



Estonia

Estonia's rapid economic growth continued

Estonia's economy grew 11.6% in the first quarter, according to the preliminary estimates from the statistical authorities. First quarter economy growth was one of the fastest in the EU area and the figure exceeds the suggested median estimates, as many estimates had been in the 9-10% range. This growth was based on a rapid increase in domestic consumption and exports. Private consumption was enlivened by the high employment rate and a rise in salaries. Net sales of enterprises in the Q1 were 22% larger than in the same period of the previous year. The expectations of local enterprises refer to sustained growth in the near future. Thus rapid economic growth is expected to continue and the Estonian Central Bank forecasts a GDP growth of 8.1% for this year,

High growth figures increased the prices of goods and services. In April, the consumer price index rose 4.7% y-o-y. The percentage change of the consumer price index rose 0.5% from April to May and 0.7% from March to April. The rise was mainly influenced by the increase in the prices of motor fuel as well as by the increase in the expenditure on housing. If inflation figures continue to stay above 4%, it will be difficult for Estonia to meet the Maastricht criteria by 1 January 2008.

Estonian central bank warns economy overheating

Estonian central bank Eesti Pank said in its new quarterly report that the overheating risks concerning the Estonian economy are increasing. The bank said that from the beginning of this year risks facing the Estonian economy have been growing: domestic consumption has clearly gone up in a year, the current account deficit is growing and the inflation rate is not falling. The bank says that the economy is on the verge of being overheated, which would further drive up inflation and slow down economic growth in forecoming years. Furthermore, Estonia decided to postpone a planned rise in excise tax in order not to fuel inflation. The rise in excise tax on alcohol and tobacco will be postponed from July 1 this year to 1 January 2008.

Salaries increased in record speed

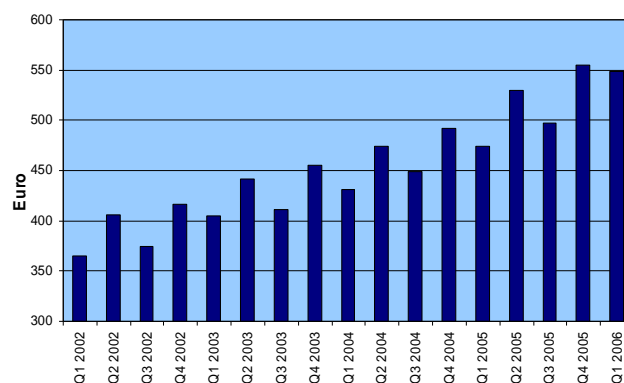
According to Statistics Estonia, the increase in wages and salaries was the highest of the last eight years in the first quarter this year. Average monthly gross wages and salaries soared to EUR 549. Comparing this to the Q1 of 2005, the average monthly gross wages and salaries grew by 15.7%. Average hourly gross wages and salaries grew 13.8% to EUR 3.3. The top wages and salaries were in financial intermediation and real estate, renting and business activities, whilst the lowest salaries were in the hotel and restaurant sector. During the first quarter of this year, the wage increase was fastest in construction (23%) and in the wholesale and retail trade (21%).

During the same quarter, productivity growth was only 4.5% in the first quarter y-o-y. Eesti Paevaleht daily writes that because of wages growing much faster than productivity, several economic sectors such as the textile industry and oil

shale industries could be soon facing massive layoffs. The layoffs would be triggered by foreign companies that would find it more efficient to produce in real low-cost countries such as China and transfer their production equipment there. The textile industry is already facing massive layoffs. Recently, a Norwegian company decided to close its textile industry in rural Estonia, Mustvee and lay off around a hundred women.

However, there are also plenty of successful cases where a foreign manufacturer has been hiring more people in Estonia. One of these success stories is the Finnish company Elcoteq which assembles mobile phones and electronic equipment and employs around 4,000 people in its two plants in Tallinn.

Trends in salaries and wages in Estonia



Source: Central Statistical Bureau of Estonia

Unemployment at a record low

The growth of employment has continued for five years and now it may be in the lowest point ever. Comparing 2005 to 2004, the annual average employment growth was 2%, but in the 1st quarter of 2006 compared to the same quarter of the previous year, employment growth was 6.8%. Employment increased in the whole country, but most in Southern Estonia. According to data from Estonian Labour Force Survey, the unemployment rate was 6.4% in the 1st quarter of 2006.

Some business highlights

- § Sparkling Group, Estonia's leading restaurant operator is opening a restaurant in Riga Old Town in the spring of 2007. The investment will be over EUR 1.3mln.
- § Tallinn Stock Exchange had 10 years anniversary on 31.5.2006. In ten years of the exchange, the highest index was 4.10.2005 when it was 700,74 points and lowest in 17.6.1996, when index was 84,24 points.
- § Kitman, Estonian industrial furniture producer, establishes itself in Finland. Kitman who manufactures furniture such as store interiors and steel cabinets has become Finland's third largest producer of steel furniture.
- § Tallink won the bidding for Silja Line. Sea Containers decided to sell its ferry group for EUR 450mln and five million shares of the Tallink group. The deal maybe made Tallink into Estonia's largest private company. The acquisition of Silja Line has considered the all-time deal for Baltic economies.
- § Pontas, the Finnish owner of Viru Hotel has sued the Tallinn City Government over its reluctance to issue the company a building permit.

Estonia - main economic indicators	1999	2000	2001	2002	2003	2004	2005	2006	as of
GDP (y-o-y %-growth, constant prices)	0.3	7.9	6.5	7.2	6.7	7.8	9.8	11.6	1-3/2006
Industrial production (y-o-y %-growth)	-3.4	14.6	8.9	8.2	11.0	8.0	9.7	8.9	1-2/2006
Inflation (CPI, end of period, y-o-y %-change)	3.9	5.0	4.2	2.7	1.1	5.0	3.6	4.7	5/2006
General government budget balance (% of GDP)	-3.7	-0.6	0.3	1.5	2.6	1.7	1.6		1-12/2005
Gross wage (period average, EUR)	284	314	352	393	430	466	555	549	Q1/2006
Unemployment (% end of period, LFS data)	12.9	13.9	11.9	11.3	9.3	8.5	7.0	6.4	Q1/2006
Exports (EUR million, current prices)	2 239	3 445	3 698	3 642	4 003	4 770	6 212	1 356	1-3/2006
Imports (EUR million, current prices)	3 224	4 615	4 798	5 079	5 715	6 704	8 192	1 739	1-3/2006
Current account (% of GDP)	-4.4	-5.5	-5.6	-10.2	-12.1	-12.7	-10.5		1-12/2005

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

Latvia

GDP in the Q1 expanded 13.1%

Latvia's rapid economic growth continued in the first quarter, being the fastest pace in the entire EU. The quarterly surge was the highest since country gained independence. The Latvian GDP also grew the fastest in the EU for 2005 being at 10.2%. The increase in GDP in Q1 was based on following sectors: 17.7% in trade, 6.0% in transport and communication, 8.8% in manufacturing and 17.5% in construction. Latvia's robust economic growth was based on the strong increase in domestic demand. The increase of trade covers almost one quarter of GDP growth in Q1. Surging growth has pushed the inflation rate to high level and Latvia was forced to drop its 2008 date for euro adoption because the rate exceeds the limit for the switchover. No new date has been set.

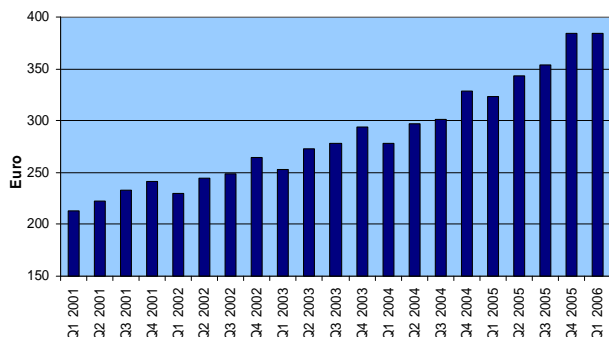
IMF warns that Latvia's economy could overheat

The extremely high growth rate has been followed by a high inflation rate increase of 6.6% in May y-o-y. The highest inflation rate in the EU and surging growth has prompted economists and the International Monetary Fund to warn that the economy may be overheating. The IMF has warned that Latvia must put the brakes on its rapid economic growth in order to prevent the economy from overheating and inflation from spiralling out of control. The steep rise in domestic demand, which was brought about by EU accession, has increased economic vulnerability in several areas, including high current account deficit, the increasing burden of foreign debt, steep salary and price inflation and a strong increase in housing prices. In addition, there are a growing number of loan transactions being carried out in foreign currencies without guarantees against risks.

Salaries grew 19.2% in Q1 in Latvia

Latvia has been reporting the EU's highest increases in labour costs for nine quarters in a row. According to Latvian statistical authorities, Latvia's average net wages grew almost three times faster than consumer prices in Q1. The total average net wages in the country within this period have grown by 19.2%. During the same period consumer price growth was 7% y-o-y, which makes the actual growth of wages 11.4%. The increase of wages was stimulated by the increase of minimum monthly wages from EUR 114 to EUR 129. Gross wages grew to EUR 383, while net wages increased as much, to an average EUR 275. The Ministry of Welfare proposes to raise the minimum wage to EUR 171 as of next year. The highest job creation rate was in Latvia, with 3.9% more workers, followed by Spain with 3.7% and Slovakia at 2.4%.

Trends in salaries and wages in Latvia



Source: Latvijas Statistika

Latvia - main economic indicators	1999	2000	2001	2002	2003	2004	2005	2006	as of
GDP (y-o-y %-growth, constant prices)	3.3	6.9	8.0	6.5	7.2	8.5	10.2	13.1	1-3/2006
Industrial production (y-o-y %-growth)	-8.8	3.2	6.9	5.8	6.5	6.0	5.6	10.0	1-5/2006
Inflation (CPI, end of period, y-o-y %-change)	3.2	1.8	3.2	1.4	3.6	7.3	7.0	6.6	5/2006
General government budget balance (% of GDP)	-4.9	-2.8	-2.1	-2.3	-1.2	-0.9	0.2		1-12/2005
Gross wage (period average, EUR)	225	268	282	297	298	314	350	410	Q1/2006
Unemployment (% end of period, LFS data)	13.2	13.3	12.9	11.6	10.3	10.3	7.8		Q1/2006
Exports (EUR million, current prices)	1 613	2 020	2 232	2 416	2 559	3 204	4 086	1 018	1-3/2006
Imports (EUR million, current prices)	2 758	3 453	3 910	4 284	4 634	5 671	6 879	1 809	1-3/2006
Current account (% of GDP)	-9.0	-4.8	-7.6	-6.6	-8.1	-12.9	-12.3	-6.2	1-3/2006

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

Strong growth in trade

According to Eurostat, in March 2006, compared to March 2005, Latvia's total retail trade rose by 16.8%, which was the highest growth figure in the EU. Latvia was followed by Estonia (12.6%) and Lithuania (10.6%). The total foreign trade turnover in January-April 2006 was 20% higher than in the corresponding period of the previous year, reaching EUR 3881mln. Exports grew 18% in May y-o-y while imports grew only 4%. This takes the foreign trade deficit to EUR 286mln, almost 44% bigger than it was a year ago.

In the domestic market, strong growth is benefiting the retailing sector as it means that more money is channelled into the economy and at the same time more jobs are created within the retail trade. On the other hand, more imports of foreign goods increases trade deficits and current account deficits, if domestic consumption is not followed up with increased exports

Latvia attracts foreign tourists

The number of foreign visitors in Latvia increased last year by 21%, which is the fastest growth in Europe. Regarding the growth of tourists, Latvia surpassed even Turkey, which grew by 20.6% last year. The number of foreign tourists in Lithuania increased 14.8% and in Estonia 5.7%. The most attractive site for tourists is the city of Vilnius, which itself attracted 1.2mln foreign tourists last year.

More investments flow into Latvia

In the Q1 Latvia received EUR 227mln in foreign direct investments (FDI), which is the largest quarterly volume ever. The investment flow is even expected to increase in the coming months as dynamic development, an attractive investment environment, the common economic area of the EU stir up increasing investor interest in Latvia. At the same time the current account deficit of the balance of payments in Q1 reached EUR 409mln, up by 42% from the same period last year. The deficit was created by the soaring and more expensive imports and the positive service balance is unable to substantially offset the deficit. In Q2 the current account is expected to grow more moderately.

Some business highlights

- § Colemont, one of the largest insurance and reinsurance broker networks in the United States, has bought a 60 percent stake in Latvia's insurance company Finansu Konsultanti Un Brokeri (FKB). The company has now changed its name to Colemont FKB Latvia.
- § World wide hotel chain, Small Luxury Hotels of the World (SLH) has signed a cooperation agreement to open a new five-star hotel in Tallinn's Old Town. The Telegraaf Hotel, a total EUR 12.8mln, will be opened in September
- § From January 1, 2007, value added tax on electric, gas, renovations and hair-dressing services will be cut from 18% to 5%. Heating supply service VAT will lower to 5% already on July 1 this year.
- § French company Bouygues Batiment International confirmed that it will be investing in the Baltic Sea Park Development in Liepaja.
- § Riga City Council will use pre exemption rights to buy land for transport infrastructure development. It is ready to spend EUR 1.2mln to acquire six properties.
- § SAS plans to open its pilot training centre at Riga airport at the beginning of 2007. The estimated costs for the building are EUR 6mln. SAS owns part of the Latvian national airline, AirBaltic.
- § Reva Hotel Latvija in Riga has become the largest hotel in Baltic states with its 578 rooms. Renovation started in 2004 and cost EUR 24mln.

Lithuania

GDP grew by 8.8% in the first quarter

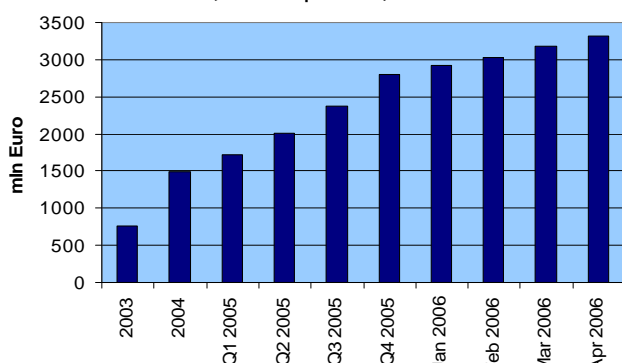
According to Statistics Lithuania's revised quarterly statistics, the GDP over the first quarter of 2006 rose by 8.8%. The rise was stimulated by the value added growth in all main economic activities. The most vigorous growth rates were observed in construction (21%) and in industrial activities (12%). Rather high growth rates were observed in the area of hotels and restaurants, transport and communications-related activities (7%) as well as other business services (9%). Final domestic consumption increased 14%, which was determined by the increasing income of population. In Q1, household consumption expenditure increased by 16%.

Lithuanians becoming richer

Latest income declaration figures show fewer Lithuanians declaring just the minimum wage, due to strong economic growth. The rise in the level of wages also indicates that some shadow economy revenues are being legalised and tax inspections are strengthened. People are encouraged to declare their real incomes by various economic incentives, including the wish to get bank loans or claim tax refunds. According to the tax authority, two years ago 60% of workers used to declare a minimum wage, and now it is 42%.

Average monthly gross earnings of employees have grown almost 40% over the last five years and are 13% in Q1 this year compared to the corresponding period last year. The average monthly gross earnings of the country are now EUR 417. The growth of the average monthly gross earnings was prompted by an increase of the minimal monthly earnings as of 1 July 2005 (from EUR 145 to EUR 159), minimal hourly wage (from EUR 0.86 to EUR 0.95) as well as heightened earnings to those employed in health care and social work.

Household loans (end of period)



Source: Monthly Bulletin of Bank of Lithuania, April 2006

Export grew faster than imports in Q1

Statistics Lithuania non final data reports that Lithuania's exports increased by 32% in Q1 2006 compared to the corresponding period last year, whilst imports increased by 39% during the same period. Lithuania's foreign trade balance has been negative for several years and in Q1 2006 the foreign trade deficit was almost 40% higher than a year ago, down to EUR 755mln. The main trade partner was Russia, with a 30% share of imports and 10% of exports. The largest exports product was mineral fuel with a 29% share, up by 52% against Q1 2005. The next largest export product was machinery and mechanical appliances, with a 12% share.

Mazeikiu Nafta partly to polish ownership

PKN Orlen, Poland's largest petrochemical company, has reached a deal with Russia's Yukos to take control of Lithuania's Mazeikiu Nafta refinery. Yukos has sold its 53.7% interest for \$1.49bn. The government of Lithuania signed an agreement with PKN Orlen for the purchase of a 30.66% stake in the Mazeikiu Nafta refinery for \$850 million. The Lithuanian state will also have an option to sell its remaining 10% stake to the Polish oil group within a five-year period. This is the largest Polish investment abroad, and will lead to the emergence of the largest fuel corporation in Eastern and Central Europe. Lithuania's parliament already gave its approval on June 1, 2006 to agreements on the sale of shares in Mazeikiu Nafta, the sole Baltic oil refining and transportation complex to PKN Orlen.

Lithuania not ready to adopt euro

The European Commission and the European Central Bank announced on May 16 that Lithuania is not ready to adopt the euro due to high inflation, which exceeded the reference rate. The annual inflation rate in Lithuania ending in March 2006 was 2.7%, which was 0.1% over the reference value of 2.6% as set by the three EU member states with the lowest inflation. The public debt, budget deficit and long term interest rates have met the prescribed requirements, while the litas has remained stable in line with ERM requirements since June 2004.

This rejection may have an adverse effect on foreign direct investments, since euro membership would have guaranteed economic stability. Moreover adoption would have favourably impacted on business productivity as euro interest rates are lower because they are controlled. In addition, with EU countries accounting for approximately 65% of Lithuania's trade, euro entry would have enabled companies to save conversion costs. It seems that inflation will continue to remain above the reference rate and Lithuania will adopt the euro no earlier than 2009.

In the same context, it is said that the country's energy dependence on Russia could be one of the reasons why Lithuania has failed to accede to the eurozone. A rise in natural gas prices may boost Lithuania's inflation, because its energy management is very dependent from Russia.

Some business highlights

- § Pro Kapital Group, a Baltic real estate developer, is developing a 34,000m² commercial and residential estate in central Vilnius. Investment will be worth EUR 20-24 mln. The project is to be completed by the end on 2009.
- § Utenos Mesa (UM) a Lithuanian meat producer has received a quality certificate from McDonald's to supply products to its restaurant chain in Europe. The first shipments of UM products will reach the McDonald's chain already in June.
- § Eika, real estate developer has declared that it will construct a 5,000m² home interior and decoration shopping centre in Klaipeda.
- § Five Lithuanian tourism projects receive EUR 5mln in EU aid to develop tourism. 32% of money has been allocated to a Norige UAB project on the reconstruction and installation of a three-star hotel in Marijampolė.
- § YIT Kausta will build the new passenger terminal at Vilnius International Airport. The value of the contract is about EUR 28mln and the three-storey terminal is scheduled to open in October 2007.
- § Mandarinas shopping centre in Vilnius, was sold to Finnish Citycon for approximately EUR 14.6mln. The centre is expected to attract 2.6mln customers in 2006.

Lithuania - main economic indicators	1999	2000	2001	2002	2003	2004	2005	2006	as of
GDP (y-o-y %-growth, constant prices)	-1.7	3.0	6.4	6.8	10.5	7.0	7.5	8.8	1-3/2006
Industrial production in sales (y-o-y %-growth)	-9.9	2.2	16.0	3.1	16.1	10.8	7.3	11.8	1-4/2006
Inflation (CPI, end of period, y-o-y %-change)	0.3	1.4	2.0	-1.0	-1.3	2.9	3.0	2.9	5/2006
General government budget balance (% of GDP)	-5.6	-2.5	-2.0	-1.4	-1.2	-1.4	-1.5		1-12/2005
Gross wage (period average, EUR)	231	263	274	293	311	335	421	417	1-4/2006
Unemployment (% end of period, LFS data)	15.3	16.9	17.9	13.0	11.6	10.6	7.1	3.5	Q1/2006
Exports (EUR million, current prices)	2 583	3 841	4 778	5 526	6 158	7 478	9 502	3 505	1-4/2006
Imports (EUR million, current prices)	4 340	5 650	6 767	7 943	8 526	9 959	12 446	4 518	1-4/2006
Current account (% of GDP)	-11.2	-5.9	-4.7	-5.1	-6.8	-7.7	-7.0		1-12/2005

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

Poland

High GDP growth in Q1 2006

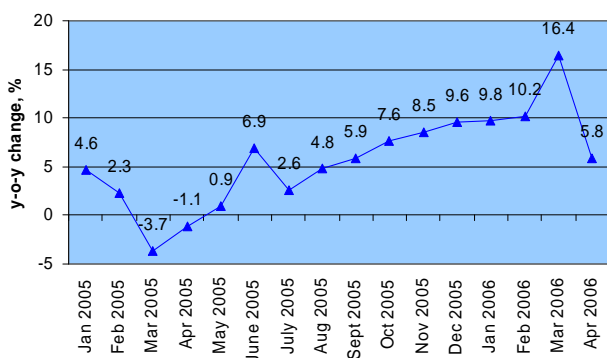
GDP growth was up by 5.2% y-o-y in the first quarter, according to statistical authorities. In Q1 2006 the economic growth turned out to be higher than market expectation, which stood, on average, at 5%. Economic growth was primarily caused by robust growth in consumption, but also by high investments and strong exports. During this period household consumption climbed 5.1% y-o-y. Expected growth for this year is around 4.5% and individual consumption is expected to increase around 4%.

According to international financial institutions, Poland has every chance of enjoying rapid and sustained economic growth and the prospects of the economy are promising. The new GDP growth projections are more optimistic than those suggested earlier. Instead of 4%, GDP is expected to grow almost 5% this year. Poland is at a strong period of the business cycle and benefiting from the implications of EU accession.

Business climate increasingly favourable

According to the Central Statistical office (GUS), entrepreneurs are increasingly optimistic about their financial situation, as well as about current and future orders. An improvement in the business climate has also been noted in the building sector. The general business climate in the manufacturing sector in May was 17% more favourable than in the previous month. In addition employment in the commercial sector increased in April 2.8% y-o-y. Furthermore, KPMG research in April, demonstrates that 75% of the surveyed investors positively assess the effects of their investments in Poland and 10% even very positively. Meanwhile, none evaluated the results of their entry onto the Polish market negatively.

Industrial output in Poland (% y-o-y)



Source: GUS, May 2006

The unexpectedly good industrial output results in Q1 2006 gave hope of an equally good economic performance for the entire year. In the first four months of this year, industrial output grew by 11% y-o-y. Thus some of April's economic data disappointed the market, because results were substantially weaker than in the previous months. The significantly lower output growth rate may have been caused by the statistical effect of fewer working days this April compared to April 2005. Although the macroeconomic foundations of the economy are still positive and high powered industrial output growth is expected to continue around 9% in 2006.

Consumer price index at all time lowest

This March, the consumer price index (CPI) dropped to 0.4% y-o-y. Apart from a temporary CPI drop in April-May 2003, this was the lowest CPI in the history of the free-market economy in Poland. After the record low inflation, the CPI increased in April to 0.7%. The slender increase was mostly the effect of higher prices of energy and fuel as well as housing goods, services and food. If the Polish economy continues to boom, inflation will accelerate in the coming years. Future increases in oil and electricity prices will impact on inflation by raising it. The Monetary Policy Council (RPP) has set their inflation target at 2.5% for forecoming years.

The downward inflationary trend has been sustained for over year and has led to the reduction of interest rates. The reference rate is 4%, the lowest level in the history.

Food exports high

Food has become one of Poland's leading exports products, and is the fourth biggest export product. Between 2004–2005, the value of food exports grew almost 35%, totalling EUR 7bln. The results of Poland's foreign trade in food, following the EU accession, surpassed the wildest expectations of analysts. The greatest increases were recorded in exports to other EU countries and in 2005 were dominated by meat and poultry products, sweet baked goods, cookies and fruit juices. The boom is expected to continue in 2006, though at a lower level. This year's foreign trade results seem to remain good. During the first three months of 2006 Polish export sales totalled EUR 19.9bln and imports EUR 22bln. In comparison to the previous quarter, exports grew 22.3% and imports 20.8%. The accelerating import growth has been attracting attention as an offspring of a recovery in domestic demand.

Some business highlights

- § Indesit, the Italian household appliances manufacturer, will open a third plant in the Lodz Special Economic Zone (SEZ). The company will invest at least EUR 80mln and create 1200 new jobs.
- § Energy concern CEZ, the biggest company in the Czech Republic, has finalised the purchase of 75% of stakes in Elektrownia Skawina power station worth EUR 181mln. CEZ also purchases 89% of Elektrociepłownia Elcho thermal power plant in Chorzow, worth EUR 202mln. CEZ is the 8th biggest energy concern in Europe.
- § Banks noted high profits in Q1 and the financial result stood close to EUR 780mln, which is two-fifths higher than in the corresponding period last year. Profitability was also higher, the net margin rose 1.3% to 9.9% y-o-y.
- § Sanitec Group, a Finnish German bathroom accessories provider, has begun building a bathroom tile factory in a sub-zone of the Lodz SEZ. The investment is estimated to be worth EUR 26mln. The plant is due to open in the first half of 2007
- § Europol Meble S.A., a company with German capital, received a permit for conducting business activity in the Kostrzyn-Stubice SEZ. The investment outlay will amount to EUR 24mln. The new factory will employ at least 500 people.
- § Anti-corruption bureau (CBA) will start its function as a new special State Security service, whose task will be to combat corruption and other malpractices detrimental to the economic interests of the State. The unit will employ 500 people and have a yearly budget of EUR 18mln at its disposal.
- § Rosa Europe, an Italian firm, is to build a factory in Walbrzych SEZ to produce plastic and metal components. The investment is approximately EUR 4mln.
- § Japanese Bridgestone builds a new tire plant in Stargard Szczeciński. It will be the second Bridgestone tire factory in Poland. The investment is estimated to be worth EUR 200mln and create jobs for 800 people.
- § Europol Meble, a company under German capital control is investing at least EUR 24mln in the Kostrzyn-Stubice SEZ. Production of wooden frames for the furniture branch creates 500 new jobs.
- § One of the largest container terminals on the Baltic coast was opened in Gdynia.

Poland - main economic indicators	1999	2000	2001	2002	2003	2004	2005	2006	as of
GDP (y-o-y %-growth, constant prices)	4.5	4.2	1.1	1.4	3.8	5.3	3.2	5.2	Q1/2006
Industrial production (y-o-y %-growth)	3.6	6.7	0.6	1.1	8.3	12.6	4.1	5.8	1-4/2006
Inflation (CPI, end of period, y-o-y %-change)	9.8	8.5	3.6	0.8	1.7	4.4	0.7	0.7	4/2006
General government budget balance (% of GDP)	-1.4	-0.7	-3.7	-3.3	-4.8	-3.9	-2.5		1-12/2005
Gross wage (period average, EUR)	401	472	557	544	497	505	591	660	Q1/2006
Unemployment (% , last survey in the year, LFS data)	15.3	16.0	18.5	19.7	19.3	18.0	16.7		Q4/2005
Exports (EUR billion, current prices)	25.7	34.4	40.4	43.4	47.5	59.7	71.4	19.9	1-3/2006
Imports (EUR billion, current prices)	43.2	53.1	56.2	58.3	60.4	71.4	80.6	22.0	1-3/2006
Current account (% of GDP)	-7.6	-6.0	-2.9	-2.6	-2.1	-3.5	-1.2	-1.3	1-3/2006

Source: Polish Official Statistics, National Bank of Poland, Eurostat, author's calculations

Estonia's path to euro area

By Andres Lipstok

Among the new EU member states Estonia has been in a group of forerunners when it comes to the issue of joining the European Monetary Union (EMU). Estonia has always stated that it seeks to join the euro area sooner rather than later and entered the European Exchange Rate Mechanism (ERM II) on 28 June 2004, shortly after acceding to the European Union. The authorities' target date for joining the euro area was then set for the beginning of a calendar year after the end of the mandatory 2 years in the ERM II, i.e. January 1, 2007.

In April 2006, the Government of Estonia, in close cooperation with the central bank, decided that due to the level of inflation the 2007 target is no longer realistic and Estonia should make practical preparations for the euro area accession as of January 1, 2008.

Estonia intends to adopt the euro as soon as possible

The postponement of the accession target does not change our strategy to join the euro area at the first opportunity. The main driver for Estonia's early entry is to reap the economic benefits of the monetary union through increased trade and financial integration, which will foster economic growth and real convergence. This could be achieved through the reduction of transaction costs and a decrease in the interest rates via eliminating the exchange rate risk premium.

Joining the monetary union or participating in ERM II is usually deemed to entail some costs in other areas, e.g. short-term costs of fiscal consolidation and the cost of giving up independent monetary policy and flexible exchange rates as stabilization tools. These possible costs are essentially non-existent in case of Estonia as we have operated a successful currency board vis-à-vis EUR (DEM) for fourteen years (including during the ERM II as a unilateral commitment). Furthermore, fiscal discipline has been strongly entrenched in our political culture – the state budget has been at least in balance (in the last 5 years even in surplus) and the public debt is the lowest in the EU (below 5% of GDP). Therefore, joining the monetary union does not entail any significant changes for our fiscal policy as it has been in line with the Stability and Growth Pact principles for more than a decade.

Markets trust our euro accession strategy

The first two years in ERM II can be regarded successful as there have been no tensions in the exchange rate market. Also, government's decision to postpone the target date for the euro area accession by one year was a non-event for the markets and rating agencies. Estonia is still expected to join within a few years and a short-term delay is not treated as a major risk to our economy. This attitude is strongly based on the assumption that prudent economic policies that have brought success to Estonia so far will continue.

It is widely accepted that Estonia's economy is basically ready for the euro area membership, as countries with a small and open economy that have been successful under the fixed exchange rate regime with the national currency pegged to the euro for several years, should be most suitable euro area candidates.

Estonia does not have problems with price stability

Although the inflation in Estonia increased up to 4.9% in September 2005 and has stayed over 4% level, we do not regard our recent developments as a threat to sustainable long-term price stability in Estonia. The overall macroeconomic situation in Estonia has been favourable in recent years. Real GDP growth has hovered over 7-8% level for more than five years and accelerated further in the second half of 2005. Based on our baseline macroeconomic projections, the moderately positive output gap should gradually vanish without creating serious tensions in the economy. This assessment, together with the relatively stable inflation expectations and possible Balassa-Samuelson impacts, serves as a basis for our own conclusion that there are currently no fundamental problems with the price stability in Estonia. Nevertheless, this situation does not make it easy for us to fulfil the price stability criterion.

In this respect, the authorities have prepared a set of measures, which aim to fulfil the criterion after the second quarter of 2007. These measures include reprogramming the excise tax increases and keeping the fiscal stance as tight as possible.

As Estonia's difficulties with the price stability criterion are not unique and concern all countries with fixed exchange rates and in the catching-up process towards the EU average price level, then Estonia supports discussions on the economically meaningful interpretation of the criterion. For instance, it is not clear why countries with the lowest positive inflation rates are almost automatically the best performers in terms of price stability. Moreover, countries with floating exchange rates need not necessarily be the best benchmarks when assessing the ability to maintain low inflation in the single currency area.

Euro area enlargement is in everybody's interests

The enlargement of the euro area will contribute to the further development of the European Union. At the same time, it is in the interests of the European Union that the enlargement of the euro area is based on transparent rules. Otherwise the credibility of the euro as an international currency would be compromised. As mentioned above, this should not preclude discussions regarding the economically meaningful interpretation of the Maastricht criteria as the European Union and the euro zone itself have changed significantly since the discussions on Maastricht Treaty rules 15 years ago.

Andres Lipstok

Governor of Eesti Pank

HELCOM - creating a new environmental strategy for the Baltic Sea

by Anne Christine Brusendorff

Today, the Helsinki Commission, or simply HELCOM, is working on an ambitious new strategy to solve major problems troubling the Baltic Sea. The HELCOM Baltic Sea Action Plan, which has already been widely heralded as a pilot project for the protection of regional seas under the newly drafted EU Marine Strategy, will provide a unique opportunity to take joint wide-scale and decisive actions to achieve the ultimate target of having a healthy marine environment with balanced ecosystems for present and future generations to enjoy.

For more than three decades, HELCOM has been acting as the main environmental policy-maker for the Baltic Sea area by developing specific measures to protect and conserve its unique marine environment. The Commission, working through intergovernmental co-operation between all coastal countries, has produced appreciable environmental gains in the past 30 years, thus validating the conviction that the deterioration of one of the most polluted seas in the world can be halted and the state of the marine environment improved.

But despite some remarkable progress in the past years, the overall state of the Baltic Sea is still not satisfactory. In order to maintain the Baltic Seas natural assets for future generations a lot more has to be done.

In view of the various environmental problems some of which are proving difficult to solve, in 2005 the Helsinki Commission decided to draw up a strategic environmental action plan to ensure that all possible measures are taken to reduce pollution in the Baltic Sea and to repair the damage done to the marine environment.

The highlight of this innovative plan is that it will be based on a clear set of Ecological Objectives defined to reflect a common vision of a healthy Baltic Sea, e.g. clear water, no excessive algal blooms and natural distribution of plants and animals. The good ecological status definition will be set based on a holistic view and by creating a balance between the health of the sea the public wants and the human influences that they will accept. With this ecosystem approach protection of the marine environment is no longer seen as an event-driven pollution reduction approach to be taken sector-by-sector. Instead, the starting point is a common understanding and definition of a sea with a good ecological balance, which is deciding the further needs for reductions of pollution loads as well as the level and extent of human activities.

Another major highlight of the HELCOM Baltic Sea Action Plan is that it will be elaborated with the active participation of all major stakeholder groups in the region – from governments, through industry and NGOs, right down to individual citizens living on the shores of the Baltic Sea, to ensure that the plan is relevant and can be effectively implemented in practice.

The consultation process behind the drafting of HELCOM's Baltic Sea Action Plan was officially launched at a 'kick-off' Stakeholder Conference held on 7 March 2006 in Helsinki, Finland, where more than 200 participants, representing scientific and business communities, governments of the coastal countries, the EU, as well as major regional organisations met to discuss the objectives of the strategy and to provide input to its further development.

Commenting on the Helsinki Commission's work to create a strategic plan to rescue the marine environment, the State Secretary from the Finnish Ministry of the Environment

Stefan Wallin underlined that "HELCOM is the only intergovernmental organisation within the Baltic Sea region with the mandate to deal comprehensively with the problems of the Baltic Sea, and to jointly agree on implementation of measures to preserve and protect the Baltic marine environment, to conserve natural habitats and biodiversity, and to ensure the sustainable use of natural resources within the Baltic Sea region". Wallin also noted that the preparation of the HELCOM action plan must be open-ended and transparent. "We must use this opportunity when preparing this new Baltic Sea Action Plan to make it as comprehensive and, at the same time, as realistic and action-oriented as possible."

The European Commission described the plan as "the cornerstone for further action" in the Baltic Sea region, and confirmed its intention to take an active part in its development over the coming months. The Commission thinks that in setting a definition of 'good ecological status' for the Baltic Sea as well as specific environmental targets and necessary measures, the Baltic Sea Action Plan will be instrumental to the successful implementation of the new EU Marine Strategy in the region. In this context the new plan makes HELCOM a forerunner, and a model to be followed by other regional marine conventions around Europe.

The Council of the Baltic Sea States (CBSS) also backed the HELCOM action plan. The Chairman of the CBSS Committee of Senior Officials, Kornelius Sigmundsson, said that "the CBSS Presidency recognises the value of HELCOM's Baltic Sea Action Plan as a very important aspect of our region's joint efforts to achieve a healthy Baltic Sea environment." Sigmundsson also added that as an overall political forum for regional intergovernmental co-operation, the Council of the Baltic Sea States will continue to encourage and support HELCOM activities.

Following the outcome of the Stakeholder Conference, at its annual meeting in March, HELCOM approved the core elements of the Baltic Sea Action Plan - a common vision of a healthy sea, and a set of Ecological Objectives to work towards so as to fulfil this vision.

The next crucial step in the development of the Baltic Sea Action Plan will be to identify and detail the kind of actions needed to achieve the agreed environmental objectives within a given timeframe for each of the four main environmental priority issues: curbing eutrophication, preventing pollution involving hazardous substances, improving safety of navigation and accident response capacity, and halting habitat destruction and the decline in biodiversity.

After a series of thematic meetings and a final Stakeholder Conference in March 2007, which will review a preliminary draft of the plan, the finalised environmental strategy will be adopted at a HELCOM Ministerial Meeting scheduled to take place on 15 November 2007 in Warsaw, Poland.

For further information on the development of the Baltic Sea Action Plan, please visit the HELCOM web site: www.helcom.fi

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European and Baltic dimension of strategic partnership between Poland and Lithuania

by Eufemia Teichman

On September the 5th this year 15 years will have passed from resuming diplomatic relations between Poland and Lithuania. The date marked a new era in the history of both countries. Both the endeavour to integrate with western cooperation structures and similar perception of their role in shaping new order and safety in Europe were main reasons for the strategic partnership which, due to Lithuanian initiative and with Poland's acceptance, has been functioning since 1997. What are the results of the experience of this partnership in the situation when strategic goals of both countries have been achieved?

In July 2006 Finland will take over the leadership in EU with four new members from the Baltic Sea region, Poland and Lithuania included. The EU Northern Dimension is known to be the priority of Finnish presidency. Will it be possible to add some experience of Polish-Lithuanian strategic partnership to this political endeavour?

The remaining part of my paper reflects on the very subject. The goal of strategic partnership between Poland and Lithuania was to cause EU and NATO accession of the two countries. To achieve this goal (following the Baltic States' example) common cooperation structures between parliaments, governments and presidents of both countries were appointed. Besides a common military unit Litpolbat, whose aim in a way was to prepare Lithuanian army for NATO partnership, was created. We gained common experience in Trans-Atlantic, European and Baltic cooperation. Another political asset of Polish-Lithuanian partnership is the dialog with our eastern neighbors: with Russia (both our countries border with the Kaliningrad region), Belarus and Ukraine.

In reality political effects of the partnership prevailed over economic co-operation, however trade exchange dynamically rose (by some 30% annually on average, although asymmetrically to Poland's advantage), capital exchange also rose (though to a lesser degree), social relations evolved regardless of national minorities' problems being always an important element of this partnership. We have also learned cross-border cooperation (including the "Niemen" and "Baltic" Euro-regions). On the other hand we have failed to take advantage of reserves inherent in maritime economy and tourism. Neither have we managed, for economic reasons, to solve several important, especially for Lithuania, matters connected with development and modernization of road and electrical power infrastructure (Via Baltica and the so-called transit energy bridge). Polish-Lithuanian strategic partnership became a significant political capital for both countries and was appreciated by both EU and NATO. Trust – strong basis for further cooperation was built. Both countries benefited from this.

What seems to be needed at present is a new big political project, the realization of which will generate new energy between partners. Strengthening of The North-South Axis on which political, economic and social activity of enlarged EU would concentrate may become such a project. This Axis, being a part of EU Finnish presidency, is devoid of ideological context (good West – bad East), does not eliminate existing trilateral alliances of the Weimar Triangle type (although

its purposefulness in its present form seems to be almost exhausted), allows both to create European network of cooperation between new member countries and the more competitive, knowledge-based innovative economies of Scandinavian countries and to actively pursue by EU the neighborhood policy towards Eastern Europe countries.

According to my authorial concept, Poland has the following strategic interests in the Baltic Sea region:

1. Poland's resolved entry into "the Baltic club" in order to develop innovative and knowledge-based economy,
2. ecologic and energy safety (the Baltic energy ring, the Baltic gas pipe-line),
3. regional transport and cooperation, including the Baltic part of Russia,
4. Poland's accepting the role of an important liaison between the Baltic and Central as well as Southern Europe; the indispensable condition for fulfilling this role is building in Poland the necessary meridian communication infrastructure, especially a network of ports, terminals, highways as well as acceleration of Via Baltica construction.

Poland and Lithuania have a lot in common on the EU forum: attitude towards energy safety, eastern policy and history. Our approach to eastern policy, energy and environment protection brings us closer to Baltic and Scandinavian countries, while cohesion policy unites Poland with other EU countries.

Poland's relationships with Latvia and Estonia, apart from being very friendly, are not advantageous enough for all the partners. We will not find allies to criticize European constitution in Estonia or Latvia, for these countries do not lose much due to diverging from the Niece Treaty, but it is in Riga and Tallinn where we can find support for our attitude toward the Baltic gas pipeline.

Scandinavians have a long tradition in promoting such values as civic liberties and also have pragmatic relations with Russia. Together we can promote activities towards our eastern neighbors, e.g. towards Belarus, without irritating Russia.

Finland will not support us in the matter of energy safety as they think it is possible to have good relations with Russia and at the same time depend on gas deliveries from Russia in almost 100%, just as Finland does. Therefore for every important national, regional or EU interest, it is essential to create multilateral expedient alliances, taking advantage of our experience gained in bilateral relations between Poland and Lithuania.

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Third Wave co-operation needed in the Baltic Sea Region

by Esko Antola

The Baltic Sea Region is facing the third wave of regional cooperation in the Post-War period. The first wave marked the institutionalisation of the Nordic cooperation. "Norden" became a sub-region of its own and demonstrated a high level of integration in many fields.

The second wave of cooperation got its dynamism from the fall of the Cold War. New institutions and networks mushroomed in the early 1990's. They served the transition of former socialist countries towards market economy. Local and regional actors became closely linked to the Baltic Sea dynamism. Pre-accession programmes of the EU strongly enhanced Baltic Sea cooperation. The most important new feature of the second wave cooperation was the very active role of civil societies in the region.

During the Second Wave "Norden" wanted to save its original Nordic institutions (Nordic Council, Nordic Council of Ministers) intact. This contributed to a new wave of institutions. The Baltic Countries followed the same pattern and established their own Baltic Assembly between the Parliaments in 1991 as well as the Baltic Council of Ministers (1994). For the region-wide cooperation the Council of Baltic Sea States (CBSS) was formed in 1992. Its geographical scope and membership pattern is wider including Norway, Iceland and Russia.

The third wave of the enlargement of the European Union in 2004 has made the Baltic Sea region an internal sea of the Union. It has become an inland sea of the European Union with one third of the EU's member countries on its shores. In a broader context, the Baltic Sea area can be considered to include all the 11 countries that are members of the Council of the Baltic Sea States.

The accession period marked a deep process of socialisation for the new EU members. Socialisation was a necessity for the adaptation to the *acquis* of the Union. It was possible because of the existing liberal-democratic value base that these countries shared before the Second World War. New member states never completely lost their cultural heritage and links with Western Europe. This greatly helped their accession seen as a "return to Europe". The "Second Wave" institutions greatly helped the socialisation process. Of a particular value was cooperation between civil society organisations.

The process of adaptation to membership has not been completed. The legislation required by the Union needs to be implemented nationally. The responsibility for implementation of the rules lies with the member countries. Nevertheless, the execution of rules and laws is not a matter of governments alone. Regions and local authorities as well as the civil society play a key role. The co-operation of the Baltic Sea area could be of great importance in strengthening common rules and ways of working. The Baltic Sea as an inland sea of the European Union will not be realised until the common rules are implemented. Particular attention should be paid to the strengthening of good governance in the Baltic Sea region.

The Baltic Sea needs a regionalisation strategy, Third Wave of institutions of cooperation. This calls for a contribution of all actors in the area. Co-operation also requires organisations and institutions that bind the projects and their implementers together. A new dimension is provided by the expanded European Union that will change the rules and ways of working in the Baltic Sea economic region.

The challenge, but at the same time a great opportunity, is closing the welfare gap that divides the region. The poorest member countries of the European Union (the Baltic States) are also the fastest growing economies in the EU. Their goal is to close the gap in the standard of living and welfare. The Nordic countries are among the wealthiest economies of the European Union, but suffer from fairly slow economic growth. They are searching for a means to preserve the welfare they have achieved.

Closing the gap would contribute to the economic competitiveness of the Baltic Sea area. The region needs a regional Lisbon Strategy. The Lisbon strategy offers a common framework to eight EU member countries. The most successful participants in the strategy are the Nordic countries and Germany. Channelling this success as the Lisbon strategy of the Baltic Sea is a major common challenge. The "Lisbon strategy of the Baltic Sea" should be made a common goal in the area.

It is impossible to envisage the Baltic Sea region without taking into account the Russian areas on the Baltic Sea. Both St. Petersburg and Kaliningrad areas are among the fastest growing economies in Europe. Connecting them as part of the Baltic Sea entity would open up new possibilities to the development of the Baltic Sea economic region as a European area. The relationship between the EU and Russia offers the framework for the participation of Russian areas bordering the Baltic Sea in the co-operation in the region. The streamlining of this framework is one of the key challenges of Finland's Presidency of the EU in autumn 2006.

The Baltic Sea now needs first of all an independent review of its institutions and instruments of cooperation. Quite many of the second way organisations seem to have lost their mission and stamina. This concerns in particular the civil society networks. But also governmental organisations should openly and critically review their activities and missions. This is in particular the case with traditional Nordic institutions.

A wider perspective is needed if the interests of the Baltic Sea are to be articulated and transformed into action. Quite obviously there is overlapping between existing institutions. Review and critical assessment of the existing institutional structure is needed for the reconstruction of the Baltic Sea cooperation. This is going to be the first task of the Centrum Balticum, a new think-tank type of an organisation that shall open its activities in Turku early autumn this year.

The power of the Baltic Sea area could be much greater in the European Union, if it was able to speak with one voice. The Baltic Sea area seldom presents itself as a unified area, and rarely speaks with one voice. The area lacks a forum needed for forming a common will. This is a particular problem in the decision-making of the European Union and influencing it. There are a number of organisations and agreements between different countries in the Baltic Sea area, but none of them has been founded to channel the power and the common interests of the area outside its sphere.

Esko Antola

Jean Monnet professor at the University of Turku.

Esko Antola has been actively involved in the establishment of the new Centrum Balticum foundation in Turku

A New Wave of the Baltic Sea Cooperation on the Rise: Focus on St. Petersburg

by Esa Kokkonen

Since the revival of the Baltic Sea cooperation in the 1990s, the political agenda, structures and financing instruments for the cooperation have been more centred around challenges of the region than its opportunities. Topics and themes of concrete cooperation activities in the main fields of the Baltic Sea cooperation still mainly concern the solving of acute problems and prevention of environmental and other soft security related threats, as was the case already in the early 1990s. In addition to the still prevailing problem-solving and threat-prevention based approach to the Baltic Sea cooperation, new emerging themes of the cooperation - such as innovation, competitiveness and information society - are rising up the today's agenda for the Baltic Sea cooperation.

During the 1990s and early 2000s, the Baltic Sea cooperation was still characterized by projects and programmes facilitating the EU accession process of the Baltic States and Poland, and supporting Northwestern Russia in various development needs. This one-way approach with the ones who donate and the ones who receive assistance is now gradually disappearing. Today's Baltic Sea cooperation is based on reciprocity and sustainable and equal partnerships, and knowledge and good practices are moving in various directions across the Baltic Sea. The old EU member countries in the Baltic Sea region are benefiting from rapid economic growth and dynamism in the region's new EU members and Northwestern Russia. This dynamism and innovative spirit is well illustrated by various "tiger leaps" that are taken in different sectors in the Baltic States - such as the astoundingly rapid information society development in Estonia.

St. Petersburg alone, as by far the largest metropolis in the Baltic Sea region, constitutes a highly interesting testing ground, resource base, and first of all, an active developer and future leader of the above presented new wave of the Baltic Sea cooperation. Considering its population of 5 million, rapid economic growth, strong innovative capacity and knowledge base in its numerous world-class universities, the involvement and inclusion of St. Petersburg in practical forms of the Baltic Sea cooperation is still on a surprisingly initial level. There are various reasons behind the fact that majority of unutilized resources and opportunities of the Baltic Sea cooperation stand in St. Petersburg. On the one hand, political and economic structures of the Baltic Sea cooperation still mainly deal with the federal level of Russian politics and economy, whereas actual needs and opportunities concern the Northwestern district. On the other hand, commitment, approach and procedures of relevant stakeholders are still sometimes based on the set-up of the 1990s "old wave" of the Baltic Sea cooperation.

After Moscow, St. Petersburg is by far the second most important center of ICT and information society related expertise in Russia. There is a half a dozen world-class technical universities with major ICT programmes in St. Petersburg. This knowledge base has attracted various major international ICT companies, including Microsoft, Siemens and IBM, to establish their R&D centers in the city. There is also a strong business cluster on programming and software development in St. Petersburg.

When also considering that St. Petersburg city administration is strongly committed to information society development by actively developing eGovernment services and infrastructure, it is easy to understand the multitude of opportunities St. Petersburg offers for ICT cooperation in the Baltic Sea region.

Considering innovation promotion as another key theme of the new wave of the Baltic Sea cooperation, St. Petersburg again constitutes a highly interesting area. The development of the regional innovation system is among key priorities of business development and investment promotion policies in St. Petersburg. Various technology centers and science parks are currently under preparation, and there is a strong interest to utilize e.g. Nordic technology center and business development concepts and practices in St. Petersburg. Regardless of strong research and development capabilities and innovation potential in universities in St. Petersburg, there is a major deficiency as regards the ability to turn scientific potential into economic results. Furthermore, there are significant defects in the protection and enforcement of intellectual property rights (IPR), including an alarming problem of large-scale counterfeit production as the most visible sign of the IPR problem.

In spite of the rise of the new wave of Baltic Sea cooperation emphasizing more opportunities than problems, environment still remains as the most important sector of the Baltic Sea cooperation for a long time. The Baltic Sea is one of the most polluted seas in the world, and its condition is so severe that it takes decades to achieve significant and sustainable improvements. As regards the strengthening EU-Russia partnership and the Northern Dimension as key elements of the Baltic Sea cooperation, and the crucial position of Northwestern Russia and St. Petersburg in the region, it is noteworthy that the Baltic Sea region is continuously facing serious risks caused by insufficient nuclear safety in Northwestern Russia, and increased transport of Russian oil through the Baltic Sea. Furthermore, so far only initial steps have been taken in the development of effective wastewater treatment in Northwestern Russia. The above mentioned risks can be managed only in close cooperation between the EU and Russia, and with effective and dynamic structures and instruments for the Baltic Sea cooperation.

Both the above presented opportunities and challenges call for further development, innovative ideas and well-tailored financing instruments for the new wave of the Baltic Sea cooperation. On its part, the Baltic Institute of Finland (BIF) is actively contributing to this task through its versatile project portfolio with St. Petersburg. BIF projects in St. Petersburg encompass a variety of both bilateral and multilateral cooperation activities from IPR to environment protection, and from eGovernment to construction sector.

Esa Kokkonen,

Director, The Baltic Institute of Finland

The Kaliningrad oblast and co-operation in the Baltic region

by Gennadiy Fedorov and Valentin Korneyevets

Co-operation between Russia and the EU also could be stimulated by deepening of their interaction on the Baltic Sea region arena, while the Kaliningrad oblast should play an active role in this process. The well-known project "The Northern Dimension of the EU" is now transforming into the greater project "The Baltic dimension". The Baltic dimension project inscribes the Northern countries as well as Poland, Lithuania, Latvia and Estonia. Germany can also play an active role. North-West of Russia, including the Kaliningrad oblast, could be involved in this project too. Russian participation in this project would allow for more effective integration with the EU (40% of Russia's trade with the EU comes to Baltic Sea countries). Certainly, Russia is interested not only in trade. Other economic aspects of high importance are the investments, tourism, telecommunications etc. Cooperation could be very useful in others spheres of the Baltic dimension project, such as science and education, culture and sport, security and politics.

Kaliningrad oblast is an active member of many organizations for Baltic Sea region co-operation. The participation in these programs contributes the development of practical co-operation, contacts adjustment, promotion of different regions and investments attraction. But unfortunately, funding of co-operation projects by Russia (including the research projects) is insufficient.

The list of projects of the Baltic Sea countries and regions that are being actively implemented also includes the following ones:

- "Via-Baltica", "Via-Hanseatica" – the projects of motorways development, connecting the countries of the region;
- "The Baltic gateway" – the project of the network of motorway and ferries;
- "The Baltic energy ring" – the project of energy system development;
- programs of the Baltic Sea cities cooperation;
- ecological programs concerning the Baltic Sea basin; and
- educational programs ("The Eurofaculty", "The Baltic University Programme" – the Kaliningrad state university takes part in these programs very actively).

Kaliningrad is involved in many projects, but often only nominally. One of the projects that might be of interest is VASAB – 2010 ("Vision and strategies around the Baltic – 2010"), which is based on such values as development, environmental sustainability, freedom and solidarity. The document consists of four spatial elements, which could be studied and implemented for the case of Kaliningrad region as well:

- cities and urban networks;
- power system and transport networks;
- territories, supporting dynamism and the quality of life (such as the border territories as an instrument of international exchange; tourist territories; coastal zones, demanding special attention; natural and cultural landscapes of special importance); and
- comprehensive spatial planning.

To lower the drawbacks of the exclave character of the Kaliningrad region it is necessary to include it in the new spatial forms of international economic integration. These are the establishments of the sub-national level including regions of several states and featuring active cross-border and interregional cooperation, constantly growing level of the socio-economic integration. These include "large regions", "triangles of growth", "working communities" (associations etc), Euroregions. Euroregions are especially actively established and are functioning in the Baltic Sea region. They develop joint strategies, pull together financial means for solving common problems and for the implementation of interregional projects. The establishment of Euroregions with Russia's participation started as early as in the second half of the 1990s.

The participation of Russian regions in the Euroregions certainly differs from that of the regions of the EU countries (since Russia is not a member of the EU, and it does not seem to be going to enter it). Nevertheless, we hope that in the course of time the differences will be eliminated.

The Kaliningrad region and its municipalities are members of 5 Euroregions: Baltics, Neman, Sheshupe, Saule, Lyna-Lava. The region most actively participates in the Euroregion "Baltic" Its national secretariat is in Baltiysk. The Council and Presidium have been established. Three working groups (those of environmental protection, spatial planning and social issues) have been formed. Future joint projects have been planned and among them are the following ones: SEBTrans-Link, connecting Russia to the EU countries, projects aimed at tourist and resort infrastructure development, security in the Baltic Sea region, networks of analytical and information centres, and that of public health service. There are projects aimed at the reconstruction of the old part of Baltiysk and the setting up of a new international multi-purpose centre on the Curonian Spit. The implementation of the "Seagull project" (aimed at the elaboration and development of the Euroregion strategy), launched in 2001, is going on. This project is financed by such European programmes as Interreg, Phare, Tacis.

There is an interesting proposal by Urpo Kivikari (Finland) about "the South Baltic growth triangle". This concept proposes to use first of all:

- investment from Sweden, Denmark, Germany;
- work force from Poland, Lithuania, Latvia;
- raw materials from Russia through the Kaliningrad oblast; and
- the combination of these three elements could give a significant effect.

This idea is quite attractive for the Kaliningrad region, because its territory fits with the project considered for the implementation.

Gennadiy Fedorov and Valentin Korneyevets

Professor Gennadiy Fedorov is a pro-rector of research and Dr Valentin Korneyevets a senior researcher at the Immanuel Kant State University of Russia

The importance of higher education to attract investment and contribute to sustain economic growth and competitiveness in Kaliningrad

by Eric Brunat

The Socio-economic situation in Kaliningrad region

With a population of just under one million people, Kaliningrad region is in the paradoxical situation of being adjacent to the rapidly developing new EU member states (Poland and Lithuania), whilst being held back by its post-soviet legacy of struggling to adapt to a market economy. Despite significant growth over the recent years, and under-investment in old, over-manned industries, and combined with a too and fragile SME and services sector, these are the major defining characteristics of an economy that is falling behind its neighbours. At the same time the regional and municipal administrative structures are also in need of further guidance with reform measures and need assistance in developing a productive relationship with the private sector. This is needed at both the strategic planning and economic development framework level in order to buttress the vital socio-economic regeneration that the region requires.

On the one hand, it is in response to this major structural dislocation between public and private sectors, and the consequent inability of one sector to support the other, that the European Union is co-operating with the Regional Government in developing the concept of a 'public private-partnership' for strengthening business and administrative education in the region. A unique, brand new state-of-the-art MBA/MPA degree programme, including an innovative 'Integrated Cross Modular Learning Programme', is being developed involving major higher education institutions in the region. This will allow civil servants and business managers the opportunity to study a combination of modules covering public-private sector subject areas. This will hopefully, contribute to both retaining the best brains and attracting new competences, to the region as a whole. The expected impact on productivity, best commercial practices, and increased competitiveness should give a huge impetus to economic development in Kaliningrad. The expected economic growth will act as a pole of attraction for further forms of investment from European Union institutions in the framework stipulated by the new Law on Special Economic Zone, based on the new tax benefits in force since April 2006.

On the other hand, the strategic location of the enclave, adjacent to the Baltic economies, provides a great potential opportunity for economic and social interaction and growth, assuming that these fundamental structural weaknesses can be addressed and corrected. However, the continuing inadequacies of the higher education/training sector in providing updated, western-style public-private sector education and training, is acting as a brake upon the sustainability of any socio-economic revival in the region especially in the area of post graduate studies. Despite action underway, there is still a question mark whether this economic growth is sustainable over the medium term, and this can be summarised as follows:

The structure of growth is not sustainable because of a lack of national and foreign direct investment due to high transaction costs. The impressive exceeding of 10% GDP growth achieved so far during the period 2001-04, is more than for Russia as a whole. This pattern of growth is characterised by a lack of contribution from medium-sized firms and a short life-expectancy for small businesses. The big firms occupy probably too large a role in this 10% growth. Moreover, the demographic trends are very bad, with

young people leaving the region, and these trends could have a major detrimental impact on the labour market in the medium term, and on the recruitment of students into higher education. So therefore, it is urgent to innovate at the post-graduate studies level to make the region more effective and attractive, keeping the best young people and attracting the best managers from other regions of Russia, and possibly from the EU and neighbouring states.

In addition, after the enlargement of the European Union it became more crucial than ever to identify the comparative advantages of Kaliningrad region within the globalisation process and the world economy.

Such problems are thus compounded by difficulties in the higher educational and training sector being able to provide the requisite advanced forms of business and public sector education that is needed to streamline, stimulate and transform business management education and public sector training; thus the capabilities of enterprises and municipal authorities is being held back by an inability to fully exploit the real market and services potential that exists for them. Training needs analyses of companies and of existing higher education and training institutions, show weaknesses in the following areas:

1. Difficulties are being experienced by institutions in fully embracing the student-centred learning methodologies
2. An insufficient or even non-existent relationship, between the higher education sector and companies and municipal authorities, and a corresponding mismatch between the training needs of the public/private sector, and the services presently available from the education and training providers
3. An inability to provide the necessary diagnostic analysis of enterprise problems, resulting in a continuing lack of much needed consultancy assistance and in-company training for managers
4. The dearth of understanding and skills in how to use experience-based teaching and learning methodologies and to contextualise training in a comparative case study framework, that relates to real life public-private sector needs
5. The lack of strong partnerships with leading European Union higher education/training institutions has resulted in Kaliningrad training providers failing to act as a necessary conduit for the latest knowledge and skills transfer to either business agents or civil servants.

Business Awareness about SME Clusters

A dominant characteristic of the economic configuration of Kaliningrad region is the lack of a developed and substantial SME sector. A number of foci could be identified around which the potential stimulation of new SME formations could take place. It is of crucial importance to strengthen the economic fabric that contributes to the emergence of new SMEs to increase the density of firms, and to reach a critical mass to increase the competitiveness of the Kaliningrad region through a virtuous cycle from investment and production to growth. In this context the clusterisation could to some degree be an outcome of any development of postgraduate studies. It is of crucial importance to systematise the dissemination of the latest tools for teaching local and regional economics. To reach these goals the modalities of local governance, the Corporate Social Responsibility and the Public-Private-Partnership concepts

are amongst the major principles governing the cultural and socio-economic development. Applied research must focus much more upon the conditions of SME development and sustainability, in short the relationships between them, and with local institutions, big firms and of course with Universities.

These are of crucial importance for facilitating the process of bottom up development. They will also relate to the consultancy and training needs including the upgrading of labour performance and customer service needs, which will be of critical importance for their orbital development around the larger firms.

This would aim to encourage an enterprise culture, to unleash entrepreneurship and could in the medium and long term be a significant positive impact on the labour market, especially for the next generation of Kaliningrad's entrepreneurs, and for SME start-ups and spin-offs.

Regional and Administrative Reform: a key component of Kaliningrad's growth and development

In a globalised and complex economy the private and public sector are intimately bound together in delivering a concatenation of socio-economic, municipal and administrative services to citizens and clients alike. Inward investors are attracted to regions not just by low labour costs but by the quality of social, educational and administrative support services provided by the host region or country.

To attract to, and then retain this investment in Kaliningrad it is vital that this whole package of services is upgraded to EU levels and where possible close to the requirements of Acquis Communautaire. Success on the economic front will not be sustainable in the long term if the public and social services are not streamlined to meet this fast changing world. Practical reforms such as decentralising budgets, educational reform and the growth of a customer-care services culture, based on responsiveness to needs will be critical for supporting economic improvements for local people, to sustain the growth and to translate it into an attractive human development.

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