Baltic Rim Economies

Estonia - Latvia - Lithuania - Poland - Baltic Russia
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Baltic Rim Economies

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Estonia

Increase in consumer price index slows down

The increase in the consumer price index (CPI) slowed down in March after a continuous rise since September 2007. Inflation achieved its high point in February with an increase of 11.3% y-o-y but slowed down in March with an increase of 10.9% says Statistics Estonia. The increase in the CPI from February to March was 0.8%. According to the Bank of Estonia, the increase was mainly due to the price rise in motor oil, otherwise the monthly inflation would only have been 0.5%.

According to the Deputy Governor of the Bank of Estonia, inflation caused by rapid wage growth has been Estonia's main obstacle in adopting the Euro and it is unlikely that Estonia can introduce the Euro before 2011. The Estonian government has announced that it is contemplating a freeze in public sector salaries for 2009 in order to better meet the inflation criteria.

Change of the CPI in selected commodity groups, March 2008 (%)

Commodity group	*3/2007-3/2008*	*2/2008-3/2008*
Food and non-alcoholic beverages	16.7	0.9
Clothing and footwear	5.3	1.4
Housing	14.9	-0.1
Transport	13.7	2.1
Hotels, cafes and restaurants	15.5	1.1
TOTAL	10.9	0.8

Source: Statistics Estonia

Construction slowed down rapidly

According to Statistics Estonia, the total production of Estonian construction enterprises in domestic operations grew by 9% in 2007. Compared to previous years marked by rapid growth (30% growth in 2006, 20% in 2005) construction market growth slowed down in 2007. The main cause for the slowing down of construction was the decrease in demand for new dwellings. Other reasons for the slowdown were increasing interest rates and a rise in construction prices. Another signal for the slowdown in the construction market is the 18% decrease in the production of building materials in February 2008 compared with February of the previous year.

The Estonian real estate market has been in serious difficulties in early 2008 as well. Private orders have decreased immensely and even public orders are to be revised in accordance with the government cutting its expenses. Construction sector unemployment has soared, leaving up to 6,000 people without a job. The construction price index reflects the current situation and grew only by 1.1% in the 1st quarter of 2008 compared to the last quarter of 2007. The future looks bleak from the perspective of the construction companies. According to the Estonian Institute of Economic Research, the assuredness of almost all industrial sectors has started to recover, the exception being construction companies.

Moderate growth in industrial production

The seasonally adjusted data of Statistics Estonia showed that industrial production grew by 2% in February compared to January. In addition, in comparison to February 2007 industrial production rose by 3%. The growth is mainly due to growth in the production of metal products, chemicals and electrical machinery which are, for the most part, manufactured for exports. However, some economic activities faced a decrease in their production. Food production decreased when the production of dairy products and beverages fell by roughly 20% compared to February 2007.

Foreign trade deficit continues to decrease

The value of Estonian exports rose by 4% to roughly 650M€ in January 2008 compared to January of the previous year. At the same time, the value of Estonian imports decreased by 4% to roughly 850M€ thus reducing the trade deficit by 60M€ to approximately 200M€ according to Statistics Estonia.

Estonian foreign trade is strongly oriented towards other EU-countries. According to the statistics, 75% of their total exports were to EU-countries particularly to Finland, Sweden and Latvia. 79% of total imports were from EU-countries particularly from Finland, Germany and Sweden.

The most important commodity group for foreign trade was machinery and equipment, with roughly a 20% share of both exports and imports. The greatest increase in commodities exports was in metals and products thereof with a growth percent of 62 compared to January of the previous year.

Some business highlights

§ Ferry capacity and competition is increasing on the Helsinki-Tallinn route. Tallink and Viking Line are replacing old ferries with new ones as well as Linda Line which is replacing a fast-ferry with a new one. In total, the capacity on the route will increase by more than 2,300 passengers.

§ The Tallinn Port handled three million tons of goods in March which is a decrease of roughly a third from the record-breaking four million tonnes handled a year before. The Port's revenues have decreased significantly since the Tallinn riots of April last year and the Port has postponed the construction of a new container terminal at Muuga.

§ Construction company Merko Ehitus will be divided into two new companies. The split is due to the criminal proceedings Merko is facing.

§ Real estate developer Arco Vara's affiliates have signed municipal water infrastructure construction projects in Estonia and Latvia worth almost 8M€.

§ SOK, the Finnish retailer, is planning to open grocery supermarkets in small Estonian towns. The expansion will most likely begin in Harjumaa County and it will be the largest investment of SOK in Estonia.

Estonia - main economic indicators	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**as of**
GDP (y-o-y %-growth, constant prices)	7.9	6.5	8.0	7.2	8.3	10.2	11.2	7.1	n/a	1-12/2007
Industrial production (y-o-y %-growth)	14.6	8.9	8.2	11.0	10.5	11.0	7.3	6.1	3.0	2/2008
Inflation (CPI, end of period, y-o-y %-change)	5.0	4.2	3.6	1.3	3.0	4.1	4.4	9.6	10.9	3/2008
General government budget balance (% of GDP)	-0.6	0.3	1.5	2.0	2.3	2.3	3.8	n/a	n/a	1-12/2006
Gross wage (period average, EUR)	314	352	393	430	466	555	596	784	n/a	Q4/2007
Unemployment (% end of period)	13.9	11.9	11.3	9.3	8.5	7.9	5.9	4.7	n/a	1-12/2007
Exports (EUR million, current prices)	3445	3698	3642	4003	4770	6190	7647	8028	1309	1-2/2008
Imports (EUR million, current prices)	4615	4798	5079	5715	6704	8213	10576	11278	1687	1-2/2008
FDI inflow (EUR million, current prices)	425	603	307	822	775	2255	1341	1817	n/a	1-12/2007
Current account (% of GDP)	-5.5	-5.6	-10.6	-11.6	-12.5	-10.5	-14.8	-14.5	n/a	Q4/2007

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

Latvia

Consumer price level rose rapidly

The consumer price level in Latvia has increased by 16.8% compared to March of the previous year reports the Central Statistical Bureau of Latvia. During the three first months of 2008 inflation has been 5.7% and the rise in the price level in March 2008 compared to the previous month was 1.5%. Heating energy, fuel and clothing and footwear had the greatest impact on the inflation level in March. The price for heating energy rose due to pre-determined administrative decisions to increase heating tariffs by 9.2%. The price level of clothing and footwear had decreased earlier in 2008 due to sales campaigns but the price level has increased again, with a growth of 4.8%. Diesel recorded the highest price increase for fuel. However, the price level of some food products and electrical household appliances decreased somewhat.

The Bank of Latvia has projected that inflation will not respond swiftly to macroeconomic stabilisation measures and the deceleration of economic growth. Instead, the Bank of Latvia estimates that annual inflation will stay on an upward trend in early 2008. Some moderation is expected towards mid-year.

Change in the consumer price in selected commodity groups, March 2008 (%)

Commodity group	*3/2007-3/2008*	*2/2008-3/2008*
Food	20.8	0.8
Clothing and footwear	2.4	4.8
Housing, water, electricity, gas and fuels	25.2	2.0
Transport	13.3	1.3
Hotels and public catering	23.5	1.7
TOTAL	16.8	1.5

Source: Central Statistical Bureau of Latvia

Annual industrial output decreases

The seasonally adjusted data of the Central Statistical Bureau shows that industrial production in February 2008 grew by 1.3% compared to the previous month. However, in comparison with February 2007 industrial output in February 2008 decreased by 4.7%.

Compared to the previous month, the most interesting growth figures in February 2008 were in mining and quarrying (4.3%) and manufacturing (1.5%). However, electricity, gas and water supply faced a decrease of 6.8%. Compared to February 2007, the most interesting growth figure in February 2008 was in mining and quarrying as well (31.4%). On the other hand, electricity, gas and water supply faced a decrease of 10.0%.

Construction costs rose in Q1 in 2008

According to the Central Statistical Bureau, construction costs rose by 20.7% in the first quarter of 2008 compared to Q1 in 2007. The most rapid rise was recorded in labour costs which grew over 40%. When compared to the last quarter of 2007 the construction costs in Q1 in 2008 rose by 5.1%. Again, the most rapid rise was recorded in labour costs which grew 6.4 % in this time. Construction costs for the renovation of office buildings has risen the most (5.3% compared to Q4 in 2007) and the construction costs of hotels have had the lowest increase (2.4% respectively).

Foreign trade grows in early 2008

According to the Central Statistical Bureau, the value of exports rose by 26.7% in February 2008 compared to the February of the previous year. The monthly growth in February was 10.1% compared to January. At the same time, the value of Latvian imports increased by 12.3% in February 2008 compared to the February of the previous year and the monthly growth in February amounted to 12.0% compared to January.

Latvian foreign trade in February 2008 was strongly oriented towards other EU-countries; roughly 77% of their total exports were to EU-countries, particularly to neighbouring Lithuania and Estonia. Approximately 78% of total imports were from EU-countries as well, particularly from Germany and Lithuania. However, Russia also maintains a position as an important trade partner with roughly a 10% share of both Latvia's exports and imports.

The largest increase in commodity exports in February 2008 compared to January was in products of the chemical and allied industries with a 38.0% increase and an increase of 52.4% compared to February of the previous year. The largest increase in commodity imports in February 2008 compared to January was in transport vehicles, with a 20.3% increase. But when compared to February of the previous year, the increase is only 3.4%.

Some business highlights

§ The Latvian government has decided in principle to build two new power plants with a 400 megawatt output each. The first power plant situated in Kurzeme would run on coal and biomass and the second one situated near Riga would run on gas. However, the realisation of the projects still faces major obstacles.

§ Latvian ports handled roughly 5% more cargo in 2007 compared to 2006. The growth continued when the turnover of the ports in Riga, Ventspils and Liepaja grew by 26.5% in January y-o-y.

§ Tapeks Noma, the construction machinery and equipment rental services company with 16 outlets around Latvia has been acquired by the international rental services provider Cramo.

§ Swedish EuroMaint Rail will open a new plant in Jelgava. The factory will manufacture spare parts for rail transport and employ 20 people.

§ Ventspils Nafta has announced that the 2007 concern earnings amounted to roughly 70 M€ according to unaudited results. The company has also stated that the transhipment of oil and petroleum products has grown roughly 15% in Q1 in 2008 when compared to the first quarter of 2007.

Latvia - main economic indicators	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**as of**
GDP (y-o-y %-growth, constant prices)	6.9	8.0	6.5	7.2	8.5	10.6	11.9	10.3	n/a	1-12/2007
Industrial production (y-o-y %-growth)	3.2	6.9	5.8	6.5	6.0	5.6	4.8	0.5	-4.7	2/2008
Inflation (CPI, end of period, y-o-y %-change)	1.8	3.2	1.4	3.6	7.3	7.0	6.8	14.1	16.8	3/2008
General government budget balance (% of GDP)	-2.8	-2.1	-2.3	-1.6	-1.0	-0.4	-0.2	0.0	n/a	1-12/2007
Gross wage (period average, EUR)	268	282	297	298	314	350	430	683	n/a	12/2007
Unemployment (% end of period)	13.3	12.9	11.6	10.3	10.3	8.7	6.8	5.4	n/a	Q4/2007
Exports (EUR million, current prices)	2020	2232	2416	2559	3204	4085	4594	5727	990	1-2/2008
Imports (EUR million, current prices)	3453	3910	4284	4634	5671	6879	8828	10986	1222	1-2/2008
FDI inflow (EUR million, current prices)	n/a	n/a	223	248	489	568	1324	1797	253	1-2/2008
Current account (% of GDP)	-4.8	-7.6	-6.6	-8.1	-12.9	-12.3	-21.1	22.8	n/a	1-12/2007

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

Lithuania

Price of consumer goods and services rose

Statistics Lithuania informs that the annual inflation in March 2008 was 11.3% compared to March 2007. During the three first months of 2008 consumer prices have risen 3.8% and the rise in the price level in March 2008 was 1.0% when compared to the previous month. Food products and non-alcoholic beverages, services by hotels, cafes and restaurants and alcoholic drinks with tobacco products had the greatest impact on the monthly price rise in March. The price of tobacco products rose due to an increase in excise duty (up by 3.1%).

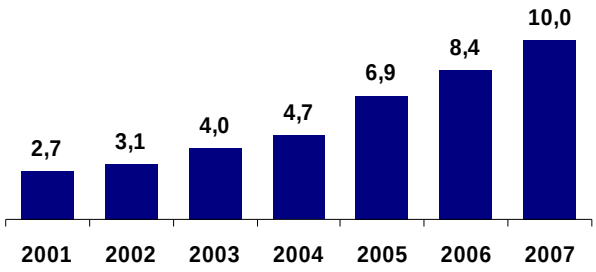
Changes in construction costs in February 2008

Construction costs rose by 0.6% in February 2008 compared to January. The construction input price index published by Statistics Lithuania also shows that the construction prices in February 2008 have risen 14.9% when compared to February 2007. A major influence on the price rise of February compared to January has been the rising prices of building materials and articles which have risen by 0.8% where the strongest influence on the price was caused by a price increase in metal products and different kinds of concrete and mortar.

Inward FDI grew in 2007

According to the provisional data of Statistics Lithuania, foreign direct investment into Lithuania during 2007 grew by approximately 20% compared to the previous year, amounting to roughly 10 billion euros.

FDI stock in Lithuania, at the end of the year (Billion €)



The largest investors were from nearby Baltic Sea region states. Investors from Poland had the largest share (18.0%) of the FDI stock followed by Denmark (12.9%) and Sweden (11.7%). More than a half of the total FDI stock fell, in terms of economic activity, per manufacturing (36.3%) and financial intermediation (17.2%). The largest sub category of manufacturing was the manufacture of petrol and chemical products with roughly a quarter share of all the manufacturing investments made. FDI from a regional perspective showed that almost 60% of all FDI went to the Capital Region of Vilnius.

Foreign trade grows in early 2008

The value of Lithuanian exports rose in January-February 2008 by 33.2% compared to the January-February of the previous year. The monthly growth in February 2008 was 13.3% compared to January. At the same time, the value of imports increased in February 2008 by 26.6% compared to the February of the previous year and the monthly growth in February amounted to 4.5% compared to January. Information is based on the non-final data of Statistics Lithuania.

Lithuania's foreign trade was oriented towards other EU-countries in January-February 2008; roughly 65% of total exports were to EU-countries, particularly to Latvia and Germany. Approximately 62% of total imports were from EU-countries as well, particularly from Germany and Poland. However, Lithuanian foreign trade is not as EU-oriented as the other Baltic States. In fact, Russia is the most important single export (14.8% share of total exports) and import (25.9%) area for Lithuania. A major contributor to Russia's significance is the Lithuanian oil sector.

The largest share of exports in January-February 2008 went to mineral products (22.4%) while machinery, mechanical appliances and electrical equipment came in second with an 11.0% share of total exports. The same commodity groups had the largest shares in imports as well - in January-February 2008 the largest share went to mineral products (25.0%) while machinery, mechanical appliances and electrical equipment came in second with a 15.3% share of total imports.

Some business highlights

§ The Port of Klaipeda achieved its highest monthly cargo ever in March of 2008 with almost 3 million tonnes of cargo loaded. Compared to March 2007, the cargo load advanced 26.2%.

§ The Lithuanian government is considering the possibility of constructing a 500M€ LNG-terminal in the early 2010's due to the imminent closure of the nuclear power plant in Ignalina.

§ According to the Economy Ministry, the oil refinery Mazeikiu Nafta is expected to experience a 52% surge in revenues this year to 3.2B€. Refining volumes are expected to reach 10 million tons as well.

§ Fortum Klaipeda has announced the construction of a new thermal power plant in Klaipeda. The 25 megawatt cogeneration power plant will burn, among other things, unrecyclable household waste suitable for energy recovery.

§ The retail chain Stockmann has signed a preliminary lease agreement for its first department store in Lithuania. The new 13,000 square-metre department store will be located in Vilnius.

Lithuania - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	2008	as of
GDP (y-o-y %-growth, constant prices)	4.1	6.6	6.9	10.3	7.3	7.9	7.7	8.0	n/a	Q4/2007
Industrial production (y-o-y %-growth)	2.2	16.0	3.1	16.1	10.8	7.3	8.9	7.2	4.0	3/2008
Inflation (CPI, end of period, y-o-y %-change)	1.4	2.0	-1.0	-1.3	2.9	3.0	3.8	8.1	11.3	3/2008
General government budget balance (% of GDP)	-2.5	-2.0	-1.4	-1.3	-1.5	-0.5	-0.3	-1.2	n/a	1-12/2007
Gross wage (period average, EUR)	263	274	293	311	335	421	459	594	n/a	Q4/2007
Unemployment (% end of period)	16.9	17.9	13.0	11.6	10.6	8.3	5.6	4.3	n/a	1-12/2007
Exports (EUR million, current prices)	3841	4778	5526	6158	7478	9502	11250	12522	2329	1-2/2008
Imports (EUR million, current prices)	5650	6767	7943	8526	9959	12446	15384	14341	3223	1-2/2008
FDI inflow (EUR million, current prices)	439	516	772	160	623	826	1448	1645	n/a	1-12/2007
Current account (% of GDP)	-5.9	-4.7	-5.1	-6.8	-7.7	-7.2	-10.8	13.7	n/a	1-12/2007

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

Poland

Growth continues in early 2008

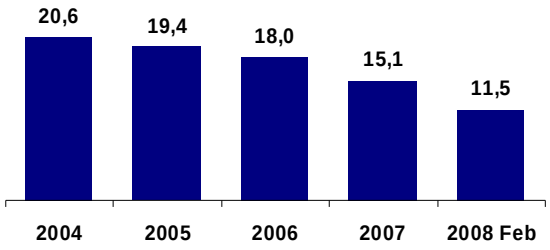
According to the National Bank of Poland, the Polish economy is still enjoying a period of strong growth. National accounts data from Q4 in 2007 and macroeconomic data for January and February 2008 indicate that economic growth has continued. However, the economic forecasts for the Euro area have become bleaker and the US economy has shown signals of an economic slowdown. Thus uncertainty over the future of the Polish market has also risen.

The Finance Ministry is predicting a slower, though still a strong growth of 5.5% for 2008. In line with the Finance Ministry, the European Commission has predicted almost similar growth for the Polish economy, lowering its earlier forecast of 5.5% to the current forecast of 5.3%. The forecasted growth is still twice as fast as in the EU as a whole.

Unemployment continues to decrease

According to the Labour Ministry, unemployment fell to 11.5% in February 2008 from 11.8% in January. In February 2007, the unemployment rate was 14.8%. The government has set a target rate of 9.9% for unemployment in the budget for 2008. Although unemployment remains relatively high, some sectors are facing a lack of employees. This is partly due to the open European Union labour market which has lured 1.2 million Poles to work abroad. The greatest demand is for workers with a university and secondary education specialised in IT, finance and logistics.

Unemployment in Poland, at the beginning of the year (%)



Source: The Central Statistical office of Poland

Prices of consumer goods and services rose

The Central Statistical Office of Poland reports that the prices of consumer goods and services rose by 13.7% in March 2008 when compared to March 2007. During the first quarter of 2008 prices have risen 1.5% when compared to the last quarter of 2007 and the rise in the price level in March 2008 was 0.4% when compared to the previous month.

The European Commission has altered its inflation forecast for Poland. The EC now predicts that inflation will reach 3.8% compared with the previously anticipated 2.8%. The EC also stated that inflation has soared due to the worldwide rise in the price of food and oil and due to rising Polish salaries. However, inflation pressure is expected to decrease later in 2008.

Foreign trade grows in early 2008

Polish exports rose in value in January 2008 by 15.1% compared to January of the previous year informs the Central Statistical Office of Poland. As in 2007, exports were overwhelmingly dominated by EU countries - roughly 80% of total exports were to Union member countries. On the imports side, the value of imports rose in January 2008 by 12.2% compared to January of the previous year. On the other hand, imports were also dominated by EU countries with roughly a 62% share of total imports but this is approximately 20 percent units less than the EU share in exports. Statistics show that only less than 15% of all Polish exports are from developing countries or from the non-EU-members of Central and Eastern Europe, whilst in imports the same national groupings have a roughly 30% share of Polish imports.

Some business highlights

§ In 2007, the Port of Gdynia handled 17 million metric tons of general and bulk cargo and more than 600,000 containers. Only five years ago Gdynia handled less than 250,000 containers. Growth in containers has been rapid making Gdynia the largest container port in Poland, and the third largest in the Baltic Sea Region, after Gothenburg and St. Petersburg. The Port is planning further and partly EU-funded improvements in its infrastructure (e.g. constructing a new ferry terminal).

§ Poland's second largest fuel concern Lotos Group has plans to increase its share of Poland's shipping fuel market to a quarter by 2011.

§ Coal exporter Weglokoks and the state-owned railway company PKP cargo have signed a contract worth almost 300M€. According to the contract, PKP Cargo will export coal abroad for the next three years.

§ MTU Aero Engines, a German aviation company, is soon starting to build a factory in Jasionka, south eastern Poland. The project is worth 70M€ and the factory will mainly produce rotating blades for low-pressure turbines.

§ BPH Bank and GE Money Bank are to merge in 2009. During 2008, BPH will be opening 30-50 new branches and GE has promised to invest around 30M€ in BPH and GE Money Bank.

§ Austrian consortium Meinl Airports International is planning to acquire a 24.9% share in the company running Bydgoszcaz Airport. The Austrians are planning to invest 23.5M€ in the expansion of the airport.

§ A new player is entering the Polish gas retail market. Cash & carry operator Makro is planning to open a network of gas stations in Poland and the company has already opened two stations in the Silesian province investing roughly 1.5M€ in them.

Poland - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	2008	as of
GDP (y-o-y %-growth, constant prices)	4.2	1.1	1.4	3.8	5.3	3.5	6.1	6.5	n/a	1-12/2007
Industrial production (y-o-y %-growth)	6.7	0.6	1.1	8.3	12.6	4.1	5.7	9.7	0.9	3/2008
Inflation (CPI, end of period, y-o-y %-change)	8.5	3.6	0.8	1.7	4.4	0.7	1.4	4.0	13.7	3/2008
General government budget balance (% of GDP)	-0.7	-3.7	-3.3	-2.9	-3.3	-6.1	-3.9	n/a	n/a	1-12/2006
Gross wage (period average, EUR)	472	557	544	497	505	591	692	825	877	2/2008
Unemployment (% end of period)	16.0	18.5	19.7	19.3	18.0	16.7	12.2	11.4	11.5	2/2008
Exports (EUR billion, current prices)	34.4	40.4	43.4	47.5	59.7	71.4	87.5	101.1	18.3	1-2/2008
Imports (EUR billion, current prices)	53.1	56.2	58.3	60.4	71.4	80.6	100.0	118.8	21.0	1-2/2008
FDI inflow (EUR billion, current prices)	10.3	6.4	4.4	3.7	10.0	8.3	15.1	12.8	n/a	1-12/2007
Current account (% of GDP)	-6.0	-2.9	-2.6	-2.1	-3.5	-1.7	-2.3	-3.6	n/a	1-9/2007

Sources: Central Statistical Office, National Bank of Poland, Eurostat, author's calculations

St. Petersburg

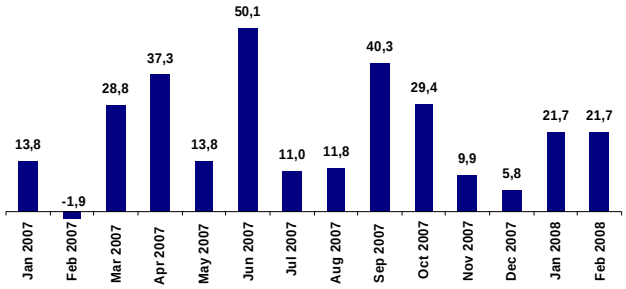
Regional GDP final estimates

Final evaluation of 2007 GRP of St. Petersburg resulted in a figure exceeding 9% which was much higher than nearly 8% of preliminary estimates. All sectors of the regional economy were growing fast, and construction became the leader by growth rate. These positive trends developed further in January-February 2008, with industrial production increasing by 12.2%, construction by 21.7%, transport by 35.4%, communication by 22.0%, catering by 26.6%, and retail trade by 9.9% y-o-y. Moreover, processing industries alone (excluding mineral extraction and power, gas, and water supply from industrial output) grew 15.8% during the first two months of 2008. Among the processing industries, electric and optical production was the leader, showing a 43.4% y-o-y growth in January-February 2008. This proves the revival of local science-intensive producers, which seems to become a new long-term target for regional authorities.

Construction changes dimension

The construction sector kept on growing in January-February 2008.

Construction contracts completed, monthly value change, Jan 2007-Feb 2008 (%)



Source: Petrostat, 2008

The main contribution to this increase belongs to office construction, while the residential space finalised by construction companies in St. Petersburg grew slightly by 0.7% compared to the level of January-February 2007. This change reflected the relative exhaustion of solvent demand on residential real estate. The average price of one square metre of residential space in St. Petersburg on March 31, 2008, reached 2574€, and became too expensive for the majority of potential buyers. Moreover, many regional banks (including the leaders, e.g. VTB) raised their interest rates for mortgage loans by 0.5% – 1.0% in March, thus making the loans even more costly. Nevertheless, the demand shifted to offices and retail centres, and enabled construction companies to further increase their output.

Inflation setting up records

In the beginning of 2008 inflation continued to accelerate, with 2.0% in January and 0.9% in February, which is equal to 13.1% y-o-y. This is, to some extent, a seasonal phenomenon, as monopolies raise tariffs in the beginning of the year. The largest 3.5% increase was observed for prices on services in January 2008 already, while in February the price rise decreased down to 0.8%. Bimonthly inflation for non-foods in January-February 2008 was 0.8% only. Food sector inflation was 2.1% in January and 1.5% in February 2008, following the relative price stabilisation on international food markets. All that means that regional inflation remains high and constitutes a big threat to the St. Petersburg economy. The only positive exception was the price of fuel in January-February 2008: the diesel price had a zero change, and gasoline became 0.7% cheaper.

Exports coming up with imports

Foreign trade of St. Petersburg was increasing fast in 2007: exports grew 40.5% y-o-y, and imports 45.9% y-o-y. In monetary terms exports grew even faster due to the skyrocketing price of mineral fuel, which took 73.0% of total regional exports. Trade balance remained negative but improved from minus 4.8B€ in 2006 to minus 2.1B€ in 2007. The total volume of foreign trade reached 28.1B€. A significant change among regional export partners was the result of the shifting of Gazpromneft's headquarters to St. Petersburg in late 2006. Being significant importers of gas from Russia, several countries, namely Italy, Slovakia, Germany, and Turkey got into the top-five of regional export partners (taking 9.3%; 8.8%; 6.5%; and 5.9% of the total city's exports respectively). However, the leading position was kept by the Netherlands, the region's traditional export partner, with its 20.9% of total exports. In 2007 China became the largest import partner of St. Petersburg taking 18.4% of total regional imports, and leaving behind Germany and Finland with 13.0% and 8.3% respectively.

Some business highlights

- § Construction costs of ZSD (Western Express Road), a road rounding St. Petersburg from western side, were raised significantly from 2.3B₴ up to 3.8B₴. The officially announced reason for this reassessment was inflation in the construction sector.
- § Regional developer Makromir started its inter-regional investment programme. The company intends to construct up to 50 various office and residential buildings and trade complexes in a number of Russian regions with planned investment totalling 1.4B₴.
- § St. Petersburg City Council approved the project of re-locating the cargo shipment facilities of railway station Moskovskaya-Tovarnaya from the city centre towards suburban zone Shushary-3. The project would change the structure of transport regional flows and release a large territory in the centre; expected investment accounted for 1B₴.
- § A Finnish retailer SOK, a member of large concern S-Group, announced its plans to take 10% of the regional retail market. SOK investor plans to create a network of 20 of its Prisma supermarkets until 2015 with planned investment of 500M₴.
- § The St. Petersburg Government approved a state programme aimed at supporting the innovation sector of the regional economy. During 2008-2011 regional and federal budgets together allocate 460M₴ on supporting innovative producers, and on the creation of the necessary infrastructure.
- § IF P&C Insurance Holding ltd, a subsidiary of Sampo, the Finnish financial group, announced its plans to acquire 100% stock of St. Petersburg insurance company Region. The sum of purchasing contract remains confidential, but the experts evaluate it at nearly 40-60M₴.

St. Petersburg - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	2008	as of
Regional GDP (y-o-y %-growth, constant prices)	10.5	4.5	17.7	8.4	7.2	8.4	8.4	9.1	n/a	1-12/2007
Industrial production (y-o-y %-growth)	26.2	0.2	31.4	5.8	14.1	4.2	-7.0	10.0	12.2	1-2/2008
Regional inflation (CPI, y-o-y %-change)	23.5	16.3	16.6	13.0	12.7	12.0	10.0	10.9	13.1	1-2/2008
Gross average wage (monthly, EUR)	n/a	n/a	217	209	285	345	407	510	518	1/2008
Unemployment (% average annual)	7.9	4.4	3.5	4.3	2.8	2.4	2.4	2.0	n/a	1-12/2007
Exports (EUR million, current prices)	2736	2134	1839	2429	3210	3954	5499	12978	n/a	1-12/2007
Imports (EUR million, current prices)	2693	4423	5158	5123	5560	8081	10299	15093	n/a	1-12/2007
FDI inflow (EUR million, current prices)	158.4	126.8	88.9	62.1	90.0	200.5	512.4	566.5	n/a	1-12/2007

Source: Petrostat, Rosstat, Central Bank of Russia, European Central Bank, author's calculations

In 2002 and 2004 average wage is for December; in 2003, 2005, 2006 and 2007 wage is for November of corresponding year

Leningrad region

Industry and construction stagnate

In 2007 the economy of Leningrad region developed slower than that of St. Petersburg. Certain stagnation or even decline was forecasted, and this came into practice in early 2008. Industry stagnated in January-February 2008, reporting a 0.4% y-o-y growth. Construction experienced a decline of 6.1% y-o-y in the first two months of 2008. The catering sector also fell by 4.3% y-o-y. Nevertheless, some sectors of the regional economy demonstrated significant growth in January-February 2008, namely transport, retail trade, and agriculture (which increased by 41.4%, 14.5%, and 10.0% y-o-y respectively). Among the branches of regional transport sector, automobile transportation was the leader: automobile transport companies of Leningrad region raised their carried cargo tonnage by 26.9% y-o-y (which together with rising tariffs resulted in the aforementioned growth). Total investment in the region showed a certain improvement compared to the autumn of 2007; in January-February 2008 it decreased by 1.7% y-o-y only. But inflation still is a serious threat for the regional economy: consumer prices grew by 2.2 in January, and by 1.1 in February 2008, which meant a 13.7% y-o-y inflation on average. In this respect the Leningrad region had outstripped neighbouring St. Petersburg.

Construction meets demand limitations

In January-February 2008 the regional construction sector experienced a significant slowdown. The basic reason was a market glut. In the first two months of 2008, 2355 residential apartments were finalised, while in the same period of 2007 this number was only 576, i.e. in 4.1 times fewer. The overproduction of real estate might have been balanced by sale discounts, but this sale promotion technology is not used yet by the majority of local developers. The same new phenomenon was observed in other Russian regions, e.g., in the Komi Republic, where poor demand and overproduction resulted in a certain decrease in regional real estate prices. Another trend by the regional construction sector is obvious, a decrease in a new apartment's size: the total residential space finalised in January-February 2008 grew from 56.4 to 201.0 thousand square metres y-o-y only (3.6 times).

Agriculture recovers

The positive trends of year 2007 were continued in January-February 2008: regional agricultural output grew 10.0% y-o-y. The main increase was observed in meat production, which rose by 26.0% in January-February 2008 y-o-y. The meat industry of the Leningrad region showed the best performance among all the regions of North-West Russia, and the region got into top-5 meat-producing territories of the whole of Russia. Production of milk in the first two months of 2008 grew 0.4% y-o-y only, but moved Leningrad region to fourth position among 85 regions of Russia, after Moscow region, the Krasnodar region, and the Republic of Tatarstan. For egg production, which increased in the same period by 3.0% y-o-y, the Leningrad region remained the national leader. The region's bimonthly production of eggs was 375.7 million, and that was the regional maximum in Russia in January-February 2008. An important reason for these positive developments is consumer demand, shifting towards less expensive, locally produced foodstuffs such as eggs, milk, and poultry.

Foreign sector grows fast

Foreign investment almost doubled in the Leningrad region, according to 2007 annual results. FDI grew 4.8% y-o-y only, while long-term credits from foreign sources rose nearly four-fold. The structure of foreign investment changed significantly in 2007: the share of FDI in foreign capital inflow decreased from 66.9% in 2006 to 37.3% in 2007, the share of other investment grew from 33.1% to 62.7% respectively. Consequently, the economy of the Leningrad region became much more dependent on foreign loans than it was before. Foreign trade grew 22.0% on the import side, and 40.0% on the export side, y-o-y.

Largest export and import partners of Leningrad region in 2007

EXPORT PARTNERS	Share in total exports (%)	IMPORT PARTNERS	Share in total imports (%)
Great Britain	38,1	Germany	21,0
Switzerland	34,3	Great Britain	11,7
Netherlands	7,1	Belgium	7,6
Finland	7,1	Spain	7,6
Estonia	2,9	Sweden	6,4
Ukraine	2,1	Finland	5,3

More than two thirds of total exports went to Great Britain and Switzerland, and the purchasers of exported commodities were oil and gas traders located in these countries. The share of mineral fuel in exports reached 80.4%, and the share of oil in this commodity group accounted for 95%. Imports consisted mostly of machinery and food, taking 61.5% and 20.4% of total imports respectively. EU countries are dominant among the import partners of the Leningrad region.

Some business highlights

§ Russian-German-Dutch pipeline consortium Nord Stream raised the costs of a planned underwater pipeline from 5B€ up to 7.4B€. The pipeline is created to export gas from Vyborg, Russia, directly to Greifswald, Germany. The cost increase is explained by growing prices of steel components and additional expenditures on environmental security.

§ Danish Jysk Stalindustri, controlled by Russian steel magnate Vladimir Lisin, announced its plans to acquire a leading shipping company of North-West Russia, namely Volgo-Balt Transport Holding (VBTH), for nearly 130M€.

§ Russian logistic holding RTL invests 80M€ in building a new car terminal for imported vehicles. The terminal would be located near Vistino, Leningrad region, on the shore of the Finnish Gulf. Expected annual capacity of the terminal would be 50 thousand imported vehicles.

§ American company Kraft Foods launched a new plant producing instant coffee in the Lomonosov district of Leningrad province, with an annual production capacity of 5 thousand tonnes. Kraft Foods invested nearly 70M€ in this project.

§ American giant Ford Motors started to produce a new, third modification of its car brand Ford Focus. Moreover, the company intends to launch a production line for its Ford Mondeo sedan already in 2009. This expansion would require 67M€ of investment, and nearly one thousand new employees.

Leningrad region - main economic indicators	2000	2001	2002	2003	2004	2005	2006	2007	2008	as of
Regional GDP (y-o-y %-growth, constant prices)	12.8	8.5	16.3	14.6	8.8	8.3	8.1	8.5	n/a	1-12/2007
Industrial production (y-o-y %-growth)	26.8	10.7	35.6	20.9	10.3	5.9	26.9	2.6	0.4	1-2/2008
Regional inflation (CPI, y-o-y %-change)	23.5	19.6	14.8	13.0	14.9	12.0	9.9	9.3	13.7	1-2/2008
Gross average wage (monthly, EUR)	106	141	152	173	190	259	324	403	400	1/2008
Unemployment (% average annual)	12.7	10.8	9.6	9.2	7.5	7.8	6.2	3.3	n/a	1-12/2007
Exports (EUR million, current prices)	1787	2350	2301	2580	3887	4862	5443	6078	n/a	1-12/2007
Imports (EUR million, current prices)	328	810	939	1061	1372	2561	2858	4759	n/a	1-12/2007
FDI inflow (EUR million, current prices)	222.5	266.0	121.9	104.5	106.6	178.7	288.0	276.5	n/a	1-12/2007

Source: Petrostat, Rosstat, Central Bank of Russia, European Central Bank, author's calculations
In 2000-2007 average wage is for November of corresponding year

Kaliningrad region

Slowdown in industrial production

The start of 2008 did not bring significant changes in Kaliningrad's economic development trends: strong growth of the regional economy continued but in some sectors growth rates decelerated. The most visible slowdown was in industrial activity – industrial output rose only by 5.7% in the first two months of 2008 (year-on-year) compared with 40% in 2007 and 67% in 2006.

Production in extractive industries was basically flat and electricity production declined by 7%. Manufacturing growth remained strong at 48% y-o-y helped by a new impressive increase in car production by 64%. Avtotor produced almost 18,000 cars in January and February. However, growth in car production this year will inevitably be lower than last year as Avtotor's output will be held back by production capacity and consumer demand. The federal government is also mulling over some measures to restrict the duty free importation of car components by the company. At the same time, other manufacturing sectors performed well at the start of the year, e.g. food manufacturing increased production by 32%, and might, to some extent, make up for slower growth in car production, although last year's growth rate in manufacturing is unlikely to be repeated this year.

Growth rates by sectors, y-on-y (%)

	Jan-Feb, 2008	*2007*
Industrial production	5.7	40.3
Mining	-2.2	1.0
Manufacturing	48.1	93.7
Utilities	-6.8	0.3
Construction	21.4	9.8
Retail trade	19.9	17.9

Source: Kaliningradstat (2007, 2008)

Construction and retail grow strongly

Strong growth continued unabated in construction and the retail trade. Construction activity grew 21% in the first two months of 2008, y-o-y. Retail sales dropped in absolute volume after the holiday season but year-on-year growth was strong – 19.9%.

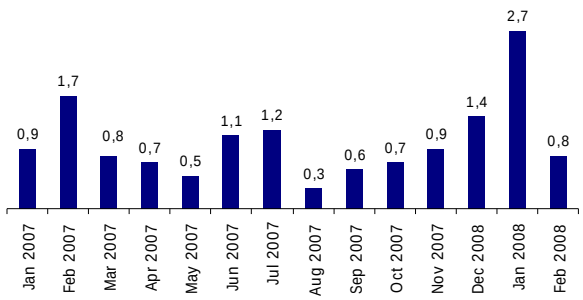
January brought a significant decline in household income growth though. Nominal per capita household income rose only by 1.5% (adjusted for inflation) y-o-y. The increase in wages was more significant – 8.2%. This decline in growth rates might be just a random fluctuation but it should be remembered that in recent years growth in wages and household income was significantly higher than that of productivity or GDP and this obviously cannot continue indefinitely.

Despite government effort consumer inflation is high

Administrative attempts to contain inflation did not bring visible results in the Kaliningrad region. In the first two months of 2008 the consumer price index increased by 3.5% (at the same rate as in Russia) compared with 2.7% in the same period last year. Annual inflation in February climbed up to 12.3% – significantly higher than the already updated government target rate of 9.5% (initially it was 8.5%).

In January alone consumer prices rose by 2.6% month on month – the largest increase in 3 years! In addition to food prices that rose by 2.1% in January (m-o-m), the traditional increase in utility tariffs (by 6.4%) pushed up the consumer inflation rate in January to this record level.

Consumer price changes, month on month in 1/2007-2/2008 (%)



Food inflation is likely to continue: agricultural prices in the first two months rose by 10.2% to December. On the other hand, manufacturing prices fell by 1.4% over the same period.

Some business highlights

§ IFC (member of the World Bank group) agreed to buy a minority stake in agricultural producer Sodruzhestvo. In addition IFC will provide a 32M€ loan to the company. Sodruzhestvo will use the funds to increase the capacity of its plant for processing soybeans and rapeseed, expand its sea terminal near Kaliningrad and refinance some of its debt.

§ Real estate subsidiary of Kaliningrad retailer Vester - VestRusDevelopment - plans to raise about 96-128M€ through a private placement of its shares and started a road show in London.

§ Chinese car producer Chery Automobile is looking for new partners to organise production of its cars and some components and had negotiations with authorities in Izhevsk, Udmurt Republic and management of IzhAvto car plant. Currently, Chery's cars are produced by Kaliningrad-based Avtotor and if the Chinese company decides to transfer production to another region it might have a strong negative impact on Avtotor.

§ Roskon opened a fish processing plant with a capacity of 8 million fish cans a month. Total investment to the plant amounted to 15M€.

§ Kaliningrad DIY retailer BauCentr has signed a letter of intent with the Qatari Barwa Real Estate Company. According to the agreement BauCentr will be an anchor tenant in shopping centres that the Qatari company plans to build in a number of cities in Russia.

§ Kaliningrad governor G.Boos signed investment memorandums at the property fair MIPIM-2008 in Cannes for the construction of two hotels in Kaliningrad that will be operated by Hilton and Accor.

Kaliningrad region - main economic indicators	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**as of**
Regional GDP (y-o-y %-growth, constant prices)	15.2	3.4	9.5	9.3	12.6	3.6	11.6	n/a	n/a	1-12/2006
Industrial production (y-o-y %-growth)	32.4	12.9	4.2	4.7	22.5	27.4	66.6	40.3	5.7	1-2/2008
Inflation (CPI, end of period, y-o-y %-change)	17.5	21.0	9.8	17.5	11.7	11.1	7.9	11.2	12.3	2/2008
Gross wage (period average, EUR)	67	99	125	137	155	193	285	375	404	Q4/2007
Unemployment (% end of period, LFS data)	15.6	10.6	7.2	7.6	6.5	6.6	4.5	n/a	n/a	Q4/2007
Exports (EUR million, current prices)	514	508	497	507	876	1470	2025	2500	n/a	1-9/2007
Imports (EUR million, current prices)	947	1169	1701	1894	2419	3282	4275	3924	n/a	1-9/2007
Exports (sales) to Russia (EUR million, current prices)	459	691	802	989	1449	1901	2471	1606	n/a	1-9/2007
FDI inflow (EUR million, current prices)	7.1	3.6	6.3	12.4	18.0	15.1	16.9	44.1	n/a	1-9/2007

Sources: Kaliningrad Statistical Office, RosStat, Central Bank of Russia, author's calculations

Why we need to modernise European universities

By Ján Figel'

In Europe we have come to recognise that we need to further develop as a knowledge society for our future wellbeing and economic sustainability and to keep our current influence in world affairs. Our universities, which operate at the heart of the knowledge triangle of education, research and innovation, have a key role in this, the overarching strategy of the Union for the present decade. But to put them in the optimal conditions to deliver their full potential, we need to go deep and tackle systemic reforms.

We have to respect the specific character that our universities have acquired over the centuries; at the same time, we must address their new roles. Universities have three main functions in today's knowledge society:

- Creating and safeguarding knowledge through research;
- Disseminating knowledge through education which is essential for the personal development of each individual and for the broader social development;
- Transferring knowledge to society, so that research can be used outside universities for innovation and growth.

In my view, universities should prepare for a new era by diversifying, both in offer and demand. On present trends, it is likely that universities and other higher–education institutions will rearrange into bigger or smaller units through alliances and co–operation across borders. New providers will enter the education market offering training courses in certain disciplines, using new technologies, and seeking recognition from quality–assurance and accreditation agencies.

For many years, most higher education institutions have striven to conform to the uniform model of research–intensive universities. Now, however, there is a growing consensus around the view that it is in nobody's interest that all institutions adopt the same model. Europe, the institutions and their students are better off when individual universities develop their own specific missions and profiles, addressing the specific needs of their environments and of the communities they are part of. As a result of these changes, students' choice is set to grow exponentially. Increasingly, student will have the option to leave their institution and work or study elsewhere at home or abroad. I have great expectations from this growing competition – and cooperation - between universities, both nationally and internationally.

To thrive in the knowledge era, we need to constantly upgrade our workforce in terms of knowledge, skills and attitudes. European universities, in all their diversity, are in a unique position to start serving new kinds of students; retraining our workforce and raising the general skills level of the population. To do this, universities need to open themselves up to new groups, such as students who get the chance to enter higher education only as adult learners and students from professional backgrounds who attend specific postgraduate courses. These adult learners will demand more in terms of quality, course delivery and student services. Besides, the deadline in the number of young people in many European countries mean that new student groups are an opportunity for universities which might otherwise risk seeing enrolments of students directly from secondary education fall over coming years.

Our universities, once fully modernised, will need more money to keep up with their new role in society. The European Commission proposes that each country should spend at least 2% of GDP on higher education. However, we have to be realistic and recognise that in many countries additional investments in higher education and research will not come entirely from the public purse. This means that more emphasis is needed on finding additional funding from private sources: enterprises, foundations and private households. The idea of private funding to higher education is hotly debated in many parts of the EU and each will find the solution that best suits the local conditions. But whatever solutions are found, it is clear that the impacts on access and equity must be carefully considered.

Universities must have the autonomy and means to address their changing missions. And for this they have to be accountable to society at large. Governments can enter into a new type of partnership with their universities and limit themselves to set the general frameworks in which universities can operate. In other words, universities need to be able to make strategic choices: extending their funding base, enhancing their areas of excellence, developing their competitive position and implementing the actions which flow from the choices.

Structured partnerships with the business community can make education and training programmes more relevant to society's needs and they can bring additional funding and management expertise. I have recently launched a new Forum to boost university–enterprise cooperation in the field of education. The Forum will be the ideal place for structured dialogue on issues such as mobility, curricula reform, continuing education and stakeholder involvement in university governance. Partnerships focusing on university education are as important as those on research and innovation. We intend to continue the Forum as a platform for dialogue.

But we have to recognise that education offers wider economic benefits; for instance, it improves the attractiveness of Europe as a business location. The recent agreement on the establishment of the European Institute of Innovation and Technology can reinforce Europe's capacity to transform education and research results into business opportunities. The EIT will boost Europe's competitive base by integrating innovation, research and education at the highest international standards, and by promoting a new model of working relationship for business and universities.

Our universities are crucial for the future of Europe; we need to create the conditions in which they can unleash their potential.

Ján Figel'

European Commissioner for Education, Training, Culture, and Youth

We need a Baltic Sea Stern Review

By Tarja Cronberg

The deterioration of the Baltic Sea has a long history, the result of both external and internal causes. Growth in nutrient emissions in Finland and Sweden has finally been checked and the treatment of effluent in Russia has been improved. However, despite these advancements the situation is still not resolved. Getting the emissions of many Baltic coastal states under control is a challenge. Diffuse pollution originating from Baltic coastal states is also an unresolved problem.

Another reason behind the deterioration of the Baltic Sea is its internal loading. Phosphorous stored in Baltic sediments dissolves into the water in oxygen-free areas at the sea floor. This accelerates the growth of blue-green algae, which binds nitrogen from the air and increases nutrient content and algal blooms, which decompose and consume oxygen. This sets off a nearly unstoppable vicious cycle that would need a massive reduction in external nutrient emissions to break. Despite this, the condition of the Baltic Sea would improve extremely slowly. This has given pessimists cause to declare the Baltic Sea as nearly "incurable".

If there is even the slightest chance of improvement, efforts must be redoubled, regardless of whether the issue is people or the environment. Indeed, this is the situation in which we find ourselves now.

Late summer blue-green algal blooms have an adverse impact on, for example, Baltic recreational uses to such an extent that the requirements for getting eutrophication under control have in recent years been tightened in the wake of heated public debate, particularly in Finland and Sweden. Blue-green algal blooms are a warning sign for the poor state of the Baltic Sea's health. They have given citizens just cause to pressure politicians to act and make good on their promises to save the sea.

The means used to save the Baltic Sea are complex, as they should be. The problems encountered in the various parts of the Baltic Sea as well as on the open sea, in coastal areas and archipelagos each have specific attributes, which must in part be resolved through means specifically tailored for them. This makes improving the condition of the sea a challenge.

The Baltic Sea Action Plan was adopted by the Helsinki Commission (HELCOM) at its Ministerial Meeting held in November 2007. The ambitious goal of the Action Plan is to reduce emissions entering the Baltic Sea to such an extent that its good ecological status would be restored by 2021.The Action Plan requires that all Baltic coastal states also take national action, through both legislative and other means, toward achieving the goals.

With expansion of the EU, the Baltic Sea is now, for all intents and purposes, fully enclosed within its borders. The EU's commitments to protecting biodiversity within the region will also provide some degree of relief to the condition of the Baltic Sea. The Convention on Biodiversity was signed in the EU in 1993. A biodiversity strategy was drafted toward its ratification. In addition to these, the Biodiversity Action Plan and the Sixth Environment Action Plan were also drafted. Agro-Environmental Schemes under the EU Common Agricultural Policy (CAP) Agenda 2000 are also geared toward the protection of biodiversity. The Water Framework Directive (Directive 2000/60/EC of the European Parliament and of the Council establishing a framework for the Community action in the field of water policy) and Integrated Coastal Zone Management (ICZM) Recommendation are also key instruments in terms of biodiversity protection and sustainable use.

The Baltic Sea Strategy is also being drafted specifically for the EU. Sweden is planning to make the Baltic Sea Strategy a central issue during its EU presidency at the end of 2009. The goal of the Strategy is to strengthen the Baltic region's competitiveness as well as tackle transnational challenges, the foremost of which are environmental challenges.

From an environmental standpoint, Finland believes that the Strategy must comprehend environmental protection measures, eutrophication prevention, agricultural nutrient loading reductions, fish stock protection and invasive alien species prevention. Development of a joint maritime traffic image would be required to monitor ever increasing shipping traffic throughout the Baltic Sea. The traffic monitoring system currently in use in the Gulf of Finland should be expanded to include the entire Baltic Sea. Oil accident prevention would also require more effective co-operation between countries in the Baltic region.

Even though the future of the Baltic Sea seems to be headed in the right direction, I am becoming more and more convinced that the Baltic Sea would need its own "Stern Review" The review would examine the state of the Baltic sea, its development and protection alternatives as well as their social and economic impacts. **The Stern Review on the Economics of Climate Change, which was drafted by** Sir Nicholas Stern, the former Head of the Government Economic Service and Adviser to the Government under Tony Blair, **would be an excellent model for such a review.**

Indeed, a clean sea does have certain monetary value. It is a commodity or "ecosystem service", which directly or indirectly provides commodities to people. These commodities can be, for example, fish production or recreational opportunities. According to researchers, the most valuable ecosystem service is the ability of sea floor sediments to store nutrients. The oxygen-poor state of sediments endangers this service. A monetary value can be calculated for all of these. Baltic Sea protection would be given new impetus if there were a review of the sea's social and economic impacts.

Tarja Cronberg

Minister of Labour

Ministry of Employment and the Economy

Finland

Is Poland really the biggest polluter of the Baltic Sea?

By Maciej Nowicki

In the last few decades Poland achieved substantial progress in improving state of the environment. Throughout these years growing environmental awareness of private investors and rising engagement of all levels of administration resulted on one hand in using more environment friendly production and wastewater treatment technologies, and on the other hand in implementing regulations which oblige to use such technologies and result in better environmental protection.

Pollution loads discharged by Poland into Baltic Sea decreased substantially in the last 15 years. Such decrease includes also substances which are particularly dangerous for Baltic environment – nutrients. Even if the changes in emissions in the first half of 90s might be perceived as a result of economy transition, the decrease observed in the following years is undoubtedly a result of environmental investments, particularly construction and modernization of municipal and industrial wastewater treatment plants.

Figure 1. Total loads of nitrogen and phosphorus discharged by Poland to the Baltic Sea.

With regard to total load from the Polish territory one should bear in mind that according to the results of monitoring by Chief Inspectorate of Environmental Protection, ca. 15% of total nitrogen and phosphorus loads discharged by rivers come as "background" from natural sources.

In the opinion of international public and decision-makers Poland is the biggest polluter in the Baltic Sea region. Nevertheless, an assessment of Polish impact on Baltic environment must not be decoupled from spatial, demographic and economic dimensions, as these issues are strongly interlinked. If these factors are not taken into account, the conclusions might be wrong and unjust.

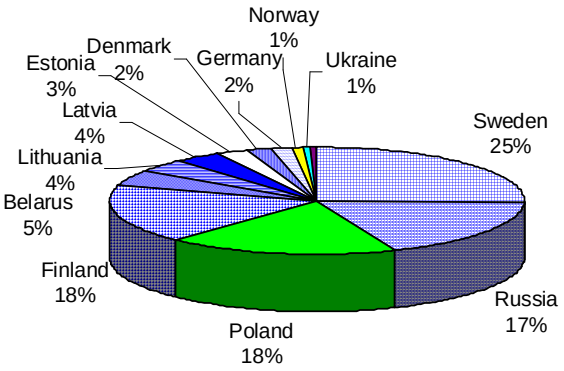


Figure 2. National shares in total Balic Sea catchment area.

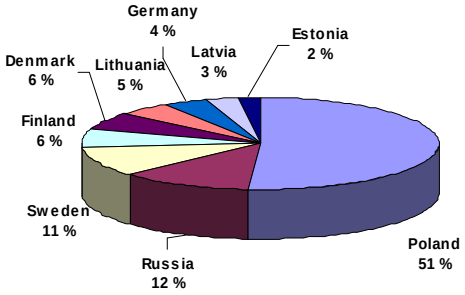
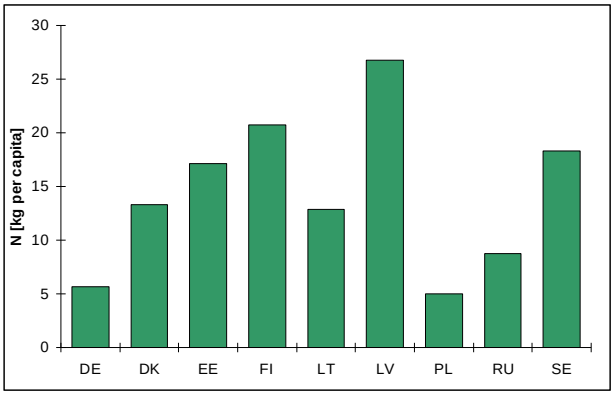


Figure 3. National shares in total Balic Sea catchment population.

Although share of Poland in the Baltic Sea catchment area is only 18%, over half of the population of Baltic Sea region lives here. Due to huge difference in population between Poland and other countries, a comparison of absolute pollution loads discharged into Baltic Sea draws a wrong picture of actual national efforts with regard to environmental protection.

Last comprehensive assessment prepared by Helsinki Commission was published in 2004 and is based on the data collected in 2000. The next edition of pollution load compilation is currently prepared and will be based on 2006 data.



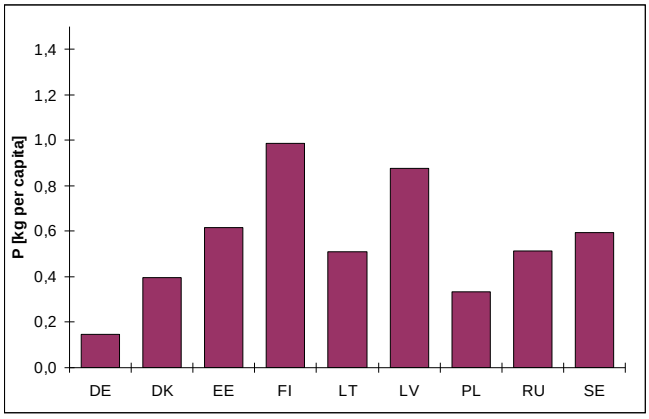


Figure 4a and 4b. National per capita pollution loads discharged into Baltic Sea.

The comparisons above show that, although absolute pollution loads discharged into Baltic Sea by Poland are high, relative per capita loads are low, particularly with regard to nitrogen, where Poland is the leader among all Baltic Sea region countries. Also with regard to phosphorus, Poland discharges less pollutants in comparison to majority of other UE Member States in the Baltic Sea region.

We should bear in mind that these indicators, both with regard to total pollution loads and to per capita emissions, will improve further after Poland matches its obligation according to – first of all – Community legislation, and afterwards – according to all other voluntary international obligations. Taking into account economic potential of Poland it should be expected that these obligations will be spread over a longer period. Due to long-term negligence Poland is obliged to reach conformity with environmental standards in much shorter period than Western Europe and Nordic countries.

Furthermore with regard to indicators above it might be necessary to review obligations of specific countries of the Baltic Sea region, according to the principle of common but differentiated responsibility.

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Minister of Environment

Ministry of Environment

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Saving the Baltic Sea with public-private cooperation, result-orientated actions

By Saara Kankaanrinta

The Baltic Sea is a very interesting area in many ways. The biggest concern is it's ecological status: Baltic Sea is the most polluted sea in the world.

90 million people – in 14 different states - who live in the catchment area of the Baltic Sea constitute a substantial burden on the naturally vulnerable and fragile sea. But this is a possibility as well, since the Baltic Sea is of supreme importance to these countries (and companies operating in the area), in terms of economy and policy and in key areas such as security, energy, transport. Even the United States is linked to the Baltic Sea area –on the basis of bilateral agreements with Poland and the Czech Republic, the US plans to station missile defence systems on their territories.

The Baltic Sea is a good example of how the environmental policy meets energy-, foreign and security policies, and how the positive co-operation in the environmental matters is particularly important and strengthens the relations of the states in general. It is of everyone's interest that the Baltic Sea is maintained healthy, peaceful and secure.

Speeding up the implementing of measures

We are in a hurry with the Baltic Sea. It is dangerously close to the hospice phase, but there's still hope, and we need to ensure that all possible steps are taken in order to save the Baltic Sea marine environment. It is obvious that only actions across borders will achieve sufficient changes. In order to save the Baltic Sea we need to have clear vision of what should be done, strong political will to push these enhancements through, and the fastest way to implement the measures in practice.

Baltic Sea Action Group (BSAG) was founded to tackle with major challenges of the Baltic Sea with a holistic approach, but well-focused projects. All three founders of the Baltic Sea Action Group, **Ilkka Herlin, Saara Kankaanrinta and Anna Kotsalo-Mustonen** have common background in John Nurminen Foundation, which played a key role in getting St. Petersburg to implement chemical phosphorous removal to its wastewater treatment plants. As John Nurminen Foundation continues to have its focus strictly on municipal wastewaters, the new foundation scales up the concrete actions with public private cooperation to the other major problems of the Baltic Sea: agriculture, marine transport and hazardous waste.

The purpose of the new foundation is to act in concrete projects that make a difference. BSAG acts as an initiator and a catalyst. We identify and analyze the problem with experts and then gather actors needed to carry out the project - whether those being states, local governments, other public institutes, researchers, private companies or individuals.

Experience from business brings new practices and useful perspective to the field of environmental protection. With our contacts to the private sector we are aiming that the business sector will contribute actively to the projects. Our approach is very conscious of economic realities, aiming to find the drivers and incentives that spur different sectors to participate in saving the Baltic Sea. Our arsenal of methods is wide, and we try to think 'out of the box'. The very essential idea of the BSAG is finding the best and the most efficient ways of doing things, not just take the traditional approach. Here we see that the business sector has new ways and approaches to offer.

Main principle is good and genuine cooperation with every actor. One of our biggest assets is the high level political network that we have created. Many projects need a strong political backup - the funds and an identified solution are not enough.

BSAG's emphasis will be in cost-effective, well-focused and tangible actions that are essential to the recovery of the Baltic Sea. All the actions are based on best available knowledge and BSAG is working closely eg. with the Academy of Finland to focus research into direction that gives practical guidance to initiate projects. BSAG works also closely with HELCOM in order to implement The Baltic Sea Action Plan by HELCOM (adopted in November 2007).

BSAG has four programs, which all include several project possibilities. The programs are: AGRICULTURE AND BIO ENERGY, CLEAN & SAFE SHIPPING, HAZARDOUS WASTE and NEW CHALLENGES.

Strategic philanthropy creates social value

We wish to supplement the efforts of the public sector, and create social value by generating greater social benefit for comparable cost, or achieve an equivalent social benefit faster - in other words with fewer euro. Our aim is to enhance the society's capacity in protecting the Baltic Sea. The work of the non-profit and civic sector should bring more resources to the environmental protection and speed up the process in general, not to replace or diminish the use of public funds or efforts to the matter.

This has been our vision: to approach philanthropy professionally and strategically, and thus use our potential to a full scale. Our potential is created by the role of being a catalyst and solving the problem as quickly as possible by agile operations and gathering of all the forces – including resources that would not have been in the picture with the traditional approach.

There are two points of view on the best way to operate using the resources available and maximizing the "social return on investment". First, the targets were chosen strategically, emphasis on the importance to the Baltic Sea,

cost-efficiency and feasibility. Second, the organization itself has to be effective and professional.

Our strategy commits us to the goal of superior performance, and it forces us to be demanding towards ourselves. Above all, our strategy defines concrete goals to serve as the basis of evaluation. We want to make sure that BSAG brings some added value to the field of saving the Baltic Sea. That is to say that we avoid being in the field just for the sake of it: in the end outcomes matter more than intentions.

The official name of the foundation, 'Foundation for a Living Baltic Sea', has been translated to the 14 languages spoken in the catchment area, but for simplicity's sake we work with the brand Baltic Sea Action Group (BSAG).

www.bsag.fi

Saara Kankaanrinta

Co-founder of the Foundation for a Living Baltic Sea /Baltic Sea Action Group (BSAG)

Finland

Belarus and Baltic Sea Region - common interests and challenges

By Aliaksandr Milinkevich

Belarus is directly adjacent to the Baltic sea region. Five out of sixth of our neighbours are washed by the Baltic Sea. Such geographical proximity had an enduring impact on Belarusian culture, traditions and history. Over centuries, Belarus developed tight commercial, political and cultural relations with the region. One would even argue that despite being land-locked, Belarus may in many respects also be considered a part of the Baltic Sea region.

The Baltic Sea countries are of vital importance for Belarus. Its independence and future as a European democracy are largely function of how far it develops the dormant potential of the European and sub-regional cooperation and integration. The anchorage and full-fledged participation of Belarus to the Baltic Sea cooperation initiatives and networks are very important part of this potential.

So, Belarus can only gain from openness to and sustained engagement with the Baltic Sea countries which are to be viewed as not only export market and source of investments and innovative technologies, but also as a model of intra-societal relations and human development opportunities.

Nowadays, the very first glance at Belarus proves that its political and societal system differs substantially from its direct and indirect northern neighbours. The monopolisation of political sphere by a small group, eager to keep and expand its tight grip on economy and civil society, impedes on private initiative and individual creativity, generates apathy and luck of trust. Regular and even increasing attempts on fundamental freedoms and pluralistic norms keep the government unaccounted and non-transparent. The misleading figures of mechanical GDP growth in Belarus should not be taken for granted. The current short-sightedness of the government becomes more and more obvious if we contrast the policy options, competitiveness and business attractiveness of Belarus with its immediate Baltic neighbours. One has to bear in mind that our starting positions were relatively similar.

Belarus' main export positions are connected to raw materials and derivatives (minerals, oil by-products, timber), but not to goods and services made with usage of new technologies. The current structure of trade balance of Belarus with the Baltic Sea countries is one of the proofs.

Because of the government's refusal to promote pluralism, both political and economic, Belarus is not able to positively contribute to regional prosperity and security and fully benefit from relationship with Baltic Sea countries based on common values and shared interests. It creates the situation where our potential of mutually beneficial relations is extremely underdeveloped.

Belarus is interested in investments and technologies from Baltic Sea countries, in learning from them how to better guarantee sustainable development, while protecting natural resources and environment. It needs further development of trade relations. Already providing important workload and transit revenues to southern Baltic rim ports of Ventspils, Klaipeda and Kaliningrad, Belarus requires enhanced cooperation in improving ports' facilities and developing its Baltic commercial fleet.

A common Baltic-to-Black sea energy and transport network that will help to diversify and reduce over-reliance on one energy supplier is at the geopolitical interest of Belarus. Developing such infrastructure will enhance regional cooperation in fighting organized crime, arms, drugs and human trafficking. Baltic technologies, expertise and assistance in strengthening the energy efficiency and developing alternative energy sources are of paramount importance for industrial and agricultural sectors of Belarus. Nowadays, when the government took a hush and non-transparent decision to start building a nuclear power plant in post-Chernobyl and authoritarian Belarus the exchanges of experience and know-how on energy efficiency become essential for Belarus to preserve its independence. Clean technologies based on renewable sources of energy such as wind and solar powers and biomass re-cycling ought to become alternative to nuclear power making the energy consumption environmental friendly and cost-efficient.

Belarus is an important partner in finding common solutions to environmental, challenges in the Baltic Sea region. With more than 40% of Belarus' total river flow coming into the Baltic Sea, our common interest is in reducing water pollution by developing more environment friendly agriculture and better waste disposal facilities in Belarus.

In sum, Belarus badly needs the largest possible political, economic, scientific, societal contacts with Baltic Sea countries. It is in Belarus' national interest to seek to create free trade area as first step of achieving free movement of labour, capital, goods and services with the EU.

The Belarusian democratic forces are aware of opportunities and challenges that a responsible and accountable Belarus' government will face in order to be integrated into Baltic area sub-regional and European networks and institutions.

Aliaksandr Milinkevich

Chairman

Movement for Freedom

Belarus

Shipping of oil products in the Baltic region

By Erkki Kotiranta

The Baltic Sea is the fastest-growing market area in Europe with great future opportunities provided by Russia. The Baltic region comprises almost half of the land area of the EU, but the current population of the Baltic region is only 23% of the EU and they produce only 16% of the EU's GDP. Economic polarities are even more extreme: the GDP of Germany is twice as much as the GDP of other Baltic Sea countries put together (excluding Russia).

On the other hand, with an average annual growth rate of over 2.1% the Baltic economies beat the EU average. It is estimated that by 2020 the Baltic countries will increase their exports by 46%, imports by 36% and trade within the Baltic area will grow by 54%. Overall, trade within the EU is expected to grow faster in the east-west direction than in the north-south direction.

Sea transportation is of primary importance for the growing Baltic trade since it accounts for a 50% share of all transported freight. In 2003, 76% of sea freight was carried out of the Baltic Sea and 24% was trade between the Baltic countries. Rapid economic development in Russia makes the Baltic Sea increasingly noteworthy, and due to the recent enlargement of the EU, European interest in the Baltic countries is reviving, as well.

Booming Oil Exports

Rapid economic development in Russia makes the Baltic Sea increasingly important, and due to the recent enlargement of the EU, European interest in the Baltic countries is reviving, as well. According to the Russian energy strategy, annual oil production will increase to 520 million tonnes by 2020, with exports accounting for 250 Mt and Baltic Sea exports for 180 Mt. Russian authorities plan to focus on developing their oil industry until 2010 and then shift their attention at expanding the export market.

In the first half of 2006 Russian oil industry accounted for 46% of Russian exports, but the share of the gas exports was only 14%. Oil industry is almost entirely in private ownership, whereas the gas industry is mostly state-controlled.

From the European viewpoint, the transport routes of Russian oil surround the entire continent. Russia's main oil ports are Novorossiysk on the Black Sea, Primorsk on the Baltic Sea and Murmansk in the north. Europeans are understandably concerned about the safety of oil shipments and after the recent accidents, governments have stepped up the pace of passing appropriate laws.

Oil transportation on the Baltic Sea has surged by 460% since 1999, and by 210% since the Primorsk oil port was opened. At present, the monthly transportation volume on the Baltic Sea is about 10 million tonnes, and rising all the time. It is expected that in 2009 the volume of oil shipments will be 18 million tonnes per month. Currently about 40% of oil shipments are carried by 100,000 dwt vessels. Moreover, it is expected that by 2010 Russia will triple the volume of oil shipments through ice-locked ports.

Russian Transport Strategy for 2020

- Priority on multimodal transportation and containers.
- Clear up bottlenecks and increase the speed of shipments by 20%.
- Increase the share of Russian ports to 85% (from 75% in 2003).
- Build up the Russian mercantile fleet.
- Improve the infrastructure in Northwest Russia with several projects.
- Develop St Petersburg as a hub of trade and tourism.

These strategic goals clearly indicate the importance of Northwest Russia and Russia's willingness to invest in this region.

Most of Russian oil exports are shipped abroad through Northwest Russia, which includes Russia's Baltic ports such as Primorsk, which has become a major outlet of crude oil with a continuously growing significance. In the future, other products will be transported through Primorsk in addition to crude oil.

Future will tell how and to what extent Russia will use the existing pipelines. Already, Russian authorities have announced that part of the oil now carried by the Druzhba (Friendship) pipeline will be redirected to Primorsk. It remains also to be seen what is Russia's overall attitude towards export pipelines running through third countries.

In addition to tankers, also passenger and container traffic is on the rise on the Gulf of Finland. At the moment, the ports on the Gulf of Finland register a total of 43,000 ship calls per year, but by 2010 the number is estimated to rise to 54,000. It is obvious that safe navigation on such busy waters requires strict rules and supervision of the entire area.

Causes for Concern

A certain tension is developing between the EU and IMO, because the EU uses its legislative power to control sea traffic on its home waters. Conflict is brewing between IMO as an expert organisation and an authority in the global shipping industry and EU as a strong regional and political force. IMO is an indispensable global player in the shipping industry and Russia wants to strengthen its influence in IMO. Overall, EU has implemented regulations proposed by IMO, but the process is slower than EU legislation in general.

Rush Hour on the Icy Sea

Baltic Sea is a sensitive sea area: its average depth is only 54 metres, whereas the average depth of the Mediterranean is more than 1 kilometre. Another significant restriction to shipping is the winter freeze-over. During harsh winters some Finnish ports may be ice-locked for more than six months, and even normal winter conditions can prevent the year-round use of regular ships.

The term ice-strengthened ship usually refers to a vessel with the ability to manoeuvre through ice-covered waterways. This requires two things: the hull of the ship must be strong enough and there must be enough engine power for icy conditions. Yet, these characteristics do not really tell whether a ship is functional in an icy environment or not. It is one thing to commission and acquire an ice-classified ship and another to actually operate it in sub-zero conditions.

It is apparent that the EU will introduce new rules and regulations concerning safety and environmental protection. Some current examples are the marine fuel sulphur directive, regulations.

Another matter of interest is the future of Helcom after the enlargement of EU. First of all, does Russia prefer direct dialogue with the EU and IMO thus bypassing Helcom partly or completely? Secondly, when the Baltic Sea was classified as a Particularly Sensitive Sea Area (PSSA), Russia opposed the motion. Apparently Russia is concerned about potential protective measures for the Baltic Sea: for example, could Denmark impose restrictions on tanker traffic in order to control Russian exports?

Nevertheless, it cannot be overemphasised that Russia is given the opportunity to participate in the decision-making process.

Conclusions

Oversupply in tanker market will decrease.

Consolidation of freight levels will continue.

Small players will be increasingly hard-pressed.

Winter premiums will erode.

Continuing growth of sea traffic increases the risk of accidents. Therefore, There will be new shipping companies and new partnerships.

The Murmansk area is developing rapidly: the distance to European ports is only four days and to U.S. ports nine days.

Our aim should be to create common rules of business in the Baltic Sea area for winter seafaring and assistance and in the qualifications approval process. The Baltic Sea as a special territory and as a semi-arctic area will set its own minimum standards for safe maritime transportation.

All Russian exports to the west cannot be carried through the Baltic area.

The willingness of European companies to make big investments in the Russian market is held back both by economic risks and complex political risks.

The Baltic Sea has become the primary energy transportation route to Europe. The construction of new gas pipelines and planning of LPG terminals on the Baltic indicate that the relevance of the region

The Challenge of New Transport Routes

Energy supplies through the Baltic to Europe continue to grow. In the Baltic region, Russia remains the main engine of growth. But the Russian economy and society are vulnerable to fluctuations in world energy prices: Energy accounts for over 60% of Russian exports and half of the federal revenue. Moreover, Russia is so enormous that producing and exporting energy alone does not bring prosperity to everybody, which is another argument for economic diversification. Europe is the most important market for Russian energy now and in the future. The best part of Russian gas, oil, coal and electricity is exported to Europe.

Future will tell how and to what extent Russia will use the existing pipelines and whether new ones will be built. The proposed BPS-2 pipeline is expected to bypass Belorussia and Poland, and part of the oil carried by the Druzhba (Friendship) pipeline may be redirected to Primorsk or Ust-Luga. In the Mediterranean, several new pipelines are on the planning stage with inevitable consequences to logistical solutions.

Baltic ports alone cannot handle Russian oil exports to the West. The Murmansk region is assuming a bigger role and in the future it will become a major energy export route. This means new challenges to shipbuilders and ship operators as the total volume of Russian oil exports through ice-locked ports is going to triple by 2012.

Erkki Kotiranta

Vice President

Neste Shipping Ltd

Finland

University reform - a global phenomenon

By Kari Raivio

In the Lisbon summit in 2000, EU approved the strategic goal of making Europe the leading and most dynamic knowledge-based economy in the world by 2010. Very soon it became apparent that the strategy is not going to succeed. By many indicators, the economic superiority of the USA was increasing, and the rising East Asian economies were closing the gap to Europe.

Reassessment of the situation in numerous conferences resulted in a decision to adhere to the goal of the Lisbon strategy but to set no target date. Important areas of development were then defined. Among these, research and development (R&D) were again emphasized, and a reform of universities was considered essential for the resuscitation of Lisbon. Economic competitiveness is the driving force, not idealistic notions about educational democracy or cultural fulfilment.

Ranking of universities has received a lot of attention from the media, decision makers, and the business world. Because ranking lists are dominated by top American research-intensive universities, with Cambridge and Oxford the sole European stars, a gloomy picture about European higher education has emerged. The most important and influential scientific publications originate in the USA. Also, the majority of Nobel Prizes after World War II have been awarded to Americans. The innovative activities of American universities are more dynamic, reflected in the number of patents and spin-off companies based on university research, but also in terms of collaboration with the private sector.

Some of the problems underlying the lacklustre performance of European universities are easy to identify. Investment in R&D is lagging far behind the target of 3 % of GDP, agreed in the Barcelona summit in 2002, the EU average being 1.4 % and only Sweden and Finland above the goal. This influences not only industrial applied research and development, but also basic research which is traditionally carried out in public institutions. Investment in higher education by the EU countries is also much lower than in the USA, both in terms of percentage of GDP (1.3 vs. 3.2) and per student (less than 10 000 US dollars PPP vs. over 20 000). The student/teacher ratio is much higher in European than in US universities, which necessarily has an impact on the quality of teaching.

Most European universities have converged upon a single mode of function, that of a research-intensive university, despite the meagre funding and lack of tradition in world class research. Doctoral degrees are awarded by most of the ca. 4 000 institutions of higher learning in Europe but only by some 250 of a similar total number of universities in the USA. Quality research is expensive, and scattering of resources means that no institution can rise to the top.

One of the recognized reasons for the mediocrity of European higher education is lack of autonomy. Detailed regulation by state authorities robs universities of their possibilities to react to the changing environment and to take advantage of their strengths. Total dependence on state budget allocations, which in many countries come with strings and earmarks attached, prevents creative new initiatives. The civil servant status of academic personnel in most European countries gives job protection but few real incentives or rewards for excellent performance. Recruitment of world-class scientists and teachers is difficult, because lack of funding and collective labour contracts prevent salary competition, a problem compounded by the high level of taxation in many countries.

Although the current unsatisfactory state of European universities has been recognized by the EU Commission, the responsibility to improve the system rests with the member states, not with the Union. The EU can publish communications and proclamations, but as long as the member states disregard joint agreements and recommendations, progress is painfully slow. Nevertheless, awareness of the problem has increased, and many countries are now taking steps to improve their universities, not only in Europe but the world over.

Germany has launched a program called “Exzellenzinitiativ”, with the purpose of elevating some universities to the top rank in the world. Over five years, a total of 1,9 billion euros will be allocated for three purposes: graduate schools, centers of excellence, and strategic development plans. In each category, funding decisions were based on evaluation by international experts of proposals submitted by universities. Nine universities received the most coveted strategic funding and the label “Exzellenz”.

At the turn of the millennium, Canada decided to boost its university system by establishing 2 000 new research professorships. These were allocated to universities in proportion to their success in competitive national research funding. Each university was required to prepare a strategic plan, delineating their strong areas and future prospects, and apply for the professorships from a foundation set up to administer the new funding. The applications were reviewed by international panels of experts to ascertain that they were in line with the strategy and that the applicants fulfilled competence requirements.

China has also launched a “top university” program by allocating major extra funding to ten of their best universities. Sweden has celebrated the 300th anniversary of Linnaeus by awarding substantial grants to advanced research programs applied for by universities and evaluated by peer review.

Competition between universities is becoming global and more intense. As described above, many countries are responding by increasing the funding of their universities, but selectively and through competition based upon quality. This will lead not only to focusing of research on limited areas, but also to a differentiation of missions. Some universities will compete on the research scene, others invest into their reputations as teaching institutions, while still others put most of their efforts on the innovation arena, in collaboration with private industry and regional developmental authorities. This is a healthy development.

The universities in the Baltic region are at different stages of development, depending on history, the economic situation, and the structure of the research institutions. The traditional Russian system of concentrating research in science academies, whereas universities were mainly teaching institutions, was usual in Eastern Europe and the Baltic states during the Soviet era. After regaining their independence in the early 1990´s, the Baltic states have already taken steps to strengthen university research. Lack of resources is the most significant obstacle, but participation in the EU research framework programs has improved both the financial situation and the participation of scientists, teachers and students in exchange programs. A complicating factor is the proliferation of private universities, fuelled by the unlimited demand for higher education. These operate on market principles and cater to the most popular fields of study, without any research component. Because of lack of accreditation, lax public control, and untested confidence of

employers, the new private universities are a significant risk for prospective students.

There are good arguments for increased university collaboration in the Baltic area. Although the fundamental problems of universities are not unique to the region, certain important research questions are. The most important of these is the physical unifying factor, the Baltic Sea itself. Mounting ecological problems are threatening its health and very existence, and these problems can only be addressed through high level multidisciplinary research. No single university, research institution, or even country is able to handle the scientific challenges involved. Mare Nostrum could be the central issue, around which universities in the Baltic region could concentrate their collaborative research efforts and, simultaneously, foster positive developments in the universities themselves.

Kari Raivio

Chancellor

University of Helsinki

Finland

Ranking of Swedish higher education institutions

By Maria Tengroth

In Sweden, the ranking of universities and other institutions for higher education is a somewhat controversial matter. The Chamber of Commerce and Industry of Southern Sweden became aware of just how controversial when we launched our own yearly ranking in 2006 and 2007. Our ranking received a lot of media attention and the following debate confirmed that although it is still provocative and controversial, there is a growing interest in discussing issues such as quality, competitiveness and ranking within the Swedish higher education system.

Background

Sweden has, at present, no official ranking of its higher education institutions (the abbreviation HEI will be used here). Therefore the Chamber of Commerce and Industry of Southern Sweden have taken on this task by developing our own ranking. By using statistical data from the Swedish National Agency for Higher Education we have put together a model consisting of eight parameters (e.g. density of teachers, international exchange, capacity to attract external financing, average time needed for students to graduate, number of published articles). Data is derived from the Swedish National Agency for Higher Education, with the exemption of published articles where the bibliometric database *Web of Science* from Thomson Scientific is used. The model then relates the individual HEI's results for each parameter to indexed average of 100. Finally, all eight parameters are added together and weighed to generate an overall value for each HEI. This then method generates a ranking of Sweden's current 30 HEIs that offer traditional theoretical education (art schools etc. are not included).

Results and conclusions

The result of the 2007 ranking can be summarised as follows: Karolinska institutet ranks as number one among Swedish higher education institutions, followed by the Swedish University of Agricultural Sciences and the Stockholm School of Economics. Also, three general conclusions can be drawn from the results. HEIs with more financial and organisational independency rank higher than those without and HEIs that are specialised rank higher than those which are not. It also seems like smaller HEIs with a well-defined strategy for e.g. attracting students, improving international programmes etc. appear to do better than others. It is also evident that the rapid expansion of Swedish higher education since the 1990's has come at a price. Quantity has not always been matched by quality. We therefore argue that Sweden is too small a country to host over 30 HEIs with a full-fledged education programmes. In order to boost quality and competitiveness, further emphasis should be put on specialisation and the strengthening of comparative advantages of each HEI.

Reactions

As expected, our ranking has been met with some critical comments. The most frequent is a principal and general objection against measuring and ranking something as elusive and vague as quality. The actual results seem more difficult to criticise since they are based on official statistics. Not surprisingly, those at the top of the list were considerably more positive towards the concept than those at the bottom. Nevertheless, in connection to the launch of the 2007 ranking, we noted a refreshing openness and willingness to discuss these issues from a number of HEI representatives.

Development

Judging from statements made by the Swedish Minister for Higher Education and Research, Lars Leijonborg, it seems more and more likely that rankings will become part of the future Swedish higher education system. Minister Leijonborg has declared an interest and openness towards rankings, both Swedish and international, preferably EU or OECD based. To this end, the Swedish National Agency for Higher Education has recently started to examine these possibilities further. We can thus see a clear Swedish trend towards an increased element of measuring quality and competitiveness. There has also been a significant change in the Swedish debate on higher education since we launched our ranking for the first time in 2006. This change of debate, both within public authorities and government, as well as in the general debate on higher education, is very encouraging. From the point of view of the Chamber of Commerce and Industry of Southern Sweden, we are very pleased to see that the argument that it is better to at least try to measure and quantify quality appears to be gaining strength. To refrain only because of methodological difficulties, is fortunately becoming an increasingly rare standpoint.

Future plans

Our long term ambition with the ranking is – perhaps somewhat ironically – that it will eventually be redundant. That will happen when the ranking of HEIs has become a natural and central part of the Swedish higher education system, enabling students and employers to form at true picture of the strengths and weaknesses of Swedish HEIs. Until then, we will continue our preparations for the launch of the 2008 ranking.

Maria Tengroth

Policy Manager

Chamber of Commerce and Industry of Southern Sweden

Sweden

Finnish SMEs in the Baltic Sea Region - growth potential and challenges

By Niina Nummela

Finnish exports have been under considerable turbulence during the last decade. The number of the markets has increased and the importance of more distant markets has grown. Exports as an operation mode has lost significance, as companies have moved their production abroad. And yet, there are many things which still remain unchanged. One of them is the importance of Baltic Sea Region for the Finnish economy.

According to a recent report by professor Urpo Kivikari, 40 per cent of Finnish exports is directed to the Baltic Sea Region and even 45 per cent of imports accumulate from the same area. Despite the growing markets in Asia, the most important trading partners of Finland are still located in there, and one could argue that their weight might even increase in the future.

Small and medium-sized enterprises – the motor of Finnish exports?

Baltic Sea Region is particularly interesting and important from the viewpoint of small and medium-sized enterprises (SMEs) who – mostly because of their limited resources – have traditionally internationalised by exporting their goods via middlemen to markets which are rather close to home markets. The countries around the Baltic Sea have offered them a very natural way to expand their operations close to home.

In line with other countries in the European Union, small and medium-sized enterprises have always been an important part of the Finnish economy. Their role in the international trade has been limited but increasing constantly. According to Finnish National Board of Customs, in 2006 the exports of SMEs grew with 17% being 14% of total Finnish exports. The trend continued positive also throughout year 2007. Particularly encouraging was the share of micro enterprises who continued to expand their international activities. Altogether almost 13.000 Finnish SMEs were exporting, i.e. almost 90% of exporters were SMEs. However, despite the volume of SMEs in exports, Finnish exports is still dominated by giants; 20 biggest exporters cover approximately half of total exports.

Small and medium-sized enterprises – the potential of Finnish exports?

In spite of the dominance of large exporters – or perhaps just because of it – small and medium-sized enterprises do possess growth potential. The recent positive development in exports is very welcome and promising, especially given the fact that there is still a great number of SMEs who have not internationalised at all so far. If even a small proportion of them would enter the international markets, the number of Finnish exporters would be multiplied.

Then again, the international growth of SMEs does not come without challenges. Although SMEs are by no means a homogenous group, many researchers agree that, in general, they seem to differ from larger ones particularly in their internationalisation. For example, their decision making, international activities, internationalisation processes and exporting stimuli are considered to be different. Research on small-business internationalisation is usually based on the assumption that small and medium-sized firms suffer from disadvantages compared with their larger counterparts. Operating on international markets demands resources, experience, skills and knowledge, which small businesses often lack. It is evident that the combination of insufficient resources and inadequate management skills discriminates small firms compared to larger ones. Nevertheless, earlier research among SMEs points out their lack of international growth orientation of being one of the greatest hurdles in internationalisation. Consequently, one of the major challenges in promoting SME exports is to help them to overcome this attitudinal barrier.

Small and medium-sized enterprises and the Baltic Sea Region?

In line with other small and medium-sized enterprises earlier, also the newcomers on international markets would probably start their international expansion from the Baltic Sea Region, as it would be the most attractive business area for them. However, compared to the pioneers in the market, these late starters suffer from lack of first-mover advantage and the fact that they enter a highly competitive environment. In order to succeed, they need to find innovative solutions to offer.

On the other hand, at the same time it can be assumed that our current picture of SMEs actively operating in the Baltic Sea Region will slightly change. First, in addition to the manufacturing companies, service firms and particularly the ones offering knowledge-intensive services will increase in number. Of the Finnish service firms already active in the region, the majority are client followers, i.e. they have entered the markets in order to serve better their existing customers. Yet, it can be anticipated that in the future we will also witness the rise of market seekers, i.e. the service firms who are there to attract the large customer potential of the area. Both strategies are as likely to succeed, if the companies acquire enough market knowledge and monitor the market development carefully.

Second, SMEs' activities will probably move from traditional exports towards operations which require more commitment than earlier. As mentioned earlier, manufacturing SMEs have traditionally relied on local partners in their operations in the Baltic Sea Region. Nevertheless, it is probable that in the future the strengthening competition will require a stronger local presence on the market. This is particularly decisive for service firms, whose customers rely on their services on the spot.

Finally, the value chains and networks of all companies are becoming more complex than ever, and this will also be reflected in the activities of small and medium-sized enterprises in the Baltic Sea Region. They may enter the market either as a member of the network of a larger company or in an attempt to create a network of their own. In both cases, the SME managers will need novel kind of competences to manage their company. These network competences will prove to be critical in their future activities in the Baltic Sea Region.

Niina Nummela

Professor, International Business

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Searching for a new leadership in the Baltic Sea Region

By Žaneta Ozoliņa

Almost all articles written about the Baltic Sea Region start with axiomatic statement that it is a region of huge potential in terms of economic achievement (a third of European GDP is accumulated in the area), human potential (one third of the EU population inhabits the region), and a high level of compatibility (50 per cent of the countries of the BSR are included in the list of the „top 20" most globalized countries). Following EU enlargement, the BSR is no longer a periphery or „silent corner", but more a core region of the EU in terms of growth, stability, modernization and innovation. The special role of the region was acknowledged by the EU when European Parliament suggested drafting a European strategy for the BSR. The EP suggested focusing on the „3E+S" formula, namely, environment, economy, education and security (I would add one more E – energy), thus offering keywords for further debate on a wider European level. These priorities are significant for not just the region itself, but for all Europe as it develops the resources necessary for playing a more influential role in the global arena. Two significant events mean that 2008 could become a historical year for the BSR: the European Commission begins drafting Strategy for the BSR, and in July the CBSS (Council of the Baltic Sea States) will address the future of the organization, and the the BSR creeping agenda issues.

These two mega-events lead to a few more specific questions. Firstly, in terms of the EU BSR strategy – who writes what, and for whom? This is not just a rhetorical question, but rather reveals the diversity of the countries and their priorities in the region. It is more than clear that drafting the strategy should be based on the principle of inclusiveness, even if some countries are not members of the EU and one, namely Russia, does not share the same values and policy goals. Therefore the questioned should be restructured - not starting with „who" but for „whom" and „what". This approach would presuppose that all involved parties present their vision of the future of the BSR, as well as their policy priorities and express their commitment to the regional development. This will give an opportunity to those countries more interested in proceeding with their own initiatives to succeed and not be stopped or influenced by others with a different approach to regional cooperation. This policy would help some countries to avoid the temptation of converting inclusiveness into a principle that hinders more committed from further integrating.

Second, what is the substance of the BSR agenda? There are at least three circles of issues that deserve to be included in the agenda. The first circle is formed by priorities that are relevant to both the BSR and the EU, and have an impact on further developments at the regional and international levels. I would particularly single out the Lisbon goals. The Lisbon strategy can be ignored as a political document, but no one would dare to ignore its core - competitiveness. The BSR has a potential. But... According to the EP document describing the BSR, the level of prosperity in the BSR is below only one peer regions. The BSR is home to only 27 of 500 fast growing companies named in the „ Europe 500". The second circle is formed by policy priorities defined by the EU in regard to its salient neighborhood. BSR countries are not fully exercising their cooperative instruments to enhance European Neighborhood Policy in the Eastern part of the EU. Countries still tend to operate on the bilateral level, instead of using the knowledge and experience of regional cooperation that has been accumulated in the BSR over the last two decades. The third circle contains issues of a global character – energy security, climate change, development policy and others.

The third question derives from the previous two – how to combine the diversity of actors and their interests with the three circles of overlapping EU and BSR agendas? It is easy to provide a verbal answer, but more difficult to implement it, having achieved tangible results. The answer is that the BSR needs leadership. There are still many „divides" in the BSR that leadership can mitigate. The BSR leadership should present the ability to change itself and the environment. It should demonstrate skills that are needed in permanently changing international system - such as adaptability, openness, and creativity. Countries that representing experienced (in order to avoid term „old") Europe have knowledge, stability, and the tools to cope with globalization. Although Europe's newcomers can offer valuable new visions, perspectives, dynamism, imagination and flexibility. In mid 1990s Sweden expressed its willingness to undertake this role, but failed. Leadership works if it diminishes its individual interests, and is able to share leadership gains with other involved parties.

I would argue that Latvia has all necessary preconditions to play this role. Latvia was, and still is known, as an ardent supporter of regional cooperation. Latvia was a long lasting advocate of regional endeavors in times when others were hesitating to involve themselves in activities that did not guarantee quick results. Latvia has, and still does, support CBSS initiatives, and would like to see the organization become an institution where the regional agenda is designed, debated and accepted. Latvia has stabilized its relations with Russia, opening new opportunities for a multilateral dialogue. Latvia has geographic privileges and infrastructure that enable it to serve as a bridge – economic, logistic, services and others - for regional cooperation. Latvia has a foreign and security agenda aimed at neighbors of the BSR thus involving the whole region in the expansion of the area of stability and prosperity, of great benefit to Europe.

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The third stage of regional economy - integration of the east and west

By Tapio Välinoro

The third stage of financial development between Southeast Finland and Southwest Russia has started. The export limitations set by Russia for raw wood and the structural changes in the production capacity of Finnish paper industry strengthen the impression of the new development stage.

From a transmitter of raw materials into a distribution centre

In the bilateral trade between Finland and the Soviet Union, Southeast Finland gained a strong position as a transition region for raw materials transported from the east to the west in the 1970s and 1980s. The transportation of oil-based chemicals from the Soviet Union by rail, intermediate storage of products and their loading for sea transportation gave birth to significant business operations in Kymenlaakso.

The first development stage in the economy between east and west ended in Southeast Finland in the 1990s. As the Soviet Union was dissolved and the new Russia was born, the Baltic countries continued the transition traffic using the ports of the former Soviet Union until Russia invested in its oil ports. Southeast Finland advanced to the second development stage in its role between east and west.

The growth in consumer demand in the new Russia and the inability of its production to respond to the needs led to rapid growth in imports. The ports of Southeast Finland acquired a new role. Their main task in the exports of Finnish forestry products and raw materials transported from the east was changed. The transmission of consumer goods from the west to the east became new business operations in the 1990s.

The second development stage in the interaction of regional economy between Southeast Finland and Southwest Russia, the St Petersburg region in particular, had started. The ports had to be prepared for container traffic. The load handling systems were changed. The sorting of transition goods for retail sales in Russia created a distribution centre role for Southeast Finland.

As oil income brought wealth to the Russian economy, a middle class with disposable income developed at the beginning of the 21st century. In addition to daily goods, the demand for private cars started to increase rapidly. Assembly plants of foreign car manufacturers in Russia were not able to respond to the growing demand. The export of cars to Russia brought new business operations in Southeast Finland.

The Port of Kotka invested quickly in the new situation. In addition to the car transportations arriving through Hanko, the growing role of Kotka in car transportations exceeded the capacity of Russian frontier stations throughout the border between Russia and Southeast Finland. Changes in the structure and transportation direction of transition goods brought up narrow passages in the Finnish east-to-west road network. The insufficient transportation capacity of the main roads leading to Russia impedes transit and decreases road safety. The situation is finally being repaired. The improvement of the E18 road east of Helsinki will be started in the 2010s.

Global changes speed up the new development stage

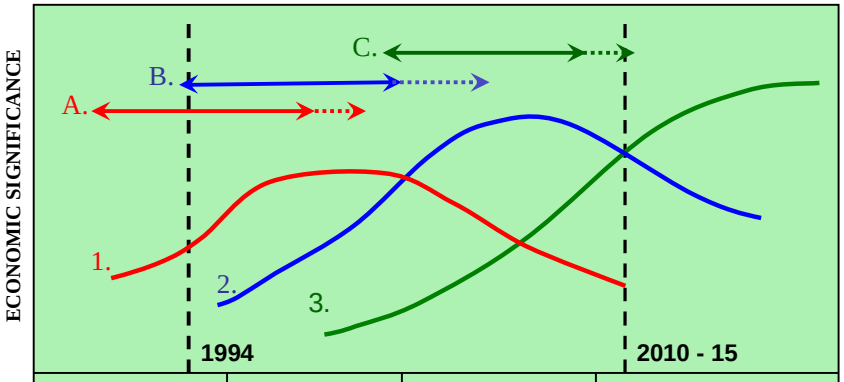
The Finnish forest industry utilised the Russian wood market that opened in the 1990s. The forest industry in Southeast Finland which constitutes 40% of all Finnish paper industry production, acquires one-third of its raw materials from Russia. The situation is changing. Russia's attempts to speed up the processing of raw wood material will tighten the availability of wood in Finland.

The transition of the growth in the paper product market from Europe and the United States to the Far East is to change the position of Finland and Southeast Finland in particular as the leading forest industry region. A fierce structural change is in progress that is sped up by wood being more difficult to acquire from Russia.

Southeast Finland is facing the third development stage in the interaction between east and west. As Russian production structures are being renewed and consumption demand is growing Southeast Finland must be involved in this development. We must secure the region's ability to compete in the transit role. We also must ensure that the region is involved in the development of the renewal of Russian production structure.

The renewed and growing production operations in Russia require competence and investment goods. They offer a market for construction in industry, commerce and housing production. They provide the possibility for becoming part of the new production chain. There will be a stage of integration in regional economy between Southeast Finland and Southwest Russia. This will be a significantly more demanding stage than the previous stages. The old Finnish saying applies: "We need to see the forest for the trees."

Development stages of Kymenlaakso



Development stage	Role	Key operations	Strategic areas of focus
A. Transit stage	1. Transition route	traffic networks and logistics services,	removal of bottlenecks
B. Creating and strengthening interaction	2. Distribution centre	terminal and frontier services distribution chains	flexibility and reactions to customers' needs
C. Integration stage	3. International production and service centre	production chains, project exports transfer of technology, int. business services	integration of production structures removal of trade policy obstacles

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Finland

Leningrad region - capitalizing geographical advantage

By Alexei Prazdnichnykh

Both before the revolution and in the soviet times Leningrad region was but a farm and stockyard for the capital city - St Petersburg. The regional economy was based on supplying resources and raw materials to the city, such as agricultural products, lumber, fossils, power, and spare parts for the city's plants. The state of affairs changed in 1991, when USSR ceased existence, St Petersburg economy fell into a deep crisis under the reforms, and the Leningrad region (Leningradskaya Oblast) became an autonomous sub-national unit of the federation. The regional administration had to formulate region's economic strategy, to compete for markets, human resources and investment, on their own.

In fact, that proved to be a blessing in disguise. In the tough state of the economy of 90-ies, the Leningrad region fitted into its market niche and learned to benefit from its location advantage. As a result, it was able to perform well enough compared to St Petersburg, and sometimes even to demonstrate higher growth rates. The region's strategy was to concentrate on a few industries, using the region's main competitive advantages. Favorable climate, experience in agriculture and proximity of the major markets – St Petersburg and Moscow – facilitated an efficient development of agriculture and foods production. Region's location benefits, and its role of transport hub, allowed the region to successfully promote the development of port and transportation infrastructure.

The new strategy aimed at attracting investment and creating a favorable investment climate. Another advantage was the availability of vast land areas for production sites. Those two factors, along with the ones mentioned above, made for a substantial inflow of foreign investment in a variety of industries, ranging from foods to machinery. Besides, that facilitated investment in creating new production sites. As a result, the region saw a variety of industries established by investors from the USA, Germany, Finland, Denmark and other states. The most illustrative examples are, among others, Ford automotive plant, Caterpillar's production of tractors, and Nokyan Tyres.

In recent years the competitive environment for the region has become more challenging, which resulted from a tougher competition for investment on the regional level. The greatest challenge came from the city of St Petersburg, which has been aggressively bringing in foreign investment. As a consequence, increased investment to the city makes for a brain drain of human resources from the region. Other regions of the Northwest Federal District have also joined the competition for investment and they are becoming more efficient in using their own advantages. The Murmansk and Arkhangelsk regions offer rich natural resources; the Novgorod and Pskov regions have cheap labor, while the Kaliningrad region uses its attractive location in the center of Europe, as well as tax incentives.

Leningrad region's cluster portfolio is highly diversified and developed compared to other Russian regions, large part of its clusters are competitive and exhibit high productivity rates. Its key clusters are forest products, furniture, construction materials, chemical products, and agricultural products. Moreover, a number of latent clusters, among them automotive, textiles, hospitality and tourism, are not yet developed enough, but are already competitive, and have bright development perspective.

The region's strongest endowment is its Baltic Rim location, in between Russia and the EU. Region's large pool of low cost land resources is still its business environment advantage. Several region's weaknesses can also be traced, among them, lack of quality transportation and logistics infrastructure, availability of qualified workers. Apart from that, the procedure of land resources acquisition for business purposes is costly and suffers from red tape, in spite of the fact that industrial land abounds. Access to electricity infrastructure is also a problem.

Other region's business climate disadvantages include underdeveloped suppliers, lack of secondary professional education and relatively low internal market size. But these weaknesses are partially counterbalanced by the closeness to St Petersburg, where necessary suppliers, educational programs, human resources and retail distributors can always be found easily.

The competitive strategy of the Leningrad region aims at a breakthrough and implies three "opportunity horizons", which require different development models and competitive advantages. During the first stage it is critical to benefit to the full extent from positioning the region as a "Door to Russia" and bring in more investment for sustaining and developing of key clusters. Presumably, the construction materials cluster, forest products and furniture clusters, and agricultural products cluster would be most important during the first stage. The corresponding regional policy directions would be aimed at an increased efficiency of the most critical business environment factors: transportation infrastructure and secondary professional (technical) education.

The second stage implies using the region's competitive advantages and positioning it as an "Efficient Production Location". This stage's key clusters could be the automotive, heavy machinery, and possibly textiles and shipbuilding. During this stage regional policy should be focused on industrial real estate development, upgrading logistics infrastructure and construction services cluster.

The strategic goal of the third strategic horizon is to turn Leningrad region into the key element of the prospering "Integrated Baltic Rim". Innovation clusters may be of great importance to the region. During the third stage there may be the following priorities for the regional government: developing an integrated transportation and distribution cluster, a hospitality and tourism cluster, establishing innovation clusters both in the suburbs of St Petersburg and in other towns of the region that show investment potential, as well as strengthening cooperation with the leader states of the Baltic Rim.

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Today's possibilities for city twinning relationships in the Baltic Sea Region

By Mika Akkanen

The first phase of town twinning activities

The city twinning activities in Europe started in the years after the Second World War. One of their goals, which at the time was very topical and justified, was to integrate the citizens of various European countries at the grass roots level and thus contribute to reducing conflicts between nations. This is how cities with similar profiles and in similar size ranges in their respective countries became selected for twinned towns – more or less with the assistance of the governments.

The city of Turku currently has six twin cities in the Baltic area, as well as cooperation agreements of various types with a number of cities.

International interaction was not one of the priorities in the municipalities' sphere of action in the post-war decades. Typically, twin city cooperation consisted of cultural exchange activities implemented by city managements based on rather formal correspondence and other top level interaction. In addition to those who took part in the preparation and implementation of the various visits with pre-planned programme, the civil servants of the cities had little contact with their colleagues in the twin towns. The twin town friendship associations that were set up around the same period and that often were supported by the cities traditionally took part in the twinning co-operation, and they for their part gave the citizens remarkable opportunities for active participation.

Era after the great revolution

A great revolution has taken place in the twin city activities, in the Baltic region in particular, since the 1990's. Several reasons can be pinpointed for this:

- The overturning of the socialist system enabled direct cross-border contacts for individuals and organisations.
- The modern information technology (Internet, e-mail etc.) makes it possible for city employees to look for information anywhere and to keep in touch with their colleagues in other countries.
- The enlargement of the EU has enabled the use of various financing instruments in the development of municipal services. These financing instruments have at the same time placed on the municipalities the obligation to open up for international co-operation.

Today, internationality is routine in the municipal organisation. Colleagues in various countries and municipalities often know each other personally. The right partners for each matter are of course sought where they can be found, by even today the twin city relationship with its own special spirit is the easiest way of finding a partner, or an answer to a question. The interaction in the twin city network takes place on a daily basis, is fast and informal and emanates trust. This is how the original idea of town twinning is elegantly put to practice in the modern times. Joint development projects and sharing of information in twin city networks help to improve services and increase the standard of wellbeing all over the Baltic region. In this respect, there is no particular competition between municipalities.

The business sector and twin city activities

Can town twinning activities bring added value to others than the municipal organisation itself as described above? The current ease of direct contacts between countries has enabled such as companies' independent operations all over the Baltic area. How can the industries make use of our twinning relationships?

In my experience, when the twin cities have jointly taken part in preparations for a visit by a company delegation, such delegations have profited from this special relationship in the following ways:

- Access to decision-makers or information that is important for establishment or other operations becomes easier. It has for example has been possible to discuss the land use plans or economic forecasts of cities directly with the persons who are responsible for these areas – to get correct information from correct persons. The municipalities value their town twinning agreements, and this is why they wish to invest in and be committed to this type of services even at the level of principle.
- Being part of a delegation put together by a twin town (such as e.g. the Turku Region Development Centre) describes the trust our city feels for the company in question and gives the other party the message that they should take the company and its endeavours seriously, for example trusting that it is seriously looking for contacts with possible business partners.
- The government representatives in either countries, the embassies and consulates, are also happy to invest in business co-operation carried out under the town twinning umbrella and give it their own valuable support.

Turku has recently gathered plenty of positive experience of making use of the twinning relationships as described above in the business sector with such cities and St Petersburg, Gdansk and Rostock.

Economical decisions are made on economic grounds, but I feel that the city twinning agreements still play their own important role in mapping out possibilities and supporting decision-making in the modern operating environment. I hope that companies will not forget to make use of this instrument, too, in their operations.

The twinning activities have changed their form and will also change in the future, as the operating environment of the municipalities develops. Beautiful traditions and proven operating methods should be continued, but twin cities must live in the present; we must have the courage to reject what is old in order to make room for what is new and matches the challenges of a new era. Only in this way can twinning activities justify their existence and, even in the future, offer meaningful added value to cities, their residents, companies and other interest groups.

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The role of the special economic zones in attracting foreign investment to the Kaliningrad region

By Vladimir Kuzin

The special economic zone (SEZ) regime in the Kaliningrad region of Russia was established in the early 1990s, after the Baltic countries gained independence. The SEZ was launched through a Decree of the Chairman of the Supreme Soviet of the RSFSR "On economic and legal status of the SEZ in the Kaliningrad region", 3 June 1991. The SEZ regime was a tool for supporting this Russian region separated from the Russian mainland. It was introduced because the decline of the Kaliningrad economy was worse than the average Russian level due to the breaking-off of economic links.

The main instruments of the SEZ were a tax free zone and the right to ship goods to the Russian mainland, while still enjoying these privileges, as long as 15-30% was added to the value of imported goods and components. However, the SEZ regime was unstable due to it being subject to frequent changes in the regulations. This instability of the SEZ regime was an important factor in deterring domestic and foreign investment in Kaliningrad region alongside limitations on access to land and poor regional investment policy. The SEZ instability was rectified by the federal law №13-FZ "On special economic zone in Kaliningrad region" adopted on 22 January 1996.

Since 1996 the SEZ has been the most attractive component of the Kaliningrad investment image. However, some experts and politicians have attacked the regime as being merely a way of enjoying "tax free imports". These kinds of criticism and exchange rate problems (a weak rouble against the US dollar and euro drive down imports) limited foreign investment activity in the region. Foreign investment declined in 1995-1997, but investments in assets (mainly domestic) nonetheless grew at the same time.

The rouble devaluation in 1998 triggered subsequent foreign investment growth. It shot up in 1998 and has shown a sustainable increase since 1999 as investment in assets. 1999 was the turning point in development as shown by investment and industrial output growth. Much expert attention is devoted to the length of the project development cycle period. The Russian practice has showed the four years business project development period as we can see in Kaliningrad between 1995 and 1999 was a relatively short and for. Event in 1998 pushed project development activity.

The results of the SEZ regime's operation were the creation of new industries such as car assembly and television sets assembly. Moreover the regime supported the development of traditional industries, mainly food processing. By 2006 figures show that companies in the SEZ accounted for the production of 80% of TV sets and 84% of vacuum cleaners, 12% of foreign brand cars, 5.7% of furniture, 19.3% canned meat and 33% of canned fish for all of Russia. These success stories were an additional factor in stimulating investment growth.

A new version of the SEZ regime was introduced on April 1, 2006 under federal law 16-FZ "On the Special Economic Zone in the Kaliningrad region and on introducing amendments into RF Legal Acts" (adopted on 10 January 2006). The main change in the regime is in its transition from preferential customs treatment for all participants in the zone to tax allowances for new investment projects except for projects in gas and oil extraction and processing, alcohol and tobacco production, retailing and finance.

The law includes a ten years transition period for companies which have been operating in the previous13-FZ OEZ regime. Around 3,500 companies are estimated to enjoy such status.

The main benefits of the new SEZ regime for Residents (projects with the value of investments into assets exceeding 150 million roubles or approximately 4.3 million euro) include full exemptions on property and profit taxes for the first six years and 50% exemptions for the next six years and protection of the legal interests of the Residents by the Administration of the SEZ (at present this is upheld by the Ministry of Economy of Kaliningrad Region). Moreover the newly adopted federal laws of the Russian Federation on additional tax duties will not be applied to a Resident company during its operation (until 2031). The rate of land rent for an investment project cannot be changed during the whole period of validity of the rental contract. A free customs zone regime applies for residents, although customs duties must be paid in the case of delivering goods to the Russian mainland.

The main results of the new SEZ regime implementation on the registration of Residents and the associated investment are as follows: There are 48 Residents divided into three categories: domestic, foreign and combined. Collectively they have announced 27,934.26 million roubles (approximately 800 million euro) investment into assets. The domestic Residents have the biggest share – 73%, foreign Residents account for 17% and combined take up the remaining10%. Residents invested 12,237.55 million roubles (around 350 million euro) during 2007 broken down into 83% from domestic, 10% from combined and 7% from foreign Residents. Residents attract capital from different sources, with a big share of Russian bank loans, so the total amount of foreign Residents investment exceeds the foreign direct investment in Kaliningrad region volume in 2007.

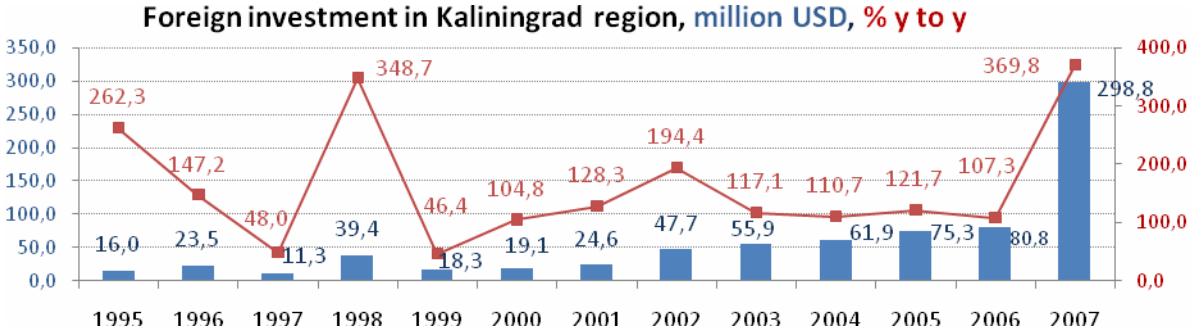
Countries of origin of Residents' investment in 2007 include Austria -1%, Czech Republic -1%, Cyprus – 7%, Lithuania – 17%, France – 22% and Great Britain – 52%.

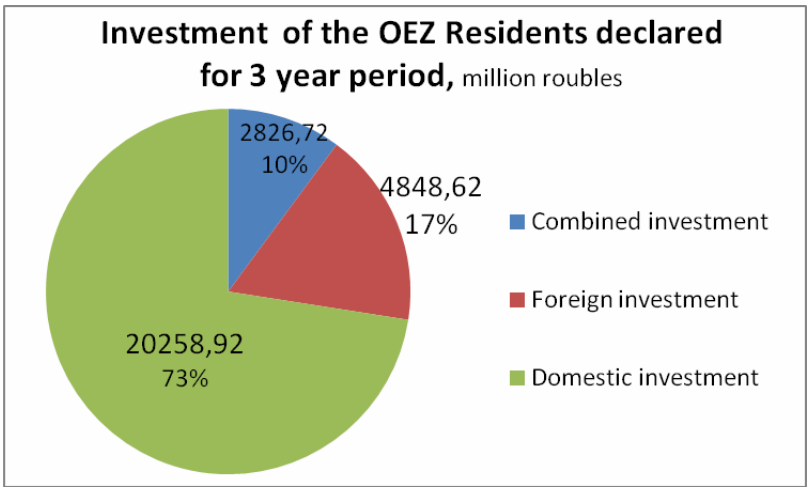
The fields of investment are in line with regional strategic priorities (energy, logistics, tourism, agriculture and food processing) established by regional law. The breakdown of Residents' projects shows logistics – 31.3%, machinery and electronics – 20.8%, real estate, agriculture and food processing – 16.7%, tourism and recreation – 12.5%, construction materials – 8.3% and other 10.4%.

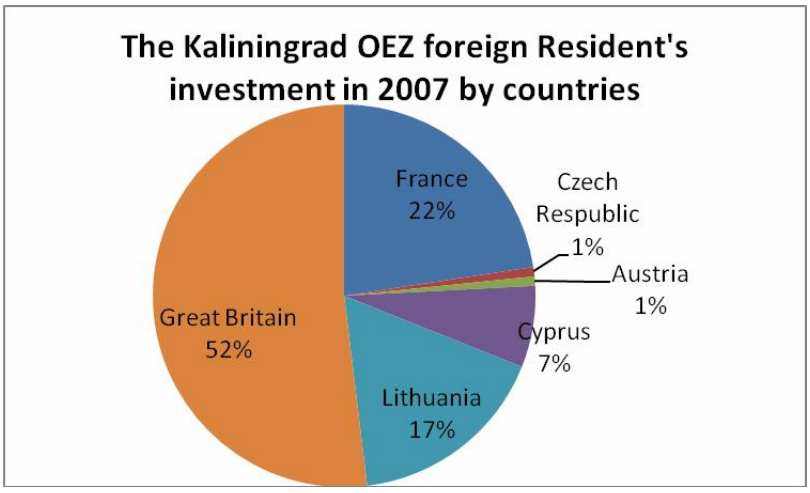
The foreign investment growth in 2007 was the result of the SEZ regime implementation. Both SEZ regimes push investment growth and strengthen industrial output. The index of foreign investment in 2007 was 369.8% and of industrial output in 2007 was 140.3%. It's extremely high growth in comparison with the base of 2005 and 2006: 127.4% and 166.6% respectively.

There are three additional factors that improve the investment attractiveness of Kaliningrad region apart from the SEZ regime. First is the pro-market position of the new regional government that took office in September 2005. Second is the establishment of a tourism special economic zone by a federal government decree, which involves federal and regional budget investment in infrastructure. Third is a gambling zone, one of only four such zones throughout Russia.

All these factors on top of the SEZ regimes are attractive to a potential investor to Kaliningrad – the Russian exclave surrounded by the EU.







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Russia

Medvedev´s new agenda for Russia - reforming a system that can not be reformed?

By Arto Luukkanen

The newly elected president of Russian Federation, Dmitry Medvedev, is now fervently supervised by specialists for Russian studies all over the world. His political agenda for the future is examined by politicians and think-tank specialists. The dilemma under the scrutiny is the obvious unbalance between the hard rhetoric's of old the president and conciliatory speeches given by newly elected president.

Mr. Medvedev - 42-year-old protégé of Mr. Putin - has promised to fight against corruption and has highlighted the need for a long period of construction inside Russia. Together with these fresh openings, Medvedev has promised friendly cooperation with its neighbours including USA and China.

Speaking to foreign reporters, the president elect said that Russia and the United States share common values and have no choice but to cooperate with each other. Moreover, Medvedev has emphasized the need to concentrate to 4 major i´s (innovations, institutions, infrastructures, investments) and has promised to transform Russia as a 5th largest economy after 10 years.

But what is more significant is his respective tone towards the civil rights. "*The talk here is about freedom in all of its manifestations: about personal freedom, about economic freedom and at last about freedom of self-expression*," Medvedev said in his famous speech at Krasnoyarsk, Siberia last February. He added, "*Freedom is inseparable from the actual recognition of the power of law by citizens*." According to Medvedev, freedom, private property and an independent judiciary would be the central planks of his administration. This is something new compared to Putin´s sarcastic attitudes towards civil rights and cold interviews with Western reporters.

Then how seriously we should take this? Should we take it as a face value? Are these nice openings made by the president-elect fabricated in order to lure the Western audience or are they just trumped-up stories for the Western armies of think-tank specialists who are busy in making their first deep political analysis concerning the new leader?

A famous Russian historian - Vladimir Shlapentokh - mentioned in his excellent analysis on Soviet system[1], that too eager reformers of the society may put in jeopardy the entire system. Nevertheless, being a true reformer requires bold assumption and true beliefs that there are real alternatives for the existing society. Shlapentokh´s speculations and dilemmas dealt mainly with Mikhail Gorbatchov and his reforms that destroyed the Soviet Union. As he aptly remarked, Soviet Union enjoyed firm content of its populations and only a small minority demanded changes in the Soviet economic system. According to Shlapentokh, it was Gorbatchov and his personality that evidently killed the Soviet beast.

To put it short, Soviet people at large directed their discontent towards bureaucracy but still accepted the Soviet dogma. Also the Western political leaders in 1990´s tried, peculiar enough, to preserve the Soviet system. For example, when inspecting the famous speech made by US President George Bush Sr. at Minsk in 1991 it is quite clear that West was not searching moment for a violent vendetta or planning to attack against its weary arch-enemy. On a contrary, it was looking forward to peaceful coexistence with the second nuclear power.

It is therefore rather fascinating to compare striking similarities between the gorbachovian reforms and the reformist rhetoric of Medvedev. When Mikhail Gorbachev came to power his first initiatives continued the political line adopted by Jury Andropov. For example, Gorbatchev followed Andropov's policies of cleaning up the party bureaucracy and he also instigated certain neo-Stalinist reforms, which were dedicated to increase workers productivity. When considering the rhetoric and bold initiatives made by Medvedev, it is quite likely, that in the short run, the practical agenda of the new president will follow above mentioned gorbachovian models.

Nonetheless, new demanding openings such as fight against the corruption and tackling with bureaucracy require tightening of the political control. However, the fight against the some part of the new elite requires the policy of involving intelligentsia for a new ally for policy-makers. This will open new perspectives to free media. If and when this happens, it will take place perhaps at the same time when Medvedev does his symbolic "patricide" and dissociates from his predecessor's policies. Perhaps Hodorkovski will be released due to Medvedev new policy.

Gorbachev himself moved from neo-Stalinist reforms to liberal reforms by the beginning of 1987. The reason why this new policy was adopted was linked with the earlier failures of reforming Soviet economy. It was then widely believed among the gorbachovian spin-doctors that the essential modification of the Soviet system would boost the economy thus saving the system itself.

The most burning quandary for nowadays spectators will be: shall Medvedev try to reform system that can not be reformed? Any attempts to adopt real principles of liberal reforms may cause mayhem to the fundamentals of the political system he inherited from Putin. The pillars of the contemporary Russia were cemented to build up new elite - "securocracy" – new ruling elite derived from the security organs. To introduce real democracy to Russia would be a death-blow to the new political order prevailing in that county.

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[1] A Normal Totalitarian Society. How the Russian Union functioned and How it Collapsed". 2001, London.

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