such circumstances there is a risk of over-investment in the pressure from various lobby or ineffective projects with negative social impact (the so-called “white elephants”)<sup>4</sup>. That is why the problem associated with the risk of misuse of oil revenues arises in countries with low-quality institutions.

This problem is typical for Russia as well. On the one hand, acceleration of economic growth requires serious structural reforms and at least a partial shift from the commodity sector to other sectors with high value added. On the other hand, bad institutions (high level of corruption, highly politicized judicial and law enforcement systems, weak protection of property rights, inefficient public administration) make it difficult to carry out reforms, and lead only to useless (in terms of economic development) spending of oil and gas revenues.

As a result, one can outline several scenarios for the Russian economy. The first is to maintain the status quo, in other words, conservation of high dependency on terms of foreign trade without de-

<sup>2</sup> Friedman, Milton (1957). A Theory of the Consumption Function. Princeton, NJ: Princeton University Press, chapters 2 and 3.

<sup>3</sup> See details in Ploeg, F. van der (2010). Natural Resources: Curse or Blessing? CESIFO Working Paper No. 3125, Category 9: Resource and Environment Economics или Ploeg, F. van der and A.J. Venables (2010a). Harnessing windfall revenues: optimal policies for resource-rich developing countries, OxCarre Research Paper 9, University of Oxford.

<sup>4</sup> Robinson, J.A. and R. Torvik (2005). White elephants, Journal of Public Economics, 89, 197-210; Collier, P., F. van der Ploeg, M. Spence and A.J. Venables (2010). Managing resource revenues in developing economies, IMF Staff Papers, 57, 1, 84-118, etc.

Expert article • 1891

velopment of oil and gas and/or manufacturing sector. Realization of such scenario implies a slow stagnation of the economy or slight positive (about 0.5%) growth under condition of an increase in world oil prices.

The second scenario suggests that Russia will be implementing structural reforms, taking into account experience of such reforms in major emerging economies (such as Brazil, India or China). This scenario assumes economic diversification and focus on high growth rates in the long term. In other words, government could energy export revenue on the maintenance of current state of the economy and its development.

In the third scenario, Russia could benefit from oil price dependence and make a bet on modernization oil and gas sector as one of the most innovative sectors. Thus, resource curse could become a blessing for our country.

In fact following the first scenario assumes further erosion of institutions, while implementation of the second and third scenario is not possible without improving institutional climate. Only life itself will give the answer how to get out of this vicious circle. ■



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# BALTIC RIM ECONOMIES

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SOILE TIRRI

# The future of Finnish-Russian cooperation – to be or not to be?

Expert article • 1892

“Finland-Russia Society” is a non-governmental organization whose task is to support Finnish-Russian cooperation on a non-governmental level in cultural, environmental and economic affairs. We have altogether five regional offices in Finland: Oulu (Northern Finland), Kuopio (Eastern Finland), Tampere (Western Finland), Helsinki (Southern Finland) and Turku (Southwestern Finland). The Society has 12 500 members in Finland and 1200 members in Southwestern Finland.

In Turku we have an active branch that is above all supporting the cultural exchange projects between twin cities Turku and Saint Petersburg. I have worked in my current position for almost 6 years now, specializing mostly in developing new and innovative ways for project cooperation between the two cities. During these strained political times it has been especially refreshing to see how actively some Finnish cities have continued their cooperation with their Russian counterparts in business, sports, culture and tourism among others. Turku is among them. And this is definitely not a given.

It is safe to say that I hear numerous comments daily on how we should turn our backs to our Eastern neighbor altogether in all levels of cooperation. Nobody seems to understand what is happening inside the Russian borders and people are baffled. This is why my work this year seems to have reached a new dimension: the role of an explainer. Someone who is asked daily about Russia, about President Putin, about the effects of the sanctions, about the Russian military, you name it.

I have always tried to answer these questions to the best of my abilities, but since I am not an expert on all matters, it has been a very trying and sometimes even a grueling task. You should never generalize, but at times it has seemed to me, that if someone has a preconceived notion of the matter in question, they very rarely change their minds. This in itself is a paradox, since most Finns have never visited Russia, don't speak the language or understand the culture. I have always wondered what facts they base their opinions on... I have to say that I cannot personally accept all the turmoil and decisions our Eastern neighbor has been making this past year but I can understand where the current situation stems from. Understanding is not accepting and without dialogue you achieve nothing.

As a friendship society our goal first and foremost has and will be supporting this dialogue in all possible levels of cooperation. As a voluntary sector organization our task is to continue to support the grass root cooperation between two civil societies and enhancing the possibilities for cooperation on the non-governmental level. A more general task naturally is to spread knowledge about Russia, Russian culture and language in Southwestern Finland. We must also not forget cooperation in the business sector. Every successful business venture in Russia requires a thorough understanding of the country and culture.

Our definite challenge for the future is to get more young members involved in our activities. This is a tough challenge for all non-governmental organizations these days, how to activate young peo-

ple and how to get them interested? The simple answer where to begin is to produce cultural events that young people find interesting. The second and equally important prerequisite is to find suitable project funding for these kinds of activities. A challenge that is easier said than done for all people working in the voluntary sector.

I have personally always wanted to showcase much more than the traditional *matreshka* dolls, *blinis* and Russian traditional dances. This is why in January this year we invited a breakdance collective from Moscow to perform and teach in local schools in the Turku region. Needless to say, the Finnish kids were ecstatic. In September we had a young graffiti artist visiting from Saint Petersburg who painted a piece of graffiti art with 15 Finnish kids. We also coordinated a three year environmental education project between 2009-2011 that was directed to 12-17 year old teenagers living in Saint Petersburg and Turku. The goal of the project was to teach environmental education in an innovative way through various creative art classes such as photography, painting, sculpture, dance etc. To this day all the teenagers who participated in the project keep in touch and visit each other between the two twin cities. To me this is the biggest accomplishment of any cultural exchange project.

The best result of any kind of dialogue is learning from one another. To me living in Russia from 2004 to 2008 was truly a life-changing experience. After diving in the Russian way of living I came back as a more assertive, vocal and confident person and learned that Finnish modesty is definitely not the best policy. So my advice to you all: Find out for yourself. Dialogue is the key. ■



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# Republic of Karelia – an after-life of socialist nation-building

Expert article • 1893

**T**he Republic of Karelia is a federal subject of the Russian Federation located in its northwestern part. It occupies a large part of the Neva basin, including coasts of Lakes Ladoga and Onega. Karelia is a key transit region for the circulation of people and commodities between the Baltic Sea region and the Arctic coast. It is home to the Oktyabrskaya railway and Kola Highway, both connecting St. Petersburg with Murmansk, as well as the White Sea-Baltic Canal.

Karelia appeared on the political map of Russia only in 1920, although as a historical region populated by the ethnic group of Karelians it has been known in Europe since the Middle Ages. Located on the periphery of Europe, Karelia saw a rise of its own nationalist movement only in the early twentieth century, considerably later than most other regions of Central or Eastern Europe. The Bolshevik revolution, the independence of Finland, and the Russian Civil War have resulted in a short upsurge of nationalist movement in northern parts of Karelia. Karelian nationalists controlled northern areas of Karelia during 1919 and early 1920; however, by the summer of 1920 the Red Army re-established Bolshevik control over most of Karelia. Yet this prominent national sentiment coupled with Finnish appeals to the international community to support the right of Karelians for self-determination pushed the Soviet government to create Karelia, in June 1920, as an autonomous region with Soviet Russia.

Karelia was established as an ethnic republic: in its original borders, ethnic Karelians made up 60% of its 147 thousand-strong population. Early Soviet nationality policies, indeed, were a sincere approach to bolster national development in Soviet regions; in some regions where local intellectual elites had failed to appear in the late imperial era, Bolshevik politicians were the main driving force behind national development. The case of Karelia was different, as here a peculiar group came to power as political, economic and cultural elite: Finnish Communist immigrants who fled their motherland in the aftermath of the Finnish Civil War. Red Finns dominated in the government of Soviet Karelia from 1920 to 1935; their period in power was characterized by an attempt to transform this region into a socialist Finland that they lost with their defeat in the Finnish Civil War. Finnish leaders of Karelia suppressed the development of Karelian literacy, arguing instead that the Finnish literary culture could bridge the gap between various Karelian dialects. Influenced by nineteenth-century economic theories, they also became advocates of economic nationalism, seeking to create a balanced and relatively autonomous regional economy.

This ambitious vision to build a self-sufficient regional economy based on the Finnish language was defeated by several factors that Red Finns were unable to overcome. One was the combination of

abundant natural resources and insufficient labour force to properly exploit them. Karelia had huge timber stocks and convenient ways of their transportation to other Russian regions by railway or for exports through White Sea ports. An increase in timber production required immigration from other regions, and during the 1920s the share of Finno-Ugric people in the population of Karelia was slowly decreasing, as new migrants came mostly from other Soviet regions, and only several thousand from Finland or Finnish communities in North America. The second factor was the overall slow rate of economic modernization based on the attempt of a balanced development of all branches of the regional economy. This frustrated advocates of accelerated industrialization, including Joseph Stalin himself, and in the late 1920s the economy of Soviet Karelia was fully incorporated into the centralized economic system of the Soviet Union as mainly a producer of raw resources, of which timber was the most important one. The Finnish leadership of Soviet Karelia was removed from power in 1935, and perished in the Great Terror of 1937-38.

The development of Karelia after the World War II generally followed the same trends. Despite a short-lived attempt at the resettlement of Ingrian Finns to Karelia in 1948-49 that brought some twenty thousand Finnish-speaking immigrants, Slavic immigration to this region continued to dominate. By 1959, Slavic people (Russians, Belorussians, Ukrainians, and Polish) made up 79% of the population of Karelia, while Finno-Ugric people (Karelians, Finns and Vepsians) only 18.5%; as of the most recent census of 2010, these figures are 85% and 9%, respectively. The economic development of Karelia is also predominantly based on the production and export of raw materials, such as timber and iron. These days, the Republic of Karelia continues to exist as a successor region to Soviet Karelia of the early 1920s, but this tradition is based on a primarily historical basis. ■



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# Drug trafficking trends in the Baltic Sea Region

Expert article • 1894

**D**ue to the profit-oriented nature of organized crime, drug trafficking—a highly lucrative commercial activity—has always been one of the fundamental sources of income for criminal organizations. The Baltic Sea Region has traditionally attracted organized crime groups (OCGs) that have been taking advantage of the high volume of trade through the sea ports to smuggle various kinds of contraband, including drugs transiting from Russia to Western markets. Since the 2000s, however, there have been major changes in the course of drug trafficking routes and the composition of domestic drug markets.

One of the major trends in the past decade is the dynamic expansion of the European cocaine market and a corresponding contraction of cocaine consumption in the United States. Despite considerable financial burden and criticism of the methods associated with the US-led War on Drugs, the hard-hitting counter-narcotics operations at the US-Mexico border have forced cocaine producers and traffickers to seek access to other markets. Since the late 2000s, the cocaine market has rapidly expanded throughout EU member states and in Russia. The Baltic Sea Region serves as an alternative entry point for cocaine trafficking, whereby organized crime groups have reversed established westward trafficking routes. Recent arrests and investigations have revealed the extent of the expansion of this drug trafficking trend. The emergence of the European cocaine market has thus created new opportunities for Baltic-based OCGs working in collaboration with Ecuadorian and Russian nationals.

In 2009, for instance, “Baltic Strike,” a joint DEA and Russian inter-agency operation against maritime trafficking of cocaine from Ecuador to Russia resulted in the seizure of circa 676 kg of cocaine and in 26 arrests of members affiliated with Vladimir Krasavchikov’s OCG, which used bananas to ship cocaine. The interception of a consignment of a total of 116 kg of cocaine from Ecuador to Latvia by Klapeida officers in December of 2014 is another illustration of the strategic importance of the Baltic Sea Region for drug trafficking.

The growing expansion of stimulants, mainly synthetic drugs and synthetic cannabinoids (e.g. fentanyls) in the Baltic Sea Region constitutes another major trend. Europol intelligence suggests that Polish and Lithuanian OCGs have gained prominence in smuggling synthetic drugs from the Netherlands to Baltic States, the UK, and non-EU post-Soviet states. They have gained access to Russia’s drug market, for example, largely due to the close ties between Russian-speaking OCGs in different states of the Baltic Sea Region. Moreover, they have arranged to procure drug precursors for the production of synthetic drugs from Russia and China, having thus gained notoriety also for the production of ecstasy and amphetamine-type drugs for both a growing local market and export, predominantly to Nordic countries and Russia.

Synthetic drugs present a serious threat to consumers because they can be clandestinely produced, are relatively cheap, and pose serious health risks. A sharp increase (by 38%) in fentanyl-induced deaths has been recorded in Estonia. In Russia too, as reported by the FSKN, 25 deaths occurred and several hundred people were hospitalized in 2014. After the 2012 ban on codeine-containing medicines that are used to synthesize desomorphine—a skin-rotting opiate nicknamed “krokodil,” the Russian government has stumbled over an epidemic caused by synthetic marijuana (K2/Spice) that has recently replaced desomorphine.

The trafficking patterns for narcotics change very fast. Only joint and coordinated actions of states can efficiently respond to drug trafficking OCGs. The anti-drug trafficking cooperation should focus on a targeted fight against transnational organized crime, undermining drug trafficking infrastructures and blocking transnational drug trafficking routes. In particular, national governments should place emphasis on the mutual application of special investigative techniques, such as international controlled deliveries, electronic and other forms of surveillance, as well as undercover operations. A generic control approach should be used to target not only known precursors of narcotics but also the entire family of substances with similar chemical composition and qualities that may be used for the production of illicit drugs should a particular precursors be placed under control, restriction, or ban.

In order to achieve these objectives, it is important that the Baltic Sea states maintain friendly diplomatic relations. In light of the recent tensions between Russia and the EU-member states following Moscow’s annexation of Ukraine’s Crimea and the conflict in the Donbas region, effective cooperation between the EU and Russia predicated on reciprocity, mutual legal assistance on criminal justice matters, and intelligence sharing would be a hard target to achieve. ■



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# Battle of the Baltic<sup>1</sup> – deeds that count

Expert article • 1895

**E**ight years have passed since the Baltic Sea Action Plan (BSAP) was adopted by all nations in the region. Six more to go towards reaching a Good Environmental Status in the Baltic. Are we on the right track? Do we understand what a healthy sea means to us, living on its shores and gaining from it daily? Do we comprehend the lost value of the Baltic being degraded to a murky marsh? Does it fit into novel EU circular economy strategy? An honest answer is “no”.

Even if we are aware of the problem and its complexity, there are always more important things to handle, while someone else should come and do the cleanup. Someone guiltier of past and current environmental sins than us. Someone with a magic wand to revert the degradation of the blue pearl of Northern Europe into one of the most polluted seas in the world. A sea surrounded by wealthy, well-educated and the “greenest” nations. A sea that provides homes and jobs to almost hundred million people in its catchment. A sea that accommodates both marine and freshwater creatures... We can only respond “yes” that we already possess the knowledge for the Baltic Sea remediation.

Let us look at what countries have committed to do and have so far achieved.

“Goods” and “bads” for the Baltic nature are jointly defined, but often with widest possible threshold levels, not to impair short-sighted national economic priorities. Researchers from all over the region deliver immense best available knowledge and precautions to policy, which are often disregarded when an *inconvenient truth* does not match policy expectations.

The Polluter Pays Principle is pretended to be a cornerstone of regional and national environmental policies, but taxpayers’ money is still easily spend to support environmentally damaging activities, whether it be fisheries, agriculture, dredging, mining or hydropower, instead of claiming and targeting compensations for rehabilitation measures.

The main polluters are well known, but countries do not dare touch a “hen laying golden eggs”. An alarming trend of mixing management and protection of natural resources and environment under the same authority leads to even further mismatch of national development priorities towards purely economic sustainability goals.

An argument that saving the sea is expensive and cannot be afforded, is commonly used, but governments keep on forgetting that the value of preserving Baltic ecosystem services and functions largely outweighs mitigation and remediation costs. Moreover, a large group of measures, e.g. banning fisheries in protected areas, gives nature an opportunity to recover and sets a basis for alternative value generating through less environmentally harmful activities.

Lack of resources to implement agreed environmental measures is often complained about, but even what is set aside to support actions for a healthy marine environment, e.g. for the EU Maritime Strategy Framework Directive (MSFD), striving for the same goal as the BSAP, is not utilized. But simply put, it is a breach of EU law not to implement commitments if funds indeed are made available.

A pan-Baltic environmental platform with its 40-year history and experience is well established and functions, but never got empowered with legally-binding instruments. Meanwhile, real better coordination means not just sharing but reducing costs and safeguarding from wasting money. Measures taken must not be compromised by either non-action by neighbouring countries or different measures that do not meet the same goals. Costly mitigation measures, taken in one country e.g. to protect valuable nature areas, will be completely in vain if nothing is done in transboundary areas close by. Hence, better coordination also means shared responsibility.

A Blue Growth is widely aspired, but even a Green one is not being implemented, falling into the same old trap of *the commons*, where no owner means no responsibility. Thus, enabling Business-as-Usual to flourish and blue-green colour still being associated only with algal blooms.

The residents of the Baltic Sea catchment have clearly expressed their concerns on the state of the Baltic Sea. We cannot accept that, when well equipped with knowledge and solutions, policies and even legal instruments, national governments hide their heads in the sand, awaiting the problem to resolve itself. Economy cannot become circular when natural values are lost, potentials missed and public money misused. What is definitely unaffordable is to continue the divide between citizens’ expectations and political implementation! We are ready to keep working hard, but are you?

“Third Armed Neutrality” by the Baltic nations escaping common environmental challenge needs to be defeated and the battle of the Baltic must go on! For the sake of the Sea, the blue pearl, and the coming generations, who we wish will be able to swim and fish in its waters and enjoy life on its clean shores. ■

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<sup>1</sup> Thomas Campbell (1777-1844)

SARI OKSANEN, MERVI KUNNASRANTA &amp; MARKUS AHOLA

# Seals without borders – Baltic Rim countries share the same seals

Expert article • 1896

Seals and humans have lived close to each other in the Baltic region since the late glacial period and archeological findings indicate that seals have played a substantial role in the economy of coastal settlements. The Baltic seal populations have been subject to various anthropogenic impacts and seals have been regarded both as a resource but also as competitors. Extensive bounty hunting and reproductive problems caused by environmental pollution led the seal populations to the brink of extinction during the 20<sup>th</sup> century. The populations are recovering since 1990s as a result of conservation measures and reductions in the concentrations of toxins in the Baltic Sea.

Nowadays grey and ringed seals are the most numerous seal populations in the Baltic, but their distributions are concentrated mostly in the northern part of the sea. The present census sizes are 32 000 grey seals and 17 600 ringed seals, which total only around fifth of the estimated number of those seals 100 years ago. In addition, less than 2000 harbour seals are found in the southwestern Baltic. The uneven distribution of seals has led to a north-south dichotomy in the management goals. In the northern areas seals cause losses to the coastal fishery and fish farming by damaging catches and gear. There hunting of the seals has become one key measure to mitigate these losses. In the south strong conservation is preferred to support the recolonization of southern areas.

## Mobile seals do not respect borders

Baltic seals have a mobile life style. Satellite tracking studies show, that Baltic ringed and grey seals range over large areas. Seals make long migrations typically from their foraging grounds to their breeding areas. Movement studies as well as genetic studies indicate that the Baltic Rim countries share the same seal populations.

Effective management of seal stocks rely on the information of their biology. During the open-water season, grey seals generally make return trips from their terrestrial resting sites to given foraging grounds some tens of kilometres away whereas ringed seals are more nomadic and change resting and foraging sites as they move. Therefore planning marine protected areas to conserve their key habitats – such as breeding, resting and foraging sites – is more straightforward for grey seals which are more faithful to given feeding and resting sites than the ringed seals. The differences in the seals' behaviour also indicate that lethal removal of individuals from the fishing gear could be effective method to reduce catch losses of fisheries in the case of grey seals but not in that of ringed seals. Some grey seal males seem to be so-called problem individuals that specialize in feeding near the trap-nets but no indication of such individuals among the ringed seal population has been found.

Winter is important time for seals as they give birth and mate during February-March. Grey seals avoid ice-covered areas and tend to move towards the open sea or south in the winter. Their main breeding areas are the drift ice, islets and skerries in the Baltic Proper and Gulf of Riga. Ringed seals rely on the stable ice cover with snow and their main breeding areas are in the Bothnian Bay, Gulf of Riga and the easternmost part of the Gulf of Finland. Both seal species return every year to the same breeding sites. This means that some individuals that breed in the south, for example, may become shot in the northern Baltic while they are foraging during the open-water season. Hunting in the north may therefore compromise the achievement of conservation goals set out for the southern part of the Baltic Sea.

## Co-management of shared seals

Effects of the climate change on the Baltic seal populations likely intensify in the future. Especially the breeding success of ringed seals, that are dependent on ice and snow in their breeding, may suffer. Grey seals breed on drifting ice floes or else on land, but their breeding success is lower on land. Interactions with fisheries may also increase further in the northern Baltic Sea due to warming of the climate. The grey seals can be expected to stay closer to the coasts if the fast ice diminishes in extent and duration, as they generally avoid areas with fast ice. The decreasing extent of the sea ice may also bring the ringed seals closer to the shores, as they haul out, moult and breed on the ice. Action taken locally can have regional effects and vice versa. Co-management of seal populations would therefore be essential. ■

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# Total negative effect on environment and economic growth

Expert article • 1897

**T**he goal of our research was to test an inverted U-shaped relation between negative effect on environment and GDP per capita in developed and developing countries and in case of estimation of significant results to reveal the main factors that decrease the level of pollution. Grossman and Krueger stated this hypothesis known as Environmental Kuznets Curve (EKC) and named after Nobel laureate Simon Kuznets in 1991. It states that at the beginning of a country's economic development industrialization pollution increases with GDP per capita and after reaching some «turning point» environmental damage starts declining as firms focus more on provision of services, government and society have enough intellectual and material resources to control and reduce pollution. We have run log-linear regressions based on data from the World Bank. We have used carbon dioxide emission per 1 thousand of square kilometers (proxy for negative effect on environment as the main pollutant) as the dependent variable and GDP per capita in constant 2005 US dollars as the explanatory variable for 89 developed and developing countries from 1960 till 2010. The countries were selected according to International Monetary Fund list of developed and developing countries. Fixed effect model on panel data for total sample identified an inverted U-shaped relation but the value of GDP per capita for turning point showed an improbably high value. So, the sample was divided into subsamples for developed and developing countries separately, and the correspondent dummy variable showed a significant difference between these two groups - intensive and extensive models of development. This formed an additional aim of the research - to determine the main factors that influence reduction in the overall level of carbon dioxide emission in developed countries.

As a result, an inverted U-shaped EKC was revealed for developed countries with the turning point at around 41 thousand dollars, but in case of developing countries, the situation was different – pollution grew with GDP per capita and no prerequisites for decrease in emission were found. Nevertheless, the significant dummy variable for the period from 1992 (when Kyoto protocol was signed) to 2010 showed a positive trend for emission reduction, but still EKC relation was not observed for this period. The same dummy variable for the subsample of developed countries identified a problem of further heterogeneity as whereas in some countries emission was already decreasing, it was not the case for others. As a result, the sample was narrowed down to the «backbone» of the European Union (16 countries that joined the EU before 1996) and included proxies for groups of factors with different influence on emission of CO<sub>2</sub>: Scale effect, Structural effect, Technological effect, Social and economic factors. Regression estimation for this group of countries showed EKC like relation with the turning point at around 40 thousand dollars. There was revealed increase in pollution with factors of the scale effect group, and decrease within the other three groups. Adaptation of new technological solutions (Tech effect) and migration from industrial production to services industry (Structural effect) make environment cleaner.

In addition, population of developed countries have demand for better living standards, enough resources for satisfaction of the main needs, and can spend more money on consumption of environmental goods. At the same time in the case of developing countries, it is impossible due to limited budgets. Individuals do not have enough money for satisfaction of basic needs and problems of the environment fade into insignificance, which was described by the theoretical model offered in this study illustrating an optimum consumption of an individual with positive utility from a bundle of basic goods and negative effect from pollution. With GDP per capita increase individuals have to rise basic goods consumption, stimulating production and consequently emission until marginal negative effect from pollution exceeds marginal utility from extra basic good and the population have to transfer a part of their savings to environmental goods. Until this, in short run governments of developing countries need to use available methods for reduction of negative effect on environment, taking advantage of practice and influence of developed countries. For example they can use direct foreign investments not only for industrial development but also for control over industrial emission and develop legal regulation of contaminating plants emission, which will give a possibility to control pollution and extend the positive trend that was identified in the subsample of developing countries. We hope that in the long run due to positive structural, technological and social effects and overall welfare growth, developing countries will be able to significantly lower the overall level of pollution, using more progressive methods. ■



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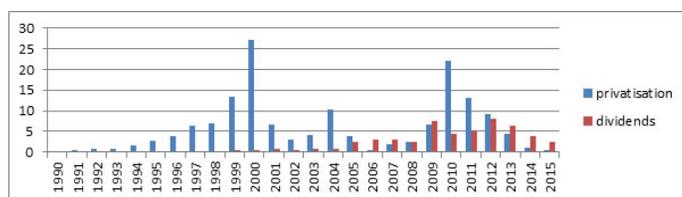
# Privatization in Poland – phasing out or reversal?

Expert article • 1898

**P**rivatization has been one of the most important driving forces behind the economic success of Poland after 1989. However, now in times of unstable politics and economic volatility the process seems to lose momentum. After the years of successful transition, the privatization has recently been phased out. Besides, the process that took place in Poland in years 2008-2014 was to some extent the sham privatization. Finally, the philosophical foundation of privatization – the high trust in the overwhelming advantage of private over public ownership now seems to be shared by fewer and fewer citizens. As a consequence, one can see now a clear process of reversal of the privatization logic.

Privatization was a key initiative of the market-based reforms introduced by the first Polish government after the fall of communism in 1989. Starting in the early 1990s, there had been a massive scale of full and partial privatization of SOEs. Privatization of small companies was very rapid, and almost complete by 1992 with 82% of such companies being privatized. The political reason behind the quick process was to create a large group of private owners with commitment to the free market economy. The process of privatizing medium and big companies was much slower. The number of remaining SOEs has diminished but even today they still play an important role in the economy, with the largest state-controlled companies often being the dominant players in their industries. After 2010, the phasing out period is easy to spot, although the missing revenues were to be replaced with dividends.

**Figure 1. Privatization revenues in Poland in 1990-2015 (PLN bn)**



At the same time however, privatization process that has taken place in Poland since 2008 was to some extent the sham privatization (cf. sham surgery). The majority of companies were sold via tender or auction mechanism. Nevertheless, a significant part (24%) were sham privatized - taken over by other state-controlled companies, communalized, municipalized or transferred to various government agencies. Admittedly, in some cases pooling state controlled companies into one entity was an effective, marketing-focused strategy. Several companies that generated losses but possessed attractive assets were packed into a coherent entity (SPV) that would attract investors and enable selling the state-controlled assets more effectively. PHN (the real estate sector) was one of the first attempts. However, presenting other contributions to SOEs or government agencies as genuine privatization is obviously misleading.

The 2007-2009 financial crisis shook the neoliberal principles and paved way to nationalist and statist policies. Now the privatization logic introduced in the 1990s is gradually being reversed. First, the

Polish government partially nationalized the assets of private pension funds. Then, some large firms were regarded strategic and selected for continuous state control. Recently, the Ministry of Treasury declared (often via CEOs of the large state-controlled entities) its intention to increase national ownership in various sectors such as banking, energy, defense and insurance. In addition to that certain measures to strengthen state control over some companies (Azoty Tarnow) with mixed ownership were taken; poison pills and golden parachutes that prevent from losing control even in cases of minority state ownership.

One of the premises behind the process might be a shift towards so-called economic patriotism. It means strengthening of national presence and a halt on further internationalization of Poland's economy. The implementation of such policies is strongly influenced by domestic pressure groups and by the self-interest of political parties. There are a few reasons for this. The first is known as political rent seeking. Second, most transactions serve some political goals of the government: cutting public services' prices, saving loss-making companies, supporting certain industrial policies, introducing "just" terms in consumer banking contracts.

The government (2008-2015) seemed to search for social consensus on the privatization issue. It attempted to generate privatization revenues, but simultaneously tried to supervise more companies, create so-called national champions in a few sectors such as banking, defense, energy, insurance, or foster growth of specific industries (PIR – Polish Investments for Development). The new government (Law and Justice Party won the election in October 2015) will most probably try to respond to the recent nationalist and statist sentiment and attempt to strengthen the national business against multinational, and the state against private. The process may have negative consequences: it can reduce competition, give way to political rent seeking and weaken the functions of market institutions. The increase of the economic role of the state can be regarded as reversal of the privatization logic that contributed so much to the success of Poland. ■

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# Benchmarks reform – time for change

Expert article • 1899

Innovation in the world of finance is customarily stimulated by competitiveness combined with globalisation processes or crises. Those innovative movements that are encouraged by markets competition usually gradually develop according to pre-existing regulations. On the contrary, innovations resulting from crises are rapid and combined with radical changes in regulatory environment. The reason for financial market crises is the hidden accumulation of risks caused by the development and innovativeness of the financial industry. Those risks have been gathering unnoticed for many years. In the beginning, they are usually too low to pose any threat, however, after some time they reach the size of systemic risk.

It can be pointed out that in the 1990s, such systemic factors were capital and leverage used to multiply profits. The Basel Accord (Basel I) was proposed in order to impose capital requirements and to review and introduce standard measurement system for regulatory capital.

At the beginning of the 21<sup>st</sup> century, liquidity grew into being a great risk factor that became systemic.

One of the most significant grounds of the crisis that occurred in 2008 was too lenient approach towards liquidity management. According to that, the most recent version of the Basel Accord (Basel III) emphasises the importance of systemic supervision by proposing adequate liquidity risk management.

For the last 3 years we have been witnessing the discovery of multiple risks that emerged due to the application of money market benchmarks. That area of finance has been developing for the past 30 years. In consequence, we are witnessing the accumulation of systemic risks.

The necessity to develop and introduce benchmarks arose in the 1970s. There was a need for the formula of defining the variable interest rate that would be generally accepted both by the banks as well as their clients, especially big financial institutions and corporations. After a few years of attempts, at the beginning of the 1980s, LIBOR came into being in order to illustrate the average interest rate of inter-bank deposit market transactions. In the second half of the 1980s, the concept of a benchmark rate developed and formulas similar to LIBOR were implemented into many European currencies. In the beginning of the 1990s, after the CEE countries transitioned to open-market economies, analogous benchmarks were formulated (such as PRIBOR, WIBOR, BUBOR).

The model of money market that existed from the 1970s to 2007, functioned in a way that savings (retail) banks were dealing with deposits. They were not able to transform deposits gained from their clients into loans, so the overbalance of deposits was sold on the inter-bank market. In that model, the price for the liquidity in interbank market was marginal cost of money. It compensated for the costs of maintaining the network, gaining and servicing clients. According to that, the average price of deposits on B2C market was usually over 1% lower than IBOR (Interbank offered rate).

That model was convenient. Banks became more specialized. On the one hand retail/savings operations and broad network, on the other hand investment banks that provide services for corporations and financial institutions. Banks gathering savings structurally encountered overbalance. The surplus was sold to investment banks that were able to generate significant assets by lending money or issuing bonds. The assets were more and more rooted in variable interest rate based on IBOR. From the beginning of the 1990s, that kind of benchmark became a standard in derivatives like IRS, CIRS, FRA and others.

In order to illustrate how much common LIBOR has become: in 2014 the market size of derivatives and on-balance instruments that were indexed to the US dollar LIBOR was USD 153 trillion. Transactions turnover indexed to USD LIBOR 3M were estimated at 1,15 trillion a day. If we ask how much id worth 1bp of LIBOR the answer is dozens of billions of US dollars.

The crisis that arose in 2008 caused changes in how the money market model is functioning. Since then, raising funding from inter-bank market in the regulatory context is treated worse than from clients. In the light of new regulations, liquidity gained directly from the client is considered more stable and secure.

There is one more factor that influenced regulatory differentiation between the sources of acquired liquidity, i.e. the crisis in confidence between banks. In consequence, inter-bank market that was active so far, shrank and became limited only to short-term transactions. Now it is a common phenomenon.

The model of financing and the redistribution of funding on the inter-bank market now has very limited functioning. According to that, the inter-bank market ceased to represent the marginal cost, nevertheless LIBOR is still used as it were.

Based on the data from European central banks, it can be stated that although before 2008 the interest rate of time deposits acquired from the clients was even 1% lower than IBOR, nowadays the interest rate of the same deposits is higher than IBOR. For instance, in 2007 in Poland, it was on average 130bp lower than WIBOR, while in 2014 30bp higher than WIBOR. Respectively, in 2007 in Finland it was 30bp lower than EURIBOR and in 2014 40bp higher than EURIBOR. Today, in various countries of the eurozone the interest rates of deposits are on different levels and they are generally higher than EURIBOR.

Due to the scandals that recently arose when it was discovered that banks were manipulating EURIBOR and LIBOR rates, The European Parliament began preparing regulations that would guarantee safety related to benchmark calculation and usage. Undoubtedly, it is the right direction and both LIBOR and EURIBOR has been already transformed. However, regulations that have been prepared suggest

Financial environments  
should join in discussion  
on reducing the  
concentration of risk in  
money market benchmarks.

that particular benchmarks should illustrate the characters of respective markets. We are witnessing a phenomenon that despite counting method remained unchanged in LIBOR and EURIBOR the character of information content changed.

In the context of discussions and projects over the issue of benchmarks, what is essential is not only providing security against manipulation. Financial environments should join in discussion on reducing the concentration of risk in money market benchmarks. It is a prerequisite to consider if the previous benchmarks are good indicators of the market and if they are adequate for the usage of balance-sheet instruments (loans, bonds) as well as in derivatives. Perhaps, following the pattern of changes in the yield curve used for derivatives (currently based on transactions OIS), it is worth to discuss benchmarks used for the balance-sheet instruments that actually replicate the cost of financing. Perhaps the time has come for the concept of benchmarks to be thoroughly analysed and adjusted to the new model of functioning of the market. It may be imposed on us by the new regulations coming into life very soon.

Let's hope to see the changes in money market benchmarks sooner than the potential crisis resulting from the risks accumulated in present indices. ■

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KATARZYNA BYRKA-KITA

# The Warsaw Stock Exchange at a crossroads

Expert article • 1900

Polish capital market belongs to the most spectacular and widely recognised successes of Polish transformation. At present, however, the growth of the Warsaw Stock Exchange has slowed as a result of fewer initial public offerings, declining total trade volume, and withdrawal of private investors. On the other hand, the number of remote players has been recently increasing, which indicates that our capital market attracts foreign investors. In 2010 the Ministry of Treasury offered to investors 26,786,530 shares of the WSE, which represent 63.82 percent of the company's total share capital. That moment marked the end of an era in the history of the Warsaw Stock Exchange, which after nearly 20 years of operation was transformed from a joint stock company owned by the Treasury into a company whose shares are traded on the stock market.

In 2015 all the WSE markets list shares and bonds offered by nearly one thousand domestic and foreign issuers. The total capitalisation of domestic companies listed on the WSE main market amounted in September 2015 to EUR 131,2 billion. According to this criterion, the WSE comes third among the CEEC and EME countries only to Turkey and Russia, but it is three times the size of the Greek stock exchange and more than six times the size of the stock exchange in Prague. Yet, the depth of the Polish capital market measured with its capitalisation relative to the country's GDP amounted to 34% in 2014, which is below both the global average for emerging markets (45%) and the figures reported by other developed countries such as Spain (over 70%), Sweden (100%) or the United Kingdom (181%)<sup>1</sup>.

Over the last several years, external environment was not supportive of either the Polish capital market, or other stock exchanges in the CEE region. The markets were affected by such events as the crisis in Greece or the conflict in Ukraine. Unfavourable changes took place also in internal environment. Since 1998, when the reform of the pension system was introduced and open pension funds were established, the WSE's capitalization was increasing mostly as a result of Poles' investing their savings in open pension funds. Gradual liquidation of these funds, initiated in 2010 and continued in 2014, has diminished the role of the Polish capital market in financing Polish companies. While before 2014, the open pension funds often acquired more than half of all the shares in IPOs on the WSE, further growth of these companies will require other sources of financing. It is noteworthy that at the moment the European Union intends to implement a programme to support development of capital markets, mostly by establishment of long-term investment funds. According to the European Commission, medium-sized companies in the United States receive five times more funding from capital markets than they do in the EU<sup>2</sup>. On the other hand, as a result of economic downturn on the WSE, share funds report no capital inflows and private investors

tend to leave the stock exchange for the forex market or search for high returns and diversification in foreign markets. To sum up, the major obstacles to the development of the Polish capital market include: limited inflow of capital, and hence low liquidity of trade, risk aversion, few IPOs and investors' preferences to deposit their savings in banks.

All the simple ideas and concepts for the development of the Warsaw Stock Exchange have already been exhausted, and the competition from other markets and trade platforms becomes ever stronger. From the theoretical point of view, the WSE may grow either by mergers and acquisitions or organically. In the past, an option was considered to merge with the stock exchange in Vienna. The Warsaw Stock Exchange is, however, too weak in terms of its capitalisation to regard such a scenario as realistic. Moreover, given the infrastructure and differences in laws and types of ownerships between the two markets, the process would be very complex, and the total value of the joint stock market would not necessarily exceed the sum of individual values of each stock exchange. According to Jacek Socha<sup>3</sup>, London is the best candidate for a strategic partner for the WSE as it might be interested in establishing its headquarters for the CEE region in Warsaw. As far as organic development is concerned, a business involving trade in shares and derivatives does not offer opportunities for considerable growth in income. Large and liquid companies are already listed on the exchange, and entities with low capitalisation offer very low liquidity and add to the reputation risk. An interesting option for expansion is further development of the market for electricity – the Polish Power Exchange (TGE), which is beyond doubt one of the WSE's successes and belongs to the most dynamically developing commodity exchanges in the region. As far as international expansion is concerned, such a venture requires both substantial financial resources and an appropriate financial infrastructure. Neither Poland's underdeveloped banking sector, nor the WSE as its institution can match competition of richer countries, especially given that the WSE was deprived of nearly all its retained profits from previous years, and – as mentioned above – the current economic downturn does not offer opportunities for high profits, either.

The Polish stock exchange has arrived at a crossroads. It is necessary to develop a new strategy for the development of the capital market; without such a strategy our capital market will gradually lose its significance. Perhaps abolishing the tax on capital gains for private investors who invest their funds in the stock market for longer periods would be a solution to boost the development of the WSE. Such efforts should be considered a priority from the viewpoint of the state's economic policy. ■

<sup>3</sup> Jacek Socha was the Minister of Treasury in the years 2004–2005. Earlier, in the years 1994–2004, he chaired the Polish Securities and Exchange Commission. At present he is vice president of PwC in Poland.

<sup>1</sup> T. Bardziński, „Skok na OFE zahamował rozwój rynku kapitałowego na który stawia UE”, *Analizy Forum Rozwoju Obywatelskiego*, 4/2015, retrieved on: 7 October 2015, <http://www.for.org.pl/pl/a/3480,Analiza-42015-Skok-na-OFE-zahamowal-rozwoj-rynku-kapitalowego-na-ktory-stawia-UE>

<sup>2</sup> [http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/green-paper\\_en.pdf](http://ec.europa.eu/finance/consultations/2015/capital-markets-union/docs/green-paper_en.pdf)

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# Polish regional approach to innovation system

Expert article • 1901

Poland and the entire Europe need innovative and effective entrepreneurial activity on a larger scale as well as changes aimed at knowledge-based and service-driven economy in order to meet the challenges posed by globalization and international competition. Changes occurring in the economy require new initiatives that should be supported by friendly environment, i.e. legal, organizational, structural and political. Observations carried out in the most developed countries indicate that despite the growing importance of internationalization of the economy, the region is seen as an alternative possibility of the existence and development of small and medium-sized enterprises in the new constellation of the global market. For this reason, one of the main objectives of the regional policy in the European Union - manifested in Green Paper on Innovation of 1995, the Lisbon Strategy of 2000 and its updates, and now in the medium-term strategy Europe 2020, in its flagship initiative Innovation Union and in the document The Role of Regional Policy in Achieving the "Smart Growth" Europe 2020 Strategy - is to ensure a successful adaptation of industrial structures in the face of global changes of social, economic and technological parameters.

The research on the innovation systems implemented in Polish regions indicate that the level of technology transfer, by determining its strengths and directions, is influenced by many economic, social or political factors whose impact is dependent on the degree of industrialization of the region. Companies tend to engage in the passive transfer of technology, which means that they are primarily a recipient of technologies. They are not involved in the creation process of these technologies, which is characteristic of the "catching up" economies. Cooperation with other organizations on the market is an important element of an innovative activity of enterprises, but the examined entities focus mainly on the passive transfer of technology. Within the active transfer of technologies, the institutional cooperation is less frequent than the sectoral one, within which entities are reluctant to transfer technologies from the competition. The process of technology transfer results in a number of positive effects. Companies using the sources of information on innovation increase their chances to create and implement technologies and only the lack of own funds proves to be an obstacle in the realization of both the passive and active technology transfers. Large organizations are primarily responsible for the implementation of technologies. Foreign capital is an important channel for technology transfer. Establishing contacts with supra-regional environment stimulates companies to undertake innovative activities along with the improvement of economic situation and qualifications of employees, which is an important factor encouraging technology transfer from the regions with a greater industrial maturity.

That is why so important seem to be the recommendations for the Polish economy related to the promotion of pro-innovation attitudes aimed at intensifying the effects of technology transfer by using the sources of information on technologies and eliminating barriers for innovation activity through greater involvement of its own financial resources, the lack of which is the principal and real limit for innovative activities in the area of technology transfer. Polish innovation policy on technology transfer should take into account the specificity of regional

economic conditions, because technology transfer is determined by both a set of homogeneous and heterogeneous conditions.

In Polish economy there should be more activities and tools supporting initiatives aimed to enhance the level of cooperation especially between the business sector and science by increasing the involvement of science in the process of commercializing its research results and by encouraging enterprises to absorb these results. Promoting cooperation among industrial enterprises in the field of innovation activity, especially the sector activity, in order to improve technology transfer processes. Identification and formulation of systemic solutions in order to change the nature and shape of innovation strategies of enterprises, which should not be aimed only at implementing but also at creating technology through a continuous process of promoting the concept of "open innovation". Additionally, there should be support for transregional innovation cooperation, which contributes to a more efficient transfer of technology along with the simultaneous construction of a system supporting the efforts to strengthen the mechanisms for technology transfer from closer business environment (but probably not local). ■



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# Polish civil society in bloom

Expert article • 1902

There is an established view among researchers and broader society on the development and functioning of civil societies in Central and Eastern Europe (CEE). The conventional view on CEE civil societies has in recent research on the topic been updated and challenged, showing that post-socialist civil societies are no longer solely characterized by financial and organizational donor dependence separated from the local context and struggling with the passivity of the grassroots. A clearly changed and more nuanced picture is emerging at the time of this writing. Despite some differences in the development of civil society among the countries in CEE, we can observe thriving activity among the grassroots and decreased importance of financial support from abroad, along with traces of “informalization” of civic engagement and the growing significance of urban social movements. Here are some of the recent findings in research on civil societies in this part of Europe, and in particular in Poland.

Several recent studies demonstrated that the assessment of passivity of civil society in CEE is outdated (Jacobsson & Saxonberg 2013; Jacobsson 2015; Jacobsson & Korolczuk forthcoming; Fabian & Korolczuk forthcoming; Polanska 2015; Polanska & Chimiak forthcoming). To summarize, these studies go against the myths of civil society in the area as weak (Howard 2003), dependent on “Western” models and support (McMahon 2002), of “uncivil” nature (Kotkin 2010), distrustful (Anheier & Siebel 1998) or solely built around family and friendship networks (Sztompka 2004). These negative and normative assessments have been discussed by researchers as a form of neo-colonialism, interpreting civil societies in CEE as weak and less developed in comparison to their Western counterparts, thus re-confirming the supremacy of the West and the peripheral position of civil societies in CEE (Buchowski 1996). It is time to challenge this powerful discourse by showing the thriving activity of civil societies in the area.

Poland is singled out as having an exceptionally lively civil sphere, intensifying its activity in the last few years. Urban movements and mobilizations have gained in popularity in the country, and the term “urban movements” was introduced to the public debate in 2010 (Mergler *et al.* 2013: 15) as a confirmation and a unifying category of the activities undertaken in the field of urban activism. This, in turn, led to further attempts to consolidate the variety of urban mobilizations and actors, and the *Congress of Urban Movements* was held for the first time in 2011. Since then it has been held annually in different Polish cities, aiming at creating a platform where various activists and organizations can discuss national urban policies and spatial planning. In many ways, 2014 was an exceptional year. The *Urban Movements’ Coalition* was founded targeting national urban policy and challenging existing political order. This was followed by local self-government elections with as many as 1,000 candidates coming from the urban movements all over the country (Domaradzka and Wijkström 2014).

There is considerable activity to be observed among Polish grassroots. Several recent studies have shown activity in fields that hitherto have been overlooked or not included in the perception of civil society. For instance, the blooming of informal social activism among Poles has been discovered to be an important and widespread feature of self-organization (Chimiak & Iwinska 2015). Meanwhile, the majority of studies have, until now, been focused on the formalized and professionalized NGO activity in the country, dismissing informal activism as lacking a political/critical angle. Civil society organizations founded

during state socialism, like rural women’s organizations, sports associations, religious groups, scouts, fire brigades, self-help groups or neighborhood groups have been omitted in studies or discarded as “false” expressions of civil society due to their a-political character (Jacobsson and Korolczuk forthcoming; Matysiak 2015; Polanska 2015). According to Iłowiecka-Tańska (2011), these kinds of organizations have been absent due to their alternative style of organizing, not comparable to the organizational style of Western NGOs. Overlooked civil society mobilizations on issues of motherhood and parenthood, tenants’ organizations, mobilizations of people in precarious positions, along with right-wing extremists in the Polish context have been examined in the work of Jacobsson and Korolczuk (forthcoming), arguing that these mobilizations’ socio-economic status, gender, religious identity or ideological position have disregarded them as not worthy/interesting enough to study. Civil society research tends to be normative and include only what is perceived as “good” civic actors, excluding those falling outside of this classification or analyzing them as an instance of “uncivil society” (Kopecký 2003). This has, however, been contested in recent studies and the narrow perspective has been broadened, showing the variety, innovative character and extent of civil society activity in the country. ■



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# The Baltic Studies Program of Stanford University Libraries

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The collection of [Baltic books, periodicals and manuscripts](#) of Stanford University Libraries (SUL) has grown significantly during the past couple of years. This, as well as the creation of the first-ever Baltic curator position in the U.S. academic libraries has been enabled by the 2011 [Kistler Ritso Foundation's endowment](#) to SUL, and the foundation's continuous support towards enhancing the Baltic studies. In addition to collection development, the library's Assistant Curator for Estonian and Baltic studies, hired in 2013, is responsible for building the Baltic Studies Program of various events and projects around the collection.

Focusing on the occupation, resistance, freedom and recovery of Estonia, Latvia and Lithuania, the SUL's Baltic collection also highlights the countries' connections to Finland and other Nordic states. With more than 30,000 titles, this is one of the strongest Baltic collections in the United States and has a great perspective of growing into being one of the top collections outside the Baltic states on the history, culture and literature of these countries. Using a large network of vendors in the Baltic states and elsewhere, and receiving new shipments on a monthly basis, SUL has developed a very strong collection of the recently published Baltic works. At the same time, SUL has partnered with other institutions in the U.S. and Canada that have strong Baltic collections (Washington University Library, University of Toronto) in filling the gaps in its collection of items published in the second half of the 20<sup>th</sup> century. Here, the growing number of donations received from the Baltic diaspora has also been significantly helpful.

In addition to printed materials, SUL has recently begun collecting Baltic manuscripts, mainly focusing on the personal papers, letters, diaries, memoirs and photos of those who were forced to leave the Baltic states during WWII and ended up in the United States. Together with the Baltic collection of neighboring [Hoover Institution Library and Archives](#) that mainly focuses on political issues (war, revolution, peace), SUL's collection aims to attract Stanford students and faculty as well as visiting scholars from all over the world, including the Baltic states.

SUL actively collaborates with other institutions and organizations on and off campus in order to enhance the Baltic studies by conducting collaborative projects, organizing events, and exchanging ideas regarding collection development. In addition to close partnership with the Estonian [Museum of Occupations](#), also supported by the Kistler-Ritso Foundation, SUL has several ongoing collaborations with other organizations in the region. For example, SUL has started to build a Baltic archive of audiovisual sources, primarily video testimonies about the Second World War and the Soviet period in the Baltic states. This project currently includes digitization of the already existing collection of 2200 video testimonies at the [Museum of the Occupation of Latvia](#), as well as the creation of 40 new video testimonies with [Unitas Foundation/Kogu Me Lugu network](#) in Estonia. Another focus of this video collection will be the so-called "Estonian mafia" – a large number of Estonians working in the ICT sector in Silicon Valley.

SUL has hosted, co-organized and supported several conferences, seminars, talks, exhibits, film screenings and other events both on and off campus. In 2014, the President of Estonia, Mr. Toomas

Hendrik Ilves, and the Prime Minister of Estonia, Mr. Taavi Rõivas visited the campus and gave talks in Green Library on issues related to [digital society](#) and [e-residency](#). SUL has also started a tradition of Baltic cultural evenings at Stanford, featuring Baltic films and talks by visiting scholars. In July 2015, the renowned Estonian TV Girls' Choir visited Stanford and gave a [public concert](#) in the Memorial Church.

This academic year, SUL partnered with Stanford Center for Russian, East European and Eurasian Studies (CREEES) in hosting the [Baltic film series](#) at Stanford - a series of public screenings of films throughout the fall quarter, focusing on various aspects of the history and culture of the Baltic countries. The series opened on Oct. 19 with the screening of Icelandic-Baltic documentary feature, "Those Who Dare" (2015). The [event](#), bringing together more than 150 people, was opened by an [introductory lecture](#) by Mr. Jón Baldvin Hannibalsson, foreign minister of Iceland from 1988-1995 and the key character of the film, "Those Who Dare".

The most recent news about the Baltic Studies Program of Stanford Libraries, and about Baltic studies elsewhere are posted on the program's [Facebook](#) and [Twitter](#) accounts. ■

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# BALTIC RIM ECONOMIES

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