



Estonia

Estonia's rapid economic growth continues

Estonia's ministry of finance recently revised its GDP growth forecast for this year to 9.6% and 8.3% to 2007. Previously the ministry had forecast economic growth of 8.2% this year and 7.7% in 2007. GDP in Q2 may weaken slightly, because in the first quarter GDP rose by an enormous 11.7%. Eesti Pank estimates that rapid economic growth will persist in the years to come and consumer price growth is expected to remain moderate.

Inflation reached 4.4% in June, whereas the target was 2.8%. Inflation was the second-fastest in the EU and was driven by economic growth and rising oil prices. Estonia's Finance Ministry raised its inflation forecast to 4.5% for this year and slowdown can only be expected at the beginning of next year.

Delay in the introduction of the euro, the government may decide to increase excise duties on fuel, tobacco and alcohol products after all. Earlier this year the government decided to postpone the excise duty raise, fearing that it would boost inflation. The government has set a new date for euro adoption of January 1st 2008. Fulfilling the Maastricht criteria in 2007 may be difficult and it is more likely that Estonia may have to delay its adoption of the euro for a second time.

The value of foreign trade increased 31% in June y-o-y. Exports increased 28% y-o-y and imports grew 33% y-o-y. The trade deficit grew to EUR 236mln, up from 159mln y-o-y.

Estonia confronts labour shortage

According to statistic authorities, the unemployment rate fell to 6.2% in Q2, down from 6.4% in Q1 and 8.1% from the same period last year. Employment was driven by the service and transport sectors, while the construction industry had a 36% jump in employment. According to the State labour market board, those registered as unemployed in August 1st was 1.6% of the labour force.

The Estonian finance ministry has said that a labour shortage is a threat to the country's economy. Because of a chronic workforce lack, more Estonian companies are seeking permission to hire workers from Ukraine. Especially high is the demand for welders and construction workers from Ukraine. Tallinna Autobussikoondis, the municipal bus company, has warned residents that its service will be affected because of a lack of drivers. Representatives of the IMF recommended Estonia to ease restrictions on hiring workers from abroad; Better access to the Estonian labour market would slow down wage growth, which is pushing up inflation rate and is delaying Estonia's accession to the euro zone. According to employers, an inflow of thousands of Ukrainian workers would allow the Estonian economy to overcome their shortage of skilled workers and ensure that the country's economy can keep growing.

Average gross wages amounted to EUR 610 in a month in the second quarter of 2006. In one year, average gross monthly wages are up by 15% and gross hourly wages by 17%. According to the Finance ministry, average gross is expected to grow 8.7% next year.

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	11.7	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	1-6/2006
Inflation (CPI, end of period, y-o-y %-change)	3.9	5.0	4.2	2.7	1.1	5.0	3.6	4.5	7/2006
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	610	Q2/2006
Unemployment (% end of period, LFS data)	12.9	13.9	11.9	11.3	9.3	8.5	7.0	6.2	Q2/2006
Exports (EUR million, current prices)	2 239	3 445	3 698	3 642	4 003	4 770	6 212	2 979	1-5/2006
Imports (EUR million, current prices)	3 224	4 615	4 798	5 079	5 715	6 704	8 192	3 978	1-5/2006
Current account (% of GDP)	-4.4	-5.5	-5.6	-10.2	-12.1	-12.7	-10.5	-16.2	1-3/2006

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

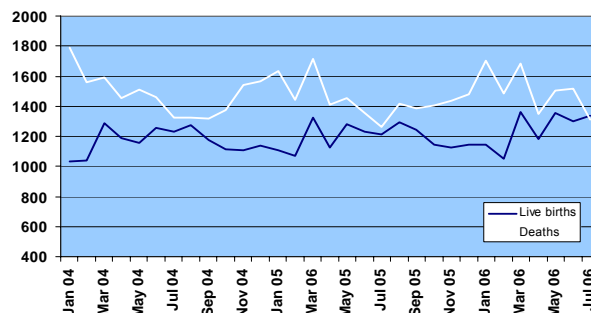
Growth of construction sector fastest in EU

According to Eurostat, Baltic States posted the EU's fastest annual growth in the construction sector in the first quarter this year. The fastest growth was registered in Estonia 24% y-o-y, followed by Lithuania 22% and Latvia 17%. Development of the construction sector probably lasts; although the lack of workforce personnel and rising interest rates are slowing down the pace. According to Statistics Estonia, the construction price index rose 8% in the Q2 of 2006 compared to the corresponding period last year. The rise was mainly influenced by the increase in the prices of the labour force, which rose 14% y-o-y and building machines 12%.

Competitiveness of Baltic countries diminishing?

According to the Baltic Times interview in July, a leading Harvard economist has suggested that Baltic governments need to increase business regulations to prevent the region from slipping into economic turmoil. He claims that Baltic countries need to increase positive business interference to maintain growth. He also warned that Baltic nations risk losing their competitive advantage if growth and wage increases are not more closely regulated. In recent years, the Baltic's had enjoyed growth, due to their high skill base, low wages and attractive tax environments. In the future, the region needs to identify a "brand" and set a clear market position so businesses and investors can understand its unique strengths, the economist claims.

Registered births and deaths in Estonia



Source: Central Statistical Bureau of Estonia

Some business highlights

- Ryanair considers adding Tallinn to its destinations. The flight route can be launched at earliest next autumn. Ryanair promises to bring at least 300,000 passengers a year to Tallinn. Ryanair already operates in Riga and Vilnius.
- Two businessmen, Ulo and Guido Parnits, father and son, plan to build Estonia's largest windmill park in Northeast Estonia, where could be even 40 windmills.
- Skanska EMW won the contract to build Estonian Defence Forces Kuusalu training ground for EUR 4.2mln.
- Estonia's largest candy maker Kalev, will start producing bread under its brand name in September.
- Estonian Energy has announced that its strategic goal would be to raise shale oil production to 500,000 tons by 2010. Present level is 130,000 tons.

Latvia

Robust economic growth continues

Latvia's rapid economic growth is expected to continue over the second quarter. The main driving force of the economy will be domestic demand, which is supported by a reduction in unemployment, rising wages and lending. In Q1, the quarterly surge was 13.1% and was the highest since the country gained independence. Therefore GDP figures to Q2 may not be as high as in Q1. However, in 2006 GDP growth is expected to slow down, near 10% and 8% in 2007, as domestic demand growth moderates. Until now, expansion has been driven by strong domestic demand, which is nevertheless likely to grow less rapidly later in 2006 and into 2007. The recent boom has been partly financed by a sharp increase in credit, but the willingness of companies and households to borrow seems to be diminishing.

Value of Latvia's exports is catching up with imports

The unit values of exported goods are starting to catch up with the unit value of imported goods during Q2 of 2006. According to the data from the Central Statistical Bureau, compared to the previous quarter, unit value increases were 3% for exported goods and 3.2% for imported goods.

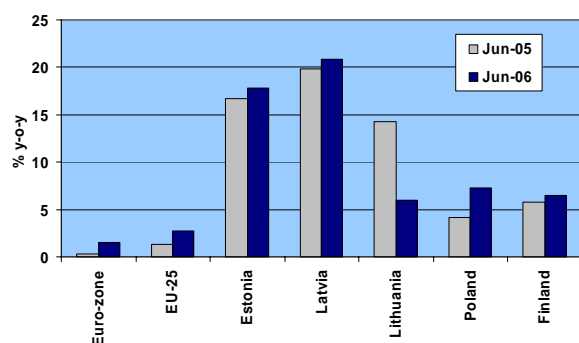
The total foreign trade turnover in January-June 2006 grew 22% compared to the corresponding period last year. Monthly imports grew 3% in June, whilst yearly growth was 26%. The value of exports increased 5% in June compared to the previous month and 24% y-o-y. The robust growth in exports was based on an increase in almost in all the main product groups. The highest increase was observed in the export of the products of chemical and allied industries 54%, plastics and plastic products 41% and for agricultural and food products 35%.

According to Eurostat, in June industrial new orders in Latvia had the steepest growth in EU, growing by 9% month-on-month. During the same period industrial new orders increased in Lithuania by 1% and Estonia by 5%.

Latvia has highest inflation rate in EU for past two years

Annual inflation rate of Latvia rose to 6.9% in July and for the past two years has been the highest in the EU. In July 2006, consumer prices posted a month-on-month rise of 0.6%. Inflationary pressures have been stoked by high fuel prices and robust domestic demand. In June prices of unprocessed food rose almost 15% as a result of the impact of a persistent drought. The first time that Latvia's annual inflation rate increased so dramatically was in August, 2004, when it rose to 8%.

Volume of retail trade



Source: Eurostat

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	5.7	1-6/2006
Inflation (CPI, end of period, y-o-y %-change)	3.2	1.8	3.2	1.4	3.6	7.3	7.0	6.9	7/2006
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	7.8	Q1/2006
Exports (EUR million, current prices)	1 613	2 020	2 232	2 416	2 559	3 204	4 086	1 786	1-5/2006
Imports (EUR million, current prices)	2 758	3 453	3 910	4 284	4 634	5 671	6 879	3 204	1-5/2006
Current account (% of GDP)	-9.0	-4.8	-7.6	-6.6	-8.1	-12.9	-12.3	-14.6	1-3/2006

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

Number of foreign tourists up by a fifth

The number of foreign visitors to Latvia increased in Q2 by 19% compared to the corresponding period of 2005. According to the survey by the Central Statistical Bureau, 66% of the total number of foreign visitors stayed in Latvia less than 24 hours. The average length of stay of visitors to Latvia was 1.3 visitor nights. The majority of foreign visitors came from Lithuania 36%, Estonia 23% and Finland 6%. The average visitor spent EUR 74 per day, which is EUR 29 more than in the corresponding period in 2005. In 2005, the number of foreign visitors grew by 30%. Air traffic also reflected the increase in tourists; Lithuanian airports served 991,400 passengers in the January-July period, which was 25% more than the same period last year.

Number of large companies grew in 2005

According to a study by Lursoft, the number of companies defined as "large" under Latvian law has increased by 35% or around 1000 companies in 2005. This is shown by a preliminary examination of 47 000 company annual reports. Some 2930 of the 47 300 companies were ranked as large companies. Reasons for the sharp growth in companies classified as "large" are the fast growth of the economy and low corporate profits taxes, which have encouraged some international companies to locate profit centres in Latvia and book a large part of their international turnover there. Furthermore, almost two-thirds of Latvia's large companies are 10-15 years old and many of them are direct successors of Soviet-era state enterprises.

Some business highlights

- Colosseum chain will open at least 20 stores in Latvia over the next few years. German-based Colosseum sells all types of apparel, footwear and accessories for men, women and children at mid-price. It already has 200 stores in Europe.
- Ministry of Welfare and Ministry of Regional Development propose to grant tax relief to families who take a mortgage loan on their first home.
- Poland's PKN Orlen is considering purchasing the Latvian stake (39%) in Ventspils Nafta, a Latvian oil company. PKN Orlen wants to purchase it in order to acquire another export channel for Mazeikiu Nafta's oil products.
- Evroset, Russia's largest retailer of cellular phones is due to open its first outlets in the Baltic's in a EUR 10mln venture. It even plans to set up even 145 stores in the Baltic's, 50 of which will be located in Latvia.
- The Kurzeme Fish Terminal has opened in Ventspils fish port. About EUR 2.1mln has been invested and it complies with EU regulations.
- According to Knight Frank, the UK estate agency, property prices in Riga have risen 45% in a year and 74% in the preceding year.
- The US owned building materials company Laticrete, has opened a new EUR 2.5mln production facility in Salaspils. The new plant will produce tile glue, which the company has invented.
- Latvian banks have been developing at a faster rate than was previously expected. The latest review by SEB Unibanka states. "Although Latvian banks still lag behind Western countries in terms of average lending volumes against GDP, with the present growth rate, Latvia might catch up with the West in two to three years time".
- According to the Latvia's Central Statistical Bureau, 26.4% of employed worked more than the official working week, which is 40 hours by law.
- Both of Latvia's sugar mills, whose fate depend on EU restrictions, could be converted producing biofuel ethanol from sugar beets, if sugar production ends.
- Riga has been ranked as the most expensive city in the Baltics, thought only the 81st most expensive metropolis among 144 surveyed by Mercer Recourse consulting. Tallinn was pegged as the 96th, while Vilnius was not even ranked.
- The new BMW dealer in Latvia, Wess Select is starting to build a 3,000m² BMW showroom centre in Riga. Investment is worth EUR 6mln.

Lithuania

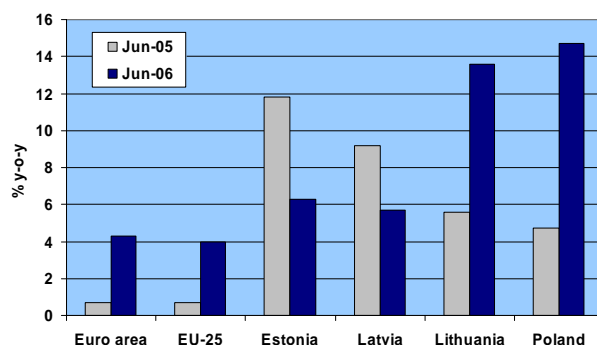
GDP up 8.4% in the Q2

According to Statistics Lithuania, the GDP over the second quarter of 2006 rose by 8.4% compared to the same period last year. In the Q1 alone GDP rose by 8.8% y-o-y. Over Q2 of 2006, the most vigorous growth rates were observed in construction and manufacturing-activities related enterprises. Growth rates in industry and construction were significant as well. GDP Growth was higher than analysts' expected, which raises fears about possible economic overheating. The higher-than-expected result puts Lithuania in the same camp as Estonia and Latvia, whose super-hot economies are near to boiling point. A moderate slowdown in GDP growth rates could be expected in the second half of the year, forecasts moves around 7%.

High growth rate accelerated the consumer price index, which rose to 4.4% in July y-o-y. The annual inflation rate in Lithuania was one of the highest in the EU. The rise was mostly influenced by the increase in prices of housing, water, electricity, gas and transport, also pick-up was in healthcare prices, food and soft beverage prices.

Development of wages is strong. According to Statistics Lithuania, average monthly gross earnings in Q2 of 2006 rose to EUR 440. An increase of 14%, compared to the corresponding period for 2005.

Industrial production growth (% y-o-y)



Source: Eurostat

Lithuania's foreign trade deficit up by one-third in H1

Rapid increase in Lithuania's foreign trade continued during the first half of 2006. Exports grew 31%, while imports grew 31% compared to the corresponding period of last year. The foreign trade deficit of Lithuania grew from previously, being 30% higher than a year ago. In June 2006 exports increased 34% y-o-y, while imports grew 41% y-o-y. Exports were mostly driven by an increase in overseas sales of processed oils, vehicles, plastics and furniture. The rise of imports was determined by a higher demand for crude oil and gas, vehicles, electrical machines and equipment and TV and video equipment and their parts. The biggest trade partner was still Russia with 11% share of exports and 29% share in imports.

Lithuania's wage growth slowest in Baltic Countries

Analysts at the Lithuanian bank, DnB NORD Banka, have upgraded their previous 2006 forecast for the wage growth rate from 10% to 13%. However, this rate is still the lowest among the Baltic States. At the end of Q1 2006, the annual

indicator for Lithuania, Estonia and Latvia was 13%, 15% and 19%, respectively. According to the average monthly wages, Lithuania ranked second with EUR 416 after Estonia EUR 549. Compared to Great Britain, wages in Lithuania are six times lower. If salaries grew at an annual rate of 12% in Lithuania, the country would catch up with Great Britain in some 15 years. Despite the growing salaries many Lithuanian companies run into shortages of skilled workers.

The Lietuvos Zinios daily writes that retailers suffer from a workforce shortage. Supermarkets in Lithuania's largest cities have been struggling to find enough employees to work in the stores. The situation is especially poor after office hours and during weekends.

A new worldwide survey by Swiss bank UBS, shows that a resident of Vilnius takes 43 minutes to earn a Big Mac. A resident of Tallinn works 39 minutes and in Riga 28 minutes for a Big Mac. The average for the surveyed countries was 35 minutes.

Reconstruction of residential building increased

In all likelihood, Lithuania will see a construction boom in the near future. According to preliminary information from the Department of Statistics, the construction of new homes in Lithuania already increased 69% y-o-y in Q2 of 2006. Most of the new apartments were built in Vilnius and Kaunas. In Q2 of 2006 permits to build rose 21%. Almost all permits were issued for construction of 1-2 dwelling buildings. The value of renovation has also risen notably. Furthermore, a cement shortage delays and frustrates Lithuanian builders. In August, cement ran out twice, because country's only cement producer was unable to keep up with demand.

Mazeikiu Nafta crude oil delivery from Russia dry up

Russian crude oil deliveries to Mazeikiu Nafta, the Baltic's only refinery, have apparently ceased for the next 9-12 months due to pipeline damage in Belarus. Since pipeline supplies have been disrupted, Mazeikiu Nafta has been importing crude oil via its terminal in Butinge, which is supplied by tankers. The number of tankers is being raised to eight. According to the company refiner's representatives, they have some alternative routes, if Russia began obstructing shipments between Primorsk Seaport and the terminal in Lithuania. Furthermore, they are ready, even if the pipeline does not work at full capacity for a long time. Polish PKN Orlen is still purchasing the ownership of Mazeikiu nafta; the pipeline crisis doesn't affect the deal.

According to the Lithuanian Department of Statistics, in H1 2006 the railway carried 30% more oil and its by-products compared to a year ago.

Some business highlights

- Klaipėdos Terminalo Grupe (KTG) and Fima electronics launched a terminal management system, which will allow use of an electronic data exchange, which will speed up carrier operations.
- Daisotra, one of Lithuania's largest transportation and logistics businesses based in Alytus, is facing bankruptcy.
- Government propose amendments to profit tax law. The new procedures are aimed to attract more foreign capital and investors to Lithuania.
- Former Hansabak executives are developing a project to build a windmill park to north of Palanga. It will have 7 windmills. Investment is worth EUR 19mln.
- Baltic Furniture Components is launching the second production line earlier than intended, due to high demand of its products. First line was opened months ago.

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	8.4	1-6/2006
Industrial production in sales (y-o-y %-growth)	-9.9	2.2	16.0	3.1	16.1	10.8	7.3	12.7	1-6/2006
Inflation (CPI, end of period, y-o-y %-change)	0.3	1.4	2.0	-1.0	-1.3	2.9	3.0	4.4	7/2006
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	440	Q2/2006
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	4 236	1-6/2006
Imports (EUR million, current prices)	4 340	5 650	6 767	7 943	8 526	9 959	12 446	5 545	1-6/2006
Current account (% of GDP)	-11.2	-5.9	-4.7	-5.1	-6.8	-7.7	-7.0	-10.6	1-3/2006

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

Poland

GDP growth expected to remain at current level

The economic situation in Poland has been continuously improving. In the first quarter of 2006 economic growth turned out to be higher than market expectation, which stood, on average, at 5.2%. In the second quarter, GDP growth will be at least as high as in Q1. Strong exports and continued high domestic demand stimulates the growth of GDP. Furthermore, the macroeconomic data for June confirm that the Polish economy is buoyant.

Economic growth has led to an increase in prices and in July inflation amounted to 1.1% y-o-y. Inflation was significantly higher than market expectation, which was 0.8%. Price rises were mainly due to a rise in fuel prices, food and housing.

According to long term forecasts, the prospects of the Polish economy are promising; therefore it is expected to grow almost 5% in 2006-2007. The driving forces behind the growth are exports and the strong momentum of the business cycle. Furthermore, increases in wages, improvement in the labour market and low interest rates will encourage individual consumption. The main stumbling block is still unemployment, which remains high, although it generally shows signs of abating. According to Central Statistical Office (GUS), the registered unemployment rate stood at 15.7% at the end of July, which represents a significant fall compared with a figure of 17.9% recorded in the corresponding month of last year.

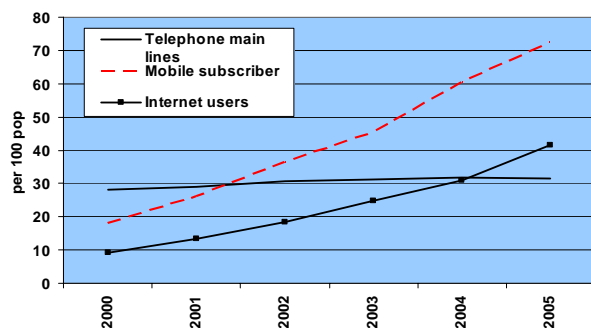
According to the Finance ministry, Poland is planning to restructure public finances in a way that will allow Poland to join the euro zone in 2009.

Poland attractive to investors

Investments are rapidly growing in Poland after a sluggish year. In Q2 investments grew 11% y-o-y and in 16% in H1 compared to the corresponding period last year. The forecast for the whole year stands at 11%, which is a substantial rise compared last year's 7%.

According to British Economist Intelligence Unit research centre, Poland is the fifth most attractive country for international corporations decentralising their operations. Poland is attractive to investors in terms of operating costs, availability of qualified labour force and investment climate. It also evaluates technical and language qualifications of staff very highly. The Polish government's actions also improve the investment climate in Poland. Furthermore, economic policy was designed to strengthen three main areas influencing economic growth: consumption, exports and investment.

Key indicators of telecommunication technology



Source: Economist Intelligence Unit: Business Eastern Europe 29/06

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	14.3	1-7/2006
Inflation (CPI, end of period, y-o-y %-change)	9.8	8.5	3.6	0.8	1.7	4.4	0.7	1.1	7/2006
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	616	Q2/2006
Unemployment (% , last survey in the year, LFS data)	15.3	16.0	18.5	19.7	19.3	18.0	16.7	16.0	Q2/2006
Exports (EUR billion, current prices)	25.7	34.4	40.4	43.4	47.5	59.7	71.4	34.1	1-5/2006
Imports (EUR billion, current prices)	43.2	53.1	56.2	58.3	60.4	71.4	80.6	38.0	1-5/2006
Current account (% of GDP)	-7.6	-6.0	-2.9	-2.6	-2.1	-3.5	-1.2	-2.1	1-3/2006

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

Production grow faster than expected

Industrial output jumped 14.3% in July y-o-y. Output rose fastest in manufacturing, such as audiovisual equipment, basic metals and motor vehicles. Growth in the mining-quarrying sector was also up markedly, while electricity, gas and water supply sector improvement was more moderate. The result was near market expectation. In total, in H1 of 2006 industrial output was 12.3% higher than in the corresponding period of last year. Industrial output is expected to rise to almost 11% for the year as a whole.

According to GUS, enterprises reported very good results in H1 of 2006. Revenues from all operations were 13% higher than for the corresponding period last year. In fact, revenues rose more rapidly than costs. In H1 more than 69% of all enterprises noted a net profit.

Booming foreign trade

High demand for Polish products has increased export, import and industrial output to a new higher level. In recent months Polish companies have had far more orders from domestic and foreign customers than before. According to preliminary data from GUS, during the first five months of 2006, exports grew 23% and imports 21% compared to the corresponding period last year. The rapid growth in exports has been continuing despite the strong zloty. The high pace of foreign trade growth is expected to continue though the rest of the year.

Retail sales have grown robustly being 10.7% higher in June than a year ago. The result was mainly in line with market expectations. The high growth rate can be taken as a reflection of the recovery in domestic demand, itself a consequence of an improvement in the labour market. Retail sales are expected to rise near to 11% for this year as a whole.

Some business highlights

- Local alternative energy concern EEZ and Invenenergy (US) have launched operations at Poland's largest wind farm located at Tymien. The complex contains 25 wind turbines each 2 mw. Investment is worth EUR 62m.
- Dr Schneider has launched operations at its new car and motorcycle components production plant at the Kamienna Gora special economic zone (SEZ). Investment in the new plant is expected to reach ZL15m and to create 150 new jobs.
- Indesit, the Italian household appliances manufacturer, will open a third plant in Lodz SEZ. The company will invest at least EUR 80m and create 1,200 new jobs.
- PGB Fasteners, Belgian manufacturer of screws, is investing EUR 1.5m to build a factory in the Katowice SEZ. The company will hire at least 37 people for the new plant, which will produce metal and plastic fastening systems.
- Novo Tech, a company under Indian Capital, will build a EUR 2.6m plant to Kostrzyn-Slubice SEZ. The plant will produce spare parts for lorries.
- Gloria, German manufacturer of fire extinguishers, opens a factory in Ropczyce. Gloria transfers production from Germany and creates 250 jobs for Poland. The investment is estimated to be worth USD 17m.
- US concern, TRW, one of the world's biggest producers of automotive security systems, expands its plant in Katowice SEZ with USD 35m. The extension creates 600 new jobs.
- Toyota intends to expand its gearbox plant with a new EUR 145m production facility in the Walbrzych SEZ. The new plant will provide work for 260 people.
- The German Optical Disc Service (ODS) is planning to build Europe's biggest DVD and CD pressing facility and distribution centre in Goleniow. The plant will cost EUR 63m and create 2500 new jobs.
- German-based Wilhelm Karmann plans to build new factory, where it plans to build car roof systems. Investment is worth EUR 10m and offers work for 100.
- SCA, Swedish hygiene product specialist intends to expand its factory in Walbrzych SEZ. Investment is worth EUR 44m and creates 130 new jobs.

Creating an innovative Europe

by Günter Gloser

With the Lisbon Strategy the EU is aiming to become in the medium term the world's most competitive economy. At present it is lagging well behind notably the United States and Japan. Germany is already spending 2.5% of GDP on research and development (R&D). By 2010, however, we want to increase R&D spending by government and industry to 3% of GDP both at the national level and EU-wide. Countries that in recent decades have invested in education, R&D and getting the framework conditions right are all well ahead today also in designing successful products. Finland in particular, which spends 3.46% of GDP on R&D – one of the highest levels in the EU – is a prime example of how closely R&D and innovation are linked to economic growth.

Following the EU's Hampton Court summit in October 2005, the European Commission sought to set the ball rolling on innovation by appointing an Independent Expert Group headed by former Finnish Prime Minister Esko Aho to identify what new efforts are needed in the field of research and innovation to achieve the Lisbon goals. The Group's report recommends the accelerated implementation of initiatives at EU and national level to boost research and innovation along the lines proposed under the revised Lisbon Strategy, including a Pact for Research and Innovation and the creation of an innovation-friendly market. It also called for greater mobility of human resources, an efficient venture capital sector and the use of European technology platforms and clusters to create new linkages favouring mobility in organization and knowledge.

The Finnish Council Presidency sees innovation in all sectors of the economy as crucial and the key concept in the creative process it plans to initiate. The German Council Presidency will build on the concrete ideas emerging from this process. Germany broadly agrees with the Report's basic analysis and is keen notably for the Structural Funds to play a more prominent role also in boosting innovation and developing R&D infrastructure in the new member states.

At national level Germany has already acted to realize many of the Report's proposals. Some have been listed as goals in our National Reform Programme, others have even been fully implemented. In Germany the private sector already accounts, for example, for two thirds of R&D spending. With its Excellence Initiative the Federal Government hopes to make its research promotion efforts still more effective. Under this Initiative designed to foster centres of excellence with a world reputation, universities will bid for an additional 1.9 billion euro available up to 2011, which will be allocated to those deemed to have submitted the best research strategies.

The Federal Government has long been a major sponsor of research in key fields. It works closely with the academic community and business to identify new innovation strategies for cutting-edge technologies such as microsystems technology, nanotechnologies, optical technologies, information and communication technology (ICT), transport and aerospace, health, biotechnology, energy and sustainability as well as services. Priority is also given to innovations that will benefit smaller businesses as well as the transfer of knowledge and technology, the development of regional clusters and international networking. All this, we hope, will help to improve the process of translating research into successful market products.

Under the Finnish Council Presidency general political agreement was reached on 24 July on the Seventh Research Framework Programme (2007 – 2013). Over the months ahead the details of the various specific programmes will need to be settled so as to ensure a smooth transition from the Sixth Framework Programme, which is due to expire shortly. For the implementation of these programmes a total of 50.521 billion euro has been earmarked which will clearly go a long way towards ensuring first-class research in Europe. The start of the German Council Presidency in January 2007 will also coincide with the establishment of the European Research Council, whose main brief is to promote basic research. Taken together, the Finnish Presidency's focus on applications-oriented research and our Presidency's focus on basic research address all the main links in the chain that leads from new ideas to innovative products. With this combined approach, our efforts are geared to giving direct practical effect to the revised Lisbon Strategy, which views action to revitalize Europe's economy and boost competitiveness, growth and employment as essential if Europe is to rise to the challenges of a globalized world.

Günter Gloser

*Minister of State for Europe in the Federal Foreign Office
Federal Republic of Germany*

Post accession developments in economic relations between Poland and Finland: Challenges ahead

by Andrzej Szyuka

Speaking about the lessons from the recent enlargement of the European Union to the Polish economy and the Polish-Finnish relations one has to be aware that not all what happened after May 2004 may be attributed to the very moment of our formal membership and it is not always possible to distinguish between causative and coincidence developments. Poland's way to the European Union started in the early 1990s. Poland undertook extensive reforms to modernise and is now a dynamic market economy. The stability provided by accession has helped us to boom the economic growth and to multiply trade and investments. The economic growth in recent two years has been on average faster (4,2%) than in the old EU member countries (1,9%). The favourable economic expectations connected with the EU-accession have been fulfilled. In two post accession years the export dynamics to the EU exceeded the import growth rate. Today more than two third of our trade is related to EU zone. Exports growing at higher pace than imports tell us that the Polish businesses were well prepared for the accession and their products proved to be competitive on the single market. Anticipated exposure to fierce competition and stringent EU regulations sped up adjustment processes in Poland's economy.

Figures related to the Polish-Finnish trade seem to follow the general trend. Exports to Finland grew from Euro 316 million in 2003 to Euro 559 million in 2005 that is by 77% whereas imports increased by 17%. Moreover, the exports increased significantly also for the goods which exports had given rise to the most serious – as it seemed – anxieties, i.e. food products such as dairy and fruits. In general, deliveries from Poland to Finland grew faster than Polish export to EU and similarly Finland's trade with Poland developed more dynamically than that one with the EU.

It is also worthwhile stressing that the positive quantitative changes in trade were accompanied by qualitative and structural ones. An important tendency in bilateral relations is the gradual change in the commodity structure of trade and in particular growing share in our exports of more value added content goods such as machinery, mechanical, electrical and optical appliances and instruments, pharmaceuticals. One should also note an increase in export of Polish services in such sectors as building and construction.

Perhaps the most far-reaching and weighty consequences of intensified Polish Finnish economic relations after May 1st 2004 derive from the transfer of Finnish know how in innovation policy and its implementation at national and EU levels.

These issues were discussed during the Polish Lisbon Strategy Forum in December 2005 with the participation of Prime Minister M. Vanhanen and during subsequent experts meeting. Joint efforts in this field, apart from their beneficial impact on Poland's economy, may and no doubt should lead to a closer cooperation in shaping of the Baltic Sea region as a more competitive, innovative and cohesive entity. In this context it is also worth mentioning that endeavours have been undertaken to implement ideas laid down in the Memorandum of Understanding on Motorways of the Baltic Sea between Polish and Finnish ports.

It needs to be stressed, however, that positive phenomena and trends in the economic relations between our two countries sparked off by Poland's membership in the EU followed by growing interest of Finnish companies in Poland, according to surveys made by ETLA and Finnish Central Chamber of Commerce, did not significantly improve Poland's position in Finnish foreign trade. With the shares of 1,3% in Finnish imports, 2,0% in exports and hardly 0,7% in total Finnish FDI in 2005 Poland is far below not only expectations but first and foremost the potentials represented by our economies. And this requires that positive tendencies shaped up during first two years of Poland's membership in the EU should be maintained, strengthened and continued.

The Polish economy is on a fast growth track. This, together with the size of the Polish market, growing consumption and in particular investment demand reinforced by the influx of EU structural funds (Poland the largest recipient country) create more opportunities for intense penetration of Polish markets by Finnish exporters and investors especially in such sectors as business process offshoring, R&D centres, ICT, environmental technologies, white goods, automotive or aviation industries. Poland, in turn is looking forward to increasing export of services and equipment as well as co-operation in subcontracting induced by booming Finnish shipbuilding sector. Equally important would be the growth in export of tourism and health services based on an attractive Polish offer reinforced by newly opened flight connection between Finland and Poland operated by Finnair, Blue1 and LOT. And last but not least, regular and close contacts between Polish and Finnish politicians and experts in the month preceding the Finnish presidency in the EU as well as during the presidency will prove conducive to the development of bilateral economic relations between Poland and Finland.

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1) According to data provided by the Polish Ministry of Economy

Kaliningrad Transit: Achievements and perspectives

by Gerhard Lohan

Back in November 2002 the EU and Russia laid the ground, by way of a joint statement adopted at the highest possible level, for the transit of persons between the Kaliningrad region and mainland Russia. It involves the use of "facilitated travel documents" and has operated to the entire satisfaction of all sides ever since it was put into effect in July 2003. On average, 1.5 million persons travel annually to/from Kaliningrad and so far only relatively few had to be refused at the border or taken off the transit trains.

Transit of goods was covered in a joint statement adopted in April 2004 in connection with the transit countries' accession to the EU. The basic principles of freedom of transit without unnecessary delays or restrictions, and the exemption from customs duties and transit duties were confirmed in accordance with the related GATT rules and those of the EU-Russia Partnership and Cooperation Agreement (PCA). While generally aiming at keeping the cost of transit as low as possible, a clear distinction was made between private-sector services which will be provided under fair competitive and market-based conditions and administrative costs which fall under the responsibility of government authorities and which need to be proportional and cost-related. The statement also aims at simplified administrative procedures by which Russian transit declarations can be submitted directly to the New Computerized Transit System (NCTS) in Lithuania.

Issues related to the specific customs procedures have been fully settled. However, transit of goods also involves a variety of other controls which are partly product-specific such as phyto-sanitary inspections, for example. Both sides have addressed such matters under the auspices of the PCA, also involving the Lithuanian and Polish authorities who are in charge of practical arrangements on the ground.

Impressive growth rates in transit flows in both directions to and from Kaliningrad during the last two years witness to the fact that EU enlargement did not create obstacles to transit. Overall, therefore, the necessary adaptations in the transit regime to the EU enlargement have been made successfully. We can now build on those achievements with a view to further supporting the social and economic development of the Kaliningrad region as called for by the April 2004 statement. Both sides can be confident about their ability to jointly find adequate solutions for any future Kaliningrad-related issues.

So what issues would be on the agenda in the future?

Concerning travel of persons, the Visa Facilitation Agreement and the Readmission Agreement signed at the joint Summit meeting in Sochi last May have, for good reasons, received much attention on both sides. Visas will be easier to obtain and cheaper for Russian citizens living in Kaliningrad and in mainland Russia alike. Of course, EU citizens traveling to Kaliningrad will also get the benefit, thereby facilitating business contacts with the region and tourism. In case of illegal stay on the other side, the simplified procedure for return of such persons enshrined in the Readmission Agreement will be applicable around the Kaliningrad region. Lithuania's and Poland's accession to the Schengen area will in due course make it easier for Kaliningrad inhabitants to travel inside the EU. The EU Member States' consulates in Kaliningrad, some of which have only recently been opened, will take the responsibility for issuing Schengen visas. If ever

the cost of such visas were to go up, this would not automatically affect the Visa Facilitation Agreement because that agreement sets the cost explicitly itself.

The abolition of the visa requirement between the EU and Russia has been agreed at the May 2003 Summit in St. Petersburg as a shared long-term perspective. When it comes, it would probably make any transit regime unnecessary. Although technical talks have started, this will take a considerable amount of time and require further substantial reforms in Russia. Visa-free transit could not be achieved any earlier through a high-speed train connection to/from Kaliningrad: this would be incompatible with the EU principles. Thus, for this option to be rejected it did not even take the feasibility studies carried out in 2004 which demonstrated the lack of cost-effectiveness of building a high-speed train connection.

Border crossing by persons to/from Kaliningrad could be made part of closer cooperation between the EU border management agency FRONTEX and the Russian Border Guard Service launched in early 2006.

Concerning transit of goods, there are a number of factors other than customs procedures and inspections which also matter, given their potential for reducing overall transport time and cost. In particular, the capacity of border crossing points and transport infrastructure may be as important. The EU has made available substantial financial support for modernization of border crossing points such as Chernyshevskoye and Bagrationovsk and projects will soon start on Mamonovo and Sovetsk. More funds could follow once the new European Neighbourhood and Partnership Instrument (ENPI) would have replaced TACIS, starting in 2007. Support to infrastructure modernization in the Kaliningrad region should be seen in connection with the implementation of the Pan-European Transport Corridors two of which cross the Kaliningrad region. These were also included in the recommendations made in 2005 by the High Level Group on the extension of the major trans-European transport axes to the neighbouring countries and regions which was co-chaired by the former Commission Vice President de Palacio and the Russian Transport Minister Levitin.

Railway cargo rates are another important factor influencing the cargo flows to/from Russia through Kaliningrad. The port of Kaliningrad is benefiting from rates which may unduly disadvantage other ports in the region. Russia's accession to the WTO can provide the context and criteria for addressing such questions.

Clearly, there are a number of other issues which together with transit determine the overall development prospects of Kaliningrad. The Commission has for some time advocated the need of a dialogue about those broader prospects. In February last, Commissioner Ferrero-Waldner visited Kaliningrad and had meetings there with Presidential Aide Yastrzhembsky and Governor Boos. The event opened a new phase of cooperation where transit and overall regional development objectives can be considered together with a view to maximizing the mutual benefit of further developments in Kaliningrad and in the Baltic Sea area at large.

Gerhard Lohan

Head, Unit Russia, European Commission

United by the Baltic Sea

by Mikko Pukkinen

This past summer will be remembered in Finland as exceptionally beautiful and warm. It has brought residents and visitors alike to the refreshing waters of the Baltic Sea. Many of them found their way to the unique Turku archipelago, which has been full of life.

Even during the summer months, parallel to prestigious sailing events like the Swan regatta and many cultural events, also "in-door" events related to the Baltic Sea and maritime issues have been organised.

In June, an important initiative took another step towards its implementation when the Foundation for Centrum Balticum was established. Among founding members are the City of Turku, the three universities based in Turku – University of Turku, Åbo Akademi University and Turku School of Economics -, the Region of Southwest Finland, as well as the cities of Uusikaupunki, Rauma, Pori and Vaasa.

The Foundation is another concrete example of a very close cooperation between the local and regional authorities and the universities. Private companies will join its work in near future.

This Foundation will establish, and maintain, a think-tank, which will specialise on the issues of the Baltic Sea Region (BSR). Its focal points will include sustainable development of the Baltic Sea, urban policy in the region, the BSR as an economic region as well as the European dimension of the BSR. The Centre will become operative during the 2nd half of 2006. Without doubt, it will become an important focal point for international cooperation.

Linked to the Centrum Balticum, the City of Turku hosted an important conference on 19 – 21 July 2006 on European Maritime Policy (see www.turku.fi/maritimepolicy). EU Commissioner responsible for Fisheries and Maritime Affairs Joe Borg and other recognised experts discussed how to combine both economic development and environmental sustainability to develop a holistic approach, which will contribute to a future Maritime Policy for the EU.

During the Turku Conference, it became evident that all issues related to the seas must be discussed as a whole, not only sectorally.

The issue of governance was also discussed. Who is actually responsible for integrated Euro-pean maritime policy, and what is the role of various actors – including the role of cities and regions?

From Turku's perspective, one key area is certainly safety issue. The size of vessels and the volume of traffic continue to grow, which has important implications for coastal cities such as ours.

Another important theme for us is the economy of coastal regions and islands. It includes issues such as tourism, development of knowledge society in isolated areas such as islands, and planning. International benchmarking would undoubtedly be very useful also in these questions.

Mr John Richardson from the European Commission raised an interesting question about possible creation of a European Certificate of Maritime Excellence. Although still only an idea, this might be an interesting path to bring concepts such as marine Centre of Excellence and integrated maritime cluster to the Europe-wide discussion.

Above, I have discussed some of the topical issues in which the City of Turku with its partners is involved in the field of maritime policy and development of the BSR.

But one may ask why Turku is so active in the Baltic Sea Region? Let me share with you some thoughts on this.

Seen from the Central European perspective, Finland is an island: about 70% of Finnish imports and 90% of exports are carried by sea. Nearly a quarter of the sea traffic between Finland and foreign countries goes through the five significant ports located in south-western Finland.

The City of Turku, with central coastal location, has a long history as a Baltic Sea city since the days of the Hanseatic League. For centuries, this oldest city of Finland has been the gateway between East and West, through which not only new products but significantly also new thoughts, cultural influences and innovations travelled.

Now that the Baltic Sea has practically become an inland sea in the EU, the BSR offers great opportunities for Turku and south-western Finland. Provided, naturally, that these are utilised through active engagement and co-operation.

Turku has excellent connections westward to Stockholm, Gothenburg and Oslo, as well as eastwards to St. Petersburg, Moscow and all the way to Beijing via the new direct train connection. Train ferries - Turku has the only such service in Finland - link the route directly to Germany and other Central European transportation networks as well. It is vital that good operational conditions for maritime traffic also secure in the future.

Logistics is therefore a crucial dimension of Turku's regional strategy - but not the only one. The three universities in Turku offer a unique expertise for active research and training related to the Baltic Sea region. For example, the University of Turku hosts the Baltic Sea University Network with almost 40 member universities. Åbo Akademi University is a key player in the Baltic University Programme, dealing especially with issues of environment and sustainable development. The work of the Pan-European Institute of the Turku School of Economics in analysing economic trends in the Russian Federation and the new EU member states is widely recognised.

Turku hosts also other important functions in the Baltic Sea cooperation. The City has the vice-presidency of the Union of the Baltic Cities, an active organisation of some 100 member cities. Turku hosts UBC's Environment and Agenda 21 secretariat, a highly appreciated and effective body with a very substantial project portfolio and an international secretariat over a dozen experts.

Turku is the home to Finland's largest maritime cluster. The biggest and most luxurious cruise ships in the world are built in Turku, which is home to leading engineers in the field worldwide. The cluster also includes shipping companies, off-shore industry and subcontractors, ports, shipping and forwarding agents, the insurance industry and maritime education and research, to name a few.

Turku, as well as the Estonian capital Tallinn, will serve as the European Capitals of Culture in 2011. This provides a unique opportunity to present the cultural heritage and modern innovations of our countries and of the whole Baltic Sea Region for an international audience.

Let us do it together!

Mikko Pukkinen

Mayor of Turku

The shared longstanding history of Finland and Estonia provides the basis for EU cooperation

by Keijo Virtanen

When the Baltic States regained their independence in 1991, it created once more a new historical situation in the Baltic Sea area. The relationship between the large and small states in the area, and their relationship with the rest of Europe, was to take shape all over again. This turned out to be an extremely significant turning point in the international relations in the post Second World War period. Today, when there are more sovereign states in the Baltic Sea Region than some years ago and while most of them are small nations, their aspirations for national benefit in politics, economy and culture are clear. At the same time, they are getting in closer connection with the big centres of Europe and, in a wider context, with other international processes. The Baltic States are evidently taking part in the European integration processes as well as in the on-going globalisation tendencies. How are we able to maintain the traditional relations between Finland and Estonia in these new circumstances?

The recent economical and societal change in Estonia, Latvia and Lithuania has been surprisingly rapid. The EU membership of our closest neighbour, Estonia, has marked a start of a new phase between it and Finland. Although we feel culturally most connected to Estonia, it would be, however, advisable to consider the diverse characteristics of the peoples and cultures in the Baltic Sea area on a larger scale. The longstanding economical and cultural relations between the Baltic countries will naturally establish the preconditions for future cooperation, but the main basis of our relations is still the shared cultural heritage. At present, Estonia and other Baltic countries are intriguing and dynamic societies, and their geographical location alone is already holding great potential. Today, these countries can determine their own interests and preferences to a great extent. It is not self-evident, for example, that the North would be the direction where our closest neighbour Estonia directs its attention in the future. On the other hand, under the present situation, the common history and culture, shared experiences and cooperation have larger significance than can sometimes be realized in today's fast pace.

The cultural and societal mentality of the Baltic countries can be examined as a northern entity or as a mosaic of different peoples and nations where each has their own ideologies and political thoughts, with their own national heroes and artists. According to the first approach, the Baltic Sea area can be seen as the opposite to the Mediterranean world. The North has traditionally been seen as a cold and remote place on the edge of the world, and where every day life has been an endless struggle against the severe natural living conditions. It has been claimed that the fate of the North has been only to react to impulses from the South, not to create its own vigorous life and culture. During the centuries, life in the North has been given mythical meaning. This meaning consisted of the ideal of simple rural life and reliance on nature. Estonia and Finland have been natural parts of the North because of their religion, culture and language.

For centuries, the conception of an integrated European culture was related to the Catholic Church. After the sixteenth-century Reformation, the Polish-Lithuanian culture was connected to Roman-Catholicism and to the South, while Lutheranism started to dictate life – both material and cultural – in the North. This can be seen as the basic factor which has had an effect on the cultural plurality and diversity in the Baltic Sea Region. On the other hand, this factor has been smoothed by the faith in science and rational thinking. According to Professor Samuel Huntington, future conflicts are caused by cultural and religious borderlines, not by the political interests of power blocs. Professor Huntington draws the Eastern border of Western Civilization in the Baltic Sea area so that Finland, Estonia, Latvia, Lithuania and Poland are all part of it. The main criteria that he uses consist of the borderline between Western Christianity and the Orthodox / Islamic world.

However, it is not possible to define this kind of division very strictly. We Finns, for example, have absorbed influences from various directions. The Swedish political dominance as well as the influence of the Roman-Catholic Church came from the West, as the influence of the German Hanseatic League arrived from the South. The influences of the commercial system of Novgorod and the Orthodox Church came from the East. But taken more broadly, the entire Baltic area, including Poland and the Baltic nations, is regarded as part of the Western mentality, and as a barrier against the East. Evidently, the Eastward expansion of the European Union will further strengthen the Western values and the political and cultural choices related to them throughout the whole Baltic Sea Region.

Estonia's development during the past few decades has been described to be a small miracle. Its economical growth has been fast, and the inflation has been rather low. Today, the economy of Estonia is strongly connected to the European Union. The former Estonian Ambassador to Finland, Matti Maasikas, states that never before have Finland and Estonia had as much in common than now. We sit at the same tables, debate about the same questions, and we have to solve the same problems. Finland is Estonia's largest trade partner. After attaining the EU membership, Estonia has become an increasingly interesting trade partner for Finnish business companies.

The cooperation between Finland and Estonia is built on future expectations, the shared history providing the setting for it. There are good preconditions for such a neighbourhood that could get our countries and their people even closer to each other. That will be of mutual benefit.

Keijo Virtanen

Honorary Consul of Estonia in Turku and the Southwest Finland

Professor of Cultural History

Rector of the University of Turku

The promotion of mutual trade is an important way of developing the competitiveness of the Baltic Sea Region

by Jarkko Heinonen

The Baltic Sea region forms an important economic area. 310 million consumers live in this region, and their combined purchasing power is 50% greater than that of all the consumers in China. Furthermore, the growth of production in the Baltic Sea region is clearly faster than the average for the EU and, moreover, the new EU countries have taken steps to make their economies more dynamic. The growth of Russia – and St Petersburg in particular – is rapid, and cooperation between the Baltic Sea states offers the most natural way of developing mutually beneficial relationships between the EU and Russia.

Trade between Baltic Sea states has almost doubled in real terms over the past ten years, representing a steady 30% of these states' total exports for this period. Mutual trade has grown fastest since 2001, and it would seem that the share of the region's exports represented by mutual trade is on the increase. For most of these states, the most important export markets, and sources of imports, are the other Baltic Sea states.

The small scale of the Baltic Sea region's economies is the single biggest structural problem facing the area. In many sectors this has led to a situation where there is very little need to compete on national markets. This can be considered a key weakness of the entire Baltic Sea economic area. Properly functioning EU internal markets and closer cooperation with the non-EU countries of the Baltic Sea region is the best, and perhaps the only solution to this problem.

Regardless of the EU's internal markets, significant obstacles to trade still exist at the practical level. These affect small and medium-sized enterprises (SMEs) in particular, who have fewer resources to cope with the bureaucratic administrative work associated with importing and exporting. By way of an example, we can mention that 71% of the SME respondents to a questionnaire recently sent to the members of the Turku Chamber of Commerce consider that the wide range of product-specific regulations, which differ from country to country, hinder exports to other EU countries, or render them impossible. Even large enterprises recognise the countless administrative obstacles posed by the internal markets of foreign countries, but these companies consider such problems to be of lesser significance, because they are able to get around them by using a subsidiary within the country in question.

As far as many of the area's companies are concerned, the Baltic Sea region forms the most important and most easily utilisable market, and it would, in my opinion, be sensible to develop both the functionality of the EU's internal markets and the region's cooperation with Russia. In this respect, the Baltic Sea region could act as a pioneer within the EU, or even as a test area, where attempts are made to investigate the problems of internal markets and devise possible solutions. We should promote ever-closer common markets within the Baltic Sea region, in order to maximise the area's imports and exports, and thus create larger "home markets" for the area's SMEs, which often operate in domestic markets that are tiny. In this way, we could create an operating environment that gives enterprises a much better basis for growth and enables them to develop into actors that can even operate in larger international markets.

Work is needed in order to bring the markets for products, capital and human resources together, and to standardise the practices of the various official bodies. An example of this is taxation. Dealing with the tax authorities of the different countries is seen by SMEs as a restriction on imports. Even

though at this stage it is not worth adopting the harmonisation of taxes as a goal, it would be useful to consider the taxation practices of other countries. In an ideal world, it should be enough for an enterprise to deal only with its local tax office. The local tax office already has all the necessary information concerning the enterprise; all that is needed now is a fluid exchange of information, and standardised practices and methods of operation. Naturally this also applies to the activities of the other authorities.

It would also be useful to consider possible steps to enforce free trade in services within the Baltic Sea region. As we all know, the service sector already accounts for approximately 70% of the gross national product of the countries of Europe. Furthermore, a large proportion of the trade in investment products includes installation and maintenance services. Opening the EU's internal markets to entirely free trade in services is therefore important not only for the development of the various service sectors, but also to prevent barriers to industrial exports. The Service Directive, which was achieved after some considerable wrangling, will naturally ease the problems associated with the export of services, but the aim must clearly be to achieve total freedom in the trade in services. Achieving functioning common markets for the entire services sector is particularly important for the EU member states within the Baltic Sea region, with the possible exception of Germany, because the relatively small size of the national markets, together with the geographical segmentation of these markets, may seriously hinder opportunities for the development of the various service sectors.

Consideration should be given in the Baltic Sea Region Development Strategy to establish methods to help SMEs reach wider markets, particularly in the Baltic Sea region. Given the size of our economic area, there are remarkably few enterprises within our region that operate on the international market. SMEs are needed that are willing to grow – ones that, in the right operating environment, would be able to exploit their potential to grow into large, expanding enterprises.

An internationally competitive cluster would provide an excellent environment for SMEs to grow, and would also increase the area's attractiveness to investors. It would therefore be useful to consider the possibilities for developing a cluster policy for Baltic Sea region. The easier it is to utilise the skills and knowledge of the various sub-contracting enterprises throughout the Baltic Sea region, the stronger the total competitiveness of the cluster. On the other hand, it would be useful for SMEs engaged in sub-contracting to be more active in seeking cooperation partners from a wider area than is currently the case. An important part of a Baltic Sea-wide cluster policy would be to facilitate networking between the so-called engine enterprises and the sub-contractors on a wider scale than is currently the case, and to maximise the benefits that this networking would bring. Genuinely functioning internal markets are, naturally, also a key factor in ensuring the viability of a Baltic Sea Region cluster.

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Baltic Sea region's new EU member states increasingly important in the internationalisation of Finnish small and medium-sized companies

by Katja Heiskanen

As Estonia, Latvia, Lithuania and Poland joined the EU in May 2004, the Baltic Sea became virtually an inland sea within the European Union leaving only Russia outside of the integrated area. The EU-membership of the four countries has increased the interest of foreign companies to increase and initiate exporting and investment operations in the area. For example foreign direct investments in Estonia have over doubled in three years' time from EUR4035 million in 2002 to EUR10415 million in the third quarter of year 2005 (Bank of Estonia). According to the Bank of Lithuania, foreign direct investments in the country have increased from EUR3818 million in 2002 to EUR5278 million in the third quarter of 2005. Also the statistics of the Bank of Latvia and the National Bank of Poland show a growing trend in FDI towards the countries respectively. The increased interest towards the Baltic Sea Rim's new EU countries is well justified as all of the four rim countries' economies have been growing rapidly. Estonian and Lithuanian economies are expected to continue their strong growth, whereas Latvia currently holds the position of the fastest growing EU country.

The internationalisation of small and medium-sized companies has accelerated strongly since the eighties and the statistics since then have shown increasing importance of SMEs in home economies as they are key contributors as job generators, exporters and innovators. Taking this into account, a study was recently conducted to find out the importance of the Baltic Sea region's new EU countries in the internationalisation of Finnish small and medium-sized companies. The study focused on exporting and investment operations of Southwest Finnish SMEs towards Estonia, Latvia, Lithuania and Poland in 2004 and in 2010. The empirical material was collected with a survey sent to the managers of SMEs known to be engaged in exporting activities.

The results of the study indicated clearly that the Baltic Sea region's new EU countries are significant and will be increasingly important export and investment destinations to the studied SMEs. The number of companies exporting to the area is high. Of the respondents 43% reported exporting to Estonia in 2004. The figure for Poland was then 15%, whereas for Latvia 12% and for Lithuania 11%. In five years' time almost two-thirds of the studied companies – 57% – will be exporting to Estonia. As the number of exporting companies increases somewhat among industrial firms, among trading companies the number of companies exporting to Estonia nearly doubles. This can be in part explained by the positive expectations of the service and trading sectors on the Estonian market growth. In year five years' time 26% of the respondents will be exporting to Poland, 23% to Latvia and 19% to Lithuania. Most of the increase stems from industrial companies. The combined proportion of Poland and the Baltic States of the share of the value of exports will increase from 16% in 2004 to approximately 20% in 2010. The importance of the four countries for the studied SMEs in was in 2004 substantially higher compared to the total of Finnish exports.

Compared to exporting investments were found to be few. This is not surprising as SMEs often choose to use non-equity modes of entry due to lack of sufficient resources. Even though the studied companies are not as inclined to engage in FDI as they are in exports, it is clear that the Baltic States and Poland attract the SMEs to invest

the most. The Baltic Sea region's new EU countries are the most important investment destination for the studied firms measured by the number of investing companies. The number of SMEs investing in Estonia will increase notably from 7% in 2004 to nearly 18% in 2010. Of the four countries Poland attracts 6% of the studied companies to engage in investment operations in five years' time. The number of firms investing in Latvia and Lithuania remains lower. Moreover, the proportion of the Baltic States and Poland of the total value of foreign investments is significant compared to the total Finnish FDI stock in the area. Interestingly enough, the results show, rather surprisingly, that the smallest of companies are a relatively active group to invest in the area. Certainly the finding implicates that the area is considered easy enough to enter even for companies with fewest resources. The growing markets were found to be a strong incentive for the studied small and medium-sized companies to be engaging in exporting as well some investment operation in the four countries.

Based on the empirical results a trend can be observed that the interest towards the Baltic States as well as Poland will be increasing in the coming years. Though the objective of the research was to find out the significance of the Baltic States and Poland to the studied companies, the growing significance of the Russian markets became clear as a by-product of the analysis. The small and medium-sized companies, in their part, seem to begin exploiting the previously unused trade potential in the vast and growing markets of Russia and Poland. The already familiar Estonian markets may very well be acting as a stepping stone to the Russian markets as well as to the southern markets of Latvia, Lithuania and Poland. The findings indicate that the main market area of the studied small and medium-sized companies is shifting from the previously more important EU15 countries to the near east. The trade with the Baltic States and Poland may to some extent be complementary to the trade with Russia. The significance of the EU15, though still considerable, will be decreasing in the favour of the Baltic Sea Rim's eastern countries, the Baltic States, Poland and Russia combined.

The whole Baltic Sea Rim area may very well be considered as a home market by the Finnish SMEs in the coming years. The countries within the area are close even for the smallest of companies to operate in. Especially the eastern part of the Baltic Sea Rim, due to the strong economic growth, offers good possibilities for those acting early on the rising opportunities. The smaller sized companies in particular, however, could benefit from actors that provide them an easy access to reliable information about the markets and the market developments. In addition to the information needs, the companies should be offered hands-on assistance on the practical level. Based on the research it can be concluded that organisations involved in local area development as well as different actors providing business support services designed for SMEs should take particularly the Baltic Sea region's eastern part into consideration when directing their efforts (www.tse.fi/pei/pub).

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Kaliningrad turns into an EU-flanked tax haven for Asian firms?

by Kari Liuhto

In 1996, a special economic zone was established in Kaliningrad to encourage investments in the region. The zone's attraction is duty-exempt import. If a company can increase the value of an imported product by 30 per cent and change its customs heading, it is entitled to sell the product exempt of duty elsewhere in Russia as well.

The special economic zone has resulted in a steep increase in Kaliningrad's foreign imports and sales to the mother country. The region's share of Russian imports is ten times bigger than its share of the country's GDP.

Despite its status as a special economic zone Kaliningrad has not managed to convince foreign investors. At the end of 2005, direct investments totalled less than 90 million US dollars, or slightly over 90 dollars per each Kaliningrad resident.

Direct foreign investments per inhabitant in Kaliningrad are only one seventh of the Russian average. In contrast, per-inhabitant investments made by foreign companies in Lithuania are nearly 20 times larger than those of Kaliningrad. This is a huge difference, taking into account that only 15 years ago both Lithuania and Kaliningrad came under the same economic system.

The Kremlin, too, has noted the disappointing progress in foreign investments. To rectify the situation, a new law for the Kaliningrad special economic zone entered into force in April 2006.

As provided in the new law, the special economic zone established in 1996 will be abolished in ten years' time. Companies that were active in Kaliningrad before the new 2006 legislation took effect will enjoy exemption from duty and may continue duty-exempt re-exports to Russia until 2016.

In a nutshell, the new law stipulates the following: a company that invests a minimum of 150 million roubles, or some 5 million US dollars, in Kaliningrad is exempted from income and property tax for a period of six years. After this it gets a 50-per cent deduction on taxes for another six years. Tax concessions are not altogether insignificant: Russia has an income tax of 24 per cent and a property tax of 2.2 per cent.

An comparison of foreign direct investment stock in the Baltic Sea region

	FDI stock change during 2000-2004	FDI stock per capita by the end of 2004 (USD)
Kaliningrad	428%	92 *
Russia	306%	689
Denmark	133%	18013
Estonia	360%	7198
Finland	230%	10695
Germany	128%	4222
Latvia	216%	1975
Lithuania	274%	1782
Poland	179%	1594
Sweden	173%	18074

* Kaliningrad FDI stock per capita at the end of 2005.

Sources: UNCTAD 2005, Kaliningrad statistics 2006, author's calculation

In terms of new investments, however, tax concessions carry less importance than does the predictability of Russia's investment climate. The main feature of the new legislation is that it will remain in force until the end of March 2031.

The new special economic zone will improve Kaliningrad's competitiveness in relation to its neighbours on the Baltic Sea. Some of the companies in Kaliningrad have already improved competitiveness at quite a startling pace. Rapid development may soon result in 'Made in Russia' being found on an increasing number of products on sale in the EU. Any assessments of the future competitiveness of Russian products should take into account, for example, that Kaliningrad-based Telebalt already engages in licence manufacture with South Korean Samsung.

In addition to Koreans, the Chinese have also noted the dormant potential in Kaliningrad. China's eighth biggest automobile manufacturer, Chery, has set up a plant in Kaliningrad, the goal being to manufacture 10,000 vehicles a year. Is Kaliningrad turning into an EU-flanked tax haven for Asian companies?

To date, Asian businesses operating in Russia have focused on the Russian market, but this may yet change. Companies and policy makers in the EU would hardly welcome the idea of an Asian tax haven in their own region.

Apart from the new special economic zone, Kaliningrad also offers splendid beaches, visited by more than 250,000 Russian tourists in 2005. The region is still waiting for a breakthrough among foreign travellers, though, with only 75,000 visitors from other countries entering the region last year. Why has Kaliningrad not managed to attract more foreign tourists?

Some of the reasons retarding the development of tourism in Kaliningrad include poor traffic and transport connections, slow border formalities, undeveloped conditions of airports, hotels and travel services, as well as the visa obligation. Granting EU citizens visa-free travel for short visits might give tourism a much-needed boost in Kaliningrad. This could apply, for example, to visits lasting a maximum of 14 days.

A decision on visa-free travel for fixed periods would carry more significance than the new law on special economic zone. If, for example, Kaliningrad were to be visited by half a million foreign tourists, each leaving 200 US dollars in the area, the foreign capital collected in one year would exceed the total amount of direct investments seen in the past 20 years.

Reciprocal visa waiver agreements between the EU and Kaliningrad should be made a long-term objective. In terms of visa-free travel, Kaliningrad could pave the road for closer cooperation between the EU and Russia.

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