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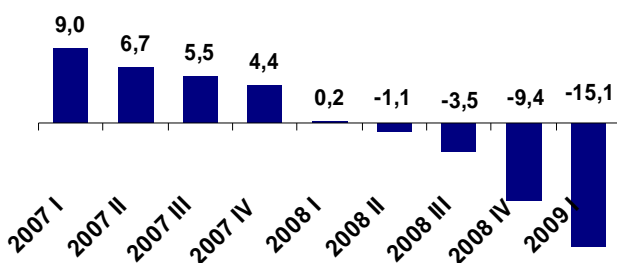
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Estonia

Fall of the economy continues

According to the first estimates by Statistics Estonia, the first quarter GDP decreased by 15.1% thus continuing the steep decline of the Estonian economy. The major factor contributing to the continuing decline was a further slowdown in external demand according to the Bank of Estonia. The declining external demand reflects the worsening situation in Estonia's main export partners. In addition, the Central Bank stated that both consumer confidence and business turnover have shrunk during the first quarter. A substantial amount of production resources has been left unutilised.

Real growth rate of GDP by quarters in 2007QI–2009QI (y-o-y, %)



Source: Statistics Estonia

Industrial production data by Statistics Estonia gives additional information on the downward trend. Industrial production continued to decrease, this time by 34% in April y-o-y. Manufacturing fell by 36% which took production back to the level of 2003. Production decreased in all branches of manufacturing. The manufacture of such goods as chemical and metal products, metals and paper products decreased by more than 50%.

The economic downturn has led to a worsening situation on the labour market. Average monthly gross wages and salaries have decreased for the first time since 1993. The first quarter decrease was 1.5% y-o-y. However, lowering salaries have been unable to salvage employment as unemployment has hit their worst figures in eight years. Unemployment rose to 11.4% in the first quarter y-o-y.

Construction and real-estate in trouble

The total production of Estonian construction enterprises decreased by a third in the first quarter y-o-y according to Statistics Estonia. Thus the downturn of the construction sector continues steeply. The decline was mainly caused by decreased volumes in dwelling construction on the domestic market. The volume of civil engineering has stayed at the

same level. The production of building materials has declined sharply, by half in April y-o-y. The future also looks bleak since only approximately 1,000 building permits were issued in the 3rd quarter, which is about half less than a year ago.

The situation has been difficult on the Estonian real estate market as well. According to Statistics Estonia, in the 1st quarter the total number of purchase-sale contracts continued to decrease, this time by almost 40% y-o-y and by a fourth compared to the previous quarter. In addition, a total of 5 400 purchase-sale transactions took place during the 1st quarter. The number of purchase-sale transactions per quarter has never been as low since Statistics Estonia started to monitor the market in 1997.

Consumer prices decrease for the first time

The consumer price index decreased by 0.3% in May y-o-y Statistics Estonia reports. This is the first time that the consumer price index, compared to the same month of the previous year, has decreased. The still continuing price decrease of transport (-10.0%) was most significant. However, prices rose in some commodity groups. The highest price rise was recorded in clothing and footwear which increased slightly to 1.8%.

Change of the consumer price index in selected commodity groups in May 2009 (%)

Commodity group	y-o-y	Previous month
TOTAL	-0.3	0.0
Food and non-alcoholic beverages	-4.8	-0.3
Clothing and footwear	1.8	0.1
Housing	0.7	-1.3
Transport	-10.0	1.6
Hotels, cafés and restaurants	1.6	0.2

Source: Statistics Estonia

The index stayed at the same level (0.0%) in May compared to the previous month. One major contributing factor was the price decrease of housing (-1.3%) which has decreased steadily for some while now. One main reason for this is the continuous decrease in the price of heating energy. Also food prices, dairy products in particular, continued their slight decrease (-0.3%).

Some business highlights

- Estonian energy giant Eesti Energia has announced a EUR 190 million investment plan on a new oil-shale plant. The plant would be situated in eastern Estonia and it would be based on significantly more environmentally friendly technology than previous facilities.
- The Estonian Bigbank AS, which runs banking services in all Baltic countries, is planning to shut down a third of its offices and lay off its personnel due to the hard competition at the credit market. At the beginning of 2009 the company had 22 offices in Estonia and a total of 45 branches in the Baltic States.

Estonia - main economic indicators	2001	2002	2003	2004	2005	2006	2007	2008	2009	as of
GDP (y-o-y %-growth, constant prices)	6.5	8.0	7.2	8.3	10.2	11.2	7.1	-9.7	-15.1	Q1/2009
Industrial production (y-o-y %-growth)	8.9	8.2	11.0	10.5	11.0	7.3	6.1	-6.5	-34.0	4/2009
Inflation (CPI, end of period, y-o-y %-change)	4.2	3.6	1.3	3.0	4.1	4.4	9.6	10.4	-0.3	5/2009
General government budget balance (% of GDP)	0.3	1.5	2.0	2.3	2.3	3.8	2.8	-3.0	n/a	1-12/2008
Gross wage (period average, EUR)	352	393	430	466	555	596	784	838	776	Q1/2009
Unemployment (% end of period)	11.9	11.3	9.3	8.5	7.9	5.9	4.7	5.5	11.4	Q1/2009
Exports (EUR million, current prices)	3698	3642	4003	4770	6190	7647	8028	8454	1992	1-4/2009
Imports (EUR million, current prices)	4798	5079	5715	6704	8213	10576	11278	10872	2370	1-4/2009
FDI inflow (EUR million, current prices)	603	307	822	775	2255	1341	1817	1366	n/a	1-12/2008
Current account (% of GDP)	-5.6	-10.6	-11.6	-12.5	-10.5	-14.8	-17.4	-9.2	n/a	1-12/2008

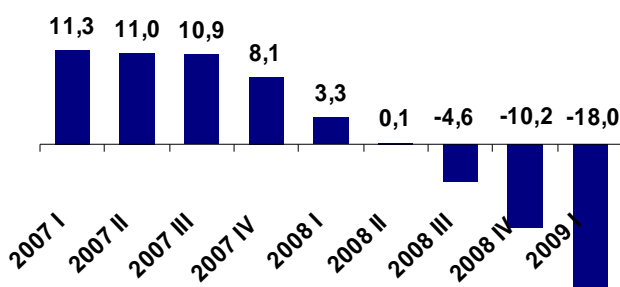
Sources: Statistics Estonia, Bank of Estonia, Eurostat, author's calculations

Latvia

Economy contracts rapidly – GDP down by 18.0%

The Latvian economy has continued to contract sharply. The Latvian GDP decreased by as much as by -18.0% in the 1st quarter y-o-y according to the Central Statistical Bureau of Latvia. The decrease in the GDP was mainly due to the drop in trade (down by 25.8%), transport and communications (-15.4%), manufacturing (-8.6%) and construction (-28.2%).

Real growth rate of GDP by quarters in 2007Q1–2009Q1 (y-o-y, %)



Source: Central Statistical Bureau of Latvia

Latvia is struggling with both the international lenders and devaluation rumours. The Latvian government is having a hard time meeting the budget and structural reforms demanded by the EU. Devaluation rumours are frequent as it would improve the competitiveness of Latvia's exports. However, since a large share of credit in Latvia has been in foreign currency, devaluation would significantly increase the credit costs for both enterprises and private consumers.

The economic troubles are evident in industrial production as well, which fell by almost 17% in April 2009 y-o-y according to the data of the Central Statistical Bureau of Latvia. Manufacturing as whole was down by nearly 20%. The most significant decreases in manufacturing subsectors were in the manufacture of textiles (-59.8%), the manufacture of motor vehicles, trailers and semi-trailers (-60.7%) and thirdly, the manufacture of rubber and plastic products (-40.3%). However, industrial production rose by almost 5% month-on-month.

Foreign trade keeps on falling in April

Latvian foreign trade has kept on shrinking sharply during the recent year. According to the Central Statistical Bureau of Latvia the value of exports decreased by 31% and the value of imports by 46% in April 2009 compared to April 2008. Latvian imports in April, EUR 524 million, was the lowest recording of imports during the current economic crisis. Exports in April, EUR 387 million, were also among the lowest recordings during the crisis.

Latvia - main economic indicators

	2001	2002	2003	2004	2005	2006	2007	2008	2009	as of
GDP (y-o-y %-growth, constant prices)	8.0	6.5	7.2	8.5	10.6	12.2	10.3	-10.3	-18.0	Q1/2009
Industrial production (y-o-y %-growth)	6.9	5.8	6.5	6.0	5.6	4.8	0.5	-6.7	-16.9	4/2009
Inflation (CPI, end of period, y-o-y %-change)	3.2	1.4	3.6	7.3	7.0	6.8	14.1	15.4	4.7	5/2009
General government budget balance (% of GDP)	-2.1	-2.3	-1.6	-1.0	-0.4	-0.2	0.0	-4.0	n/a	1-12/2008
Gross wage (period average, EUR)	282	297	298	314	350	430	683	678	662	Q1/2009
Unemployment (% end of period)	12.9	11.6	10.3	10.3	8.7	6.8	5.4	9.9	13.9	Q1/2009
Exports (EUR million, current prices)	2232	2416	2559	3204	4085	4594	5727	6202	1523	1-4/2009
Imports (EUR million, current prices)	3910	4284	4634	5671	6879	8828	10986	10534	2223	1-4/2009
FDI inflow (EUR million, current prices)	n/a	223	248	489	568	1324	1797	909	50	1-3/2009
Current account (% of GDP)	-7.6	-6.6	-8.1	-12.9	-12.3	-21.1	-22.8	-12.6	n/a	1-12/2008

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

Exports kept on decreasing in almost all of the main commodity groups y-o-y. For instance, exports in machinery and mechanical appliances decreased by 28.7%. Likewise, exports in wood and wood products still decreased, now by 40.4% and exports in base metals and articles of base metals fell by 53.5%. In imports, the trend was negative as well. For instance, imports in machinery and mechanical appliances decreased, now by almost 60%, imports in products of chemical and allied industries by 32.5%. Likewise, base metals and articles of base metals fell by as much as 50.9%.

Inflation still decelerating – now at 4.7%

The consumer price level rose by 4.7% y-o-y in May 2009 according to the Central Statistical Bureau of Latvia. Thus inflation has continued its gradual decrease and is getting closer to the Euro criteria. In regard to different commodity groups, the price increase of housing, water, electricity, gas (11.5%) was, as previously, the biggest, but the price trend has been downwards. The price level of food has increased only by 1.4%. The price level of transport on the other hand has continued to decrease, now by 3.9%. Compared to the previous month, however, consumer prices have already started to fall (-0.5%). The price decrease of housing, water, electricity, gas (-3.0%) was the biggest. However, the price level of transport increased (-0.7%).

Change of the consumer price index in selected commodity groups in May 2009 (%)

Commodity group	y-o-y	Previous month
TOTAL	4.7	-0.5
Food	1.4	-0.3
Clothing and footwear	-4.5	-0.9
Housing, water, electricity, gas and fuels	11.5	-3.0
Transport	-3.9	0.8
Hotels and public catering	4.1	-0.6

Source: Central Statistical Bureau of Latvia

Some business highlights

- A biogas complex is planned to be built to the Vainode County in south-western Latvia. The planned investment is worth EUR 60 million. The planned output for the power plant is 12 MW and the main fuel will be pig manure which will be processed. The entire complex should be finished in two to three years.
- The Latvian government approved Parex Bank's reconstruction plan in May which was then sent to the European Commission for approval. The goal of the plan is to be profitable again in 2011. However, the losses for 2009 are projected at EUR 85 million and EUR 35 million in 2010.
- SIA Ventspils nafta terminals, a Latvian crude oil and petroleum products transshipment company, is planning to become the only company in the Baltics to produce a special fuel blend comprised of motor gasoline and butane. The company plans to invest some EUR 1 million in to the new product and the company, once fully operational, would be able to blend approximately 60,000 tonnes of butane annually.

Lithuania

Ongoing economic decline

According to Statistics Lithuania, the Lithuanian GDP decreased 13.6% during the first quarter of 2009 y-o-y. The downward trend was evident in all market activities. The most significant decrease was recorded for the value added of construction (down by 37.3%), trade, transport and communication (down by 20.9%) and industry and energy (down by 13.5%) activities. The value added of financial intermediation, real estate and business activities went down more moderately by 7.5% and agriculture and fisheries activities by 1.3%. Growth results were recorded only for non-market services: the value added of public administration and defence, education, health and social work, and other community, social and personal service activities increased by 2.2%.

Inflation decreases gradually

The consumer price level in May 2009 increased by 5.2% compared with the corresponding month of 2008, Statistics Lithuania reports. The price level increase was mostly affected by the rises in prices of housing, water, electricity, gas and other fuels (17.9%), health care goods and services (17.3%), alcoholic beverages and tobacco products (13.4%), and food products and non-alcoholic beverages (3.6%). The price level of clothing and footwear went down by 8.6% and transport by 5.5%.

However, the price level in May against the previous month decreased slightly by 0.2%. The inflation rate was mostly influenced by the increase in prices of alcoholic beverages and tobacco (up by 1.8%) and transport (up by 1.4%), as well as the decrease in prices of food products and non-alcoholic beverages (down by 0.6%), clothing and footwear (down by 1.1%), and housing, water, electricity, gas and other fuels (down by 0.7%).

Change of the consumer price index in selected commodity groups in May 2009 (%)

Commodity group	y-o-y	Previous month
Food and non-alcoholic beverages	3.6	-0.6
Clothing and footwear	-8.6	-1.1
Housing, water, electricity, gas etc.	17.9	-0.7
Transport	-5.5	1.4
Hotels, cafés and restaurants	8.5	-0.3
TOTAL	5.2	-0.2

Source: Statistics Lithuania

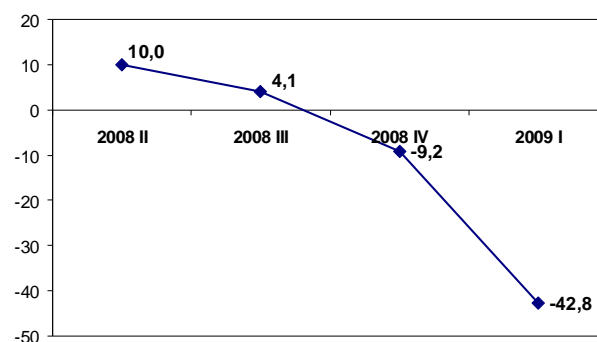
Construction output decreased sharply

Construction output in Lithuania decreased by 42.8% in the first quarter of 2009 y-o-y, reported Eurostat. According to Eurostat this was the sharpest drop across the EU, when the average among the EU27 was -9.1%.

Lithuania - main economic indicators	2001	2002	2003	2004	2005	2006	2007	2008	2009	as of
GDP (y-o-y %-growth, constant prices)	6.6	6.9	10.3	7.3	7.8	7.8	8.9	3.0	-13.6	Q1/2009
Industrial production (y-o-y %-growth)	16.0	3.1	16.1	10.8	7.1	7.3	4.0	2.7	-25.5	4/2009
Inflation (CPI, end of period, y-o-y %-change)	2.0	-1.0	-1.3	2.9	3.0	3.8	8.1	8.5	5.2	5/2009
General government budget balance (% of GDP)	-2.0	-1.4	-1.3	-1.5	-0.5	-0.3	-1.2	-3.2	n/a	1-12/2008
Gross wage (period average, EUR)	274	293	311	335	421	459	594	630	635	Q1/2009
Unemployment (% end of period)	17.4	13.8	12.4	11.4	8.3	5.6	4.3	5.8	11.9	Q1/2009
Exports (EUR million, current prices)	4778	5526	6158	7478	9502	11250	12522	16067	3620	1-4/2009
Imports (EUR million, current prices)	6767	7943	8526	9959	12446	15384	14341	21024	3997	1-4/2009
FDI inflow (EUR million, current prices)	516	772	160	623	826	1448	1645	1223	n/a	1-12/2008
Current account (% of GDP)	-4.7	-5.1	-6.8	-7.7	-7.2	-10.8	-13.7	-11.6	0.0	1-3/2009

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

Change in construction output by quarters (y-o-y, %)



Source: Eurostat

Construction output in Lithuania in Q1 2009 compared with the previous quarter (Q4 2008, seasonally adjusted) went down by 24%. Again it was the largest decline among the EU27 countries, among which the average was -1.0%. The most significant decrease was registered in building construction, -53.1% y-o-y, while civil engineering construction went down by 11.9% y-o-y.

Unemployment reached 11.9%

The unemployment rate in Lithuania has been on an upward trend since the latter half of 2008 and reached 11.9% in the first quarter of 2009. According to Statistics Lithuania, the unemployment rate increased 1.5 times over a quarter and 2.4 times over a year, and hasn't been this high for approximately five years. The male unemployment rate has increased more rapidly than the female unemployment rate; in Q1 2009 the former reached 14.6% (3 times higher than a year ago) while the latter 9.2% (1.8 times higher than a year ago). This is mainly due to a significant decline in the number of persons employed in construction and industrial enterprises which are largely male-dominated industries.

Some business highlights

- Lietuvos Energija has signed an agreement with the Norwegian company Nord Pool Consulting. Nord Pool Consulting will advise Lithuania on reforming the Lithuanian electricity market and thus preparing for the decommissioning of the Ignalina nuclear power plant.
- Lithuania's better business environment is attracting foreign businessmen, especially Latvians. This is mainly due to Lithuania's smaller value-added tax rate, better government policy for taxes, fewer bureaucratic obstacles and various state support programmes for enterprises, such as a LTL 5 billion (EUR 1.4 billion) economic stimulus programme for businesses approved in January by the Lithuanian government and funded by structural funds of the EU.

Poland

GDP growth slowed down

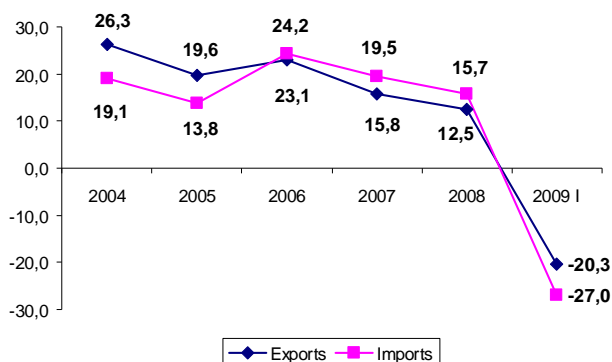
The pace of GDP growth in Poland slowed down during 2008 and the decrease is expected to continue in 2009. The GDP growth in 2008 was 4.9%, which is almost 2 percentage points lower than in 2007. According to the Central Statistical Office preliminary data, the GDP growth in the first quarter of 2009 was 0.8%. On the other hand, Poland's performance in resisting the impact of economic crisis is relatively good compared to other Central European countries.

The decline in industrial output reflects the downward trend in the Polish economy. According to Central Statistical Office, industrial production in April 2009 fell by 12.4% y-o-y. Output was down in 26 out of 34 industrial sectors. The mining and quarrying sector suffered the steepest decline, 21.1%. The manufacturing sector decreased by 12.6% and the production in electricity, gas, steam and air conditioning supply by 7.6%. A particularly sharp drop in Polish manufacturing sub-sectors was seen in basic metals (down by 40.5%), motor vehicles, trailers and semi-trailers (down by 26.1%), and coke and refined petroleum products (down by 23%). However, better figures were reported e.g. in tobacco products, which were the most rapidly expanding sector (up by 7.9%) and pharmaceuticals (up by 6.5%).

Foreign trade decreases significantly in Q1

According to the Central Statistical Office data, the value of Polish exports in the first quarter of 2009 amounted to EUR 22.7 billion which is 20.3% lower than in the corresponding period of 2008. The value of imports to Poland totaled EUR 24.6 billion which marks a 27% decrease y-o-y. Thus the Polish foreign trade deficit was more than 60% smaller than during the same period in 2008.

Growth of foreign trade in Poland from 2004 to 2008 and Q1 2009 (y-o-y, %)



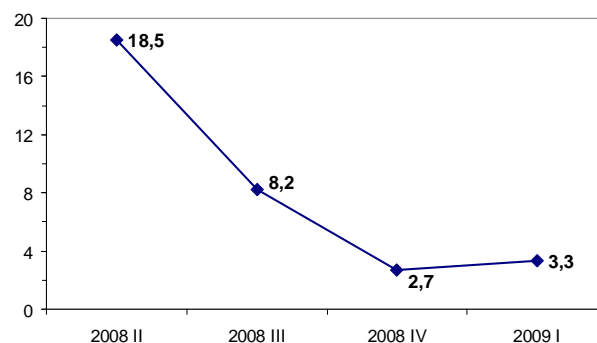
Source: Central Statistical Office

Regarding the main foreign trade partners of Poland, exports to Russia in Q1 declined sharply, by 37.4%. On the other hand, exports to Italy (down by 11.3%) and exports to France (down by 12.6%) were among the least decreased. Imports from France suffered a sharp decline, 37.5%, while imports from China and the United States were least affected, both stating approximately a 2% decline. The higher surpluses were registered in Polish trade with EU and other developed countries, whereas a slightly lower deficit with developing and South-East European states.

Construction output rises

According to Eurostat, construction output in Poland increased by 3.3% in Q1 2009 y-o-y. Among the EU Member States for which data are available for March 2009, construction output only increased in Poland and Romania (3.5%). Construction output in March 2009, compared with the previous month, rose by 0.2%.

Change in construction output by quarters (y-o-y, %)



Source: Eurostat

Some business highlights

- The World Bank is negotiating with the Polish government about providing a loan of approximately EUR 370 million to the Poland's largest bank PKO BP. The sum is intended for supporting lending to small and medium-sized enterprises.
- Guardian Industries, a U.S.-based manufacturer of glass, automotive and building products will invest PLN 85.5 million (EUR 19.3 million) to the Walbrzych Special Economic Zone in south-western Poland. The company plans to build a plant in Bolesławiec within the Walbrzych zone and it will create 160 jobs.
- The PBG company will build a pumping station for natural gas in Goleniów in north-western Poland. The Gaz-System company which holds the main gas pipelines in Poland will commission the project, worth around PLN 67 million (EUR 15.1 million). The pumping station is scheduled to be ready at the end of 2010 and will enable Gaz-System to supply more gas to north-western Poland.

Poland - main economic indicators	2001	2002	2003	2004	2005	2006	2007	2008	2009	as of
GDP (y-o-y %-growth, constant prices)	1.1	1.4	3.8	5.3	3.5	6.2	6.8	4.9	0.8	Q1/2009
Industrial production (y-o-y %-growth)	0.6	1.1	8.3	12.6	4.1	5.7	9.7	3.5	-12.4	4/2009
Inflation (CPI, end of period, y-o-y %-change)	3.6	0.8	1.7	4.4	0.7	1.4	4.0	4.2	4.0	4/2009
General government budget balance (% of GDP)	-3.7	-3.3	-2.9	-3.3	-6.1	-3.9	-1.9	-3.9	n/a	1-12/2008
Gross wage (period average, EUR)	557	544	497	505	591	692	825	821	718	Q1/2009
Unemployment (% end of period)	18.5	19.7	19.3	18.0	16.7	12.2	11.4	9.5	10.8	5/2009
Exports (EUR billion, current prices)	40.4	43.4	47.5	59.7	71.4	87.5	101.1	114.6	22.7	1-3/2009
Imports (EUR billion, current prices)	56.2	58.3	60.4	71.4	80.6	100.0	118.8	139.3	24.6	1-3/2009
FDI inflow (EUR billion, current prices)	6.4	4.4	3.7	10.0	8.3	15.1	12.8	11.1	1.9	1-3/2009
Current account (% of GDP)	-2.9	-2.6	-2.1	-3.5	-1.7	-2.3	-3.7	-5.4	n/a	1-12/2008

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

St. Petersburg

Economy: falling decelerates

The first four months of 2009 demonstrated one of the deepest falls of regional output since the introduction of market economy in Russia in early 1990-ies. The strongest fall of regional economy took place in February 2009, when industrial production decreased by 23.7%, y-o-y, and construction fell by 40.6% y-o-y. In April 2009 the y-o-y reduction of industrial output and that of construction in St. Petersburg became less impressive, accounting for 17.3% and 19.5% respectively. Thus the first quarter of 2009 became something like "a bottom" of the crisis, at least, for now. Almost all significant branches of the regional industrial sector were in deep recession during January-April 2009. The deepest 62.0% y-o-y fall was reported by fuel producers: decreasing exports and a sharp reduction in local consumption led to a fast contraction in their revenues. Less visible but a very negative signal of the four first months of 2009 was an 11.2% y-o-y decrease in food production: this phenomenon reflects the reduction of basic-level consumption in the region, as the food industry is very sensitive towards mass consumer incomes and employment. Another negative trend was observed in the investment field: in January-April 2009 investment in St. Petersburg's economy contracted by 22.6% y-o-y. Retail trade decreased in the first four months of 2009 by 6.8% only, but this could be partly explained by huge discounts and sales of goods purchased or imported in 2008. Catering reported almost the same fall as food production: 11.4% y-o-y. The only growing branches in the region were those dominated by natural monopolies: transport, communication, and utilities. These monopolies raised their tariffs despite the crisis; the monetary output in those sectors in January-April 2009 grew 12.2%; 8.5%; and 13.8% respectively, y-o-y. At the same time, the physical output of these branches contracted. For example, cargo turnover (in tonnes) of regional transport companies in the first four months of 2009 fell by 24.4% y-o-y.

Construction: slight improvement on the horizon?

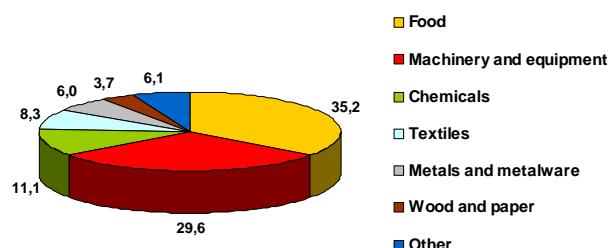
St. Petersburg's construction sector was heavily damaged by the crisis in the beginning of 2009. In fact, it was the only sector of the regional economy where the external influence of global economic recession came along with its internally-born cyclical crisis, which logically followed the market's overheating of 2006-2008. The output of the sector in January-April 2009 decreased by 20.8% y-o-y. This, however, regards monetary output only. The physical volumes of residential construction, for example, experienced a much better performance. While total dwelling space finalised in the first four months of 2009 fell 9.7% y-o-y, the number of built apartments within the same period grew 5.6% y-o-y. This controversial data reflects two basic trends on the regional real estate market. The first one is the decrease of prices, both on real estate and on construction ware. Since January 1, 2009, until June 8, 2009, prices on real estate both on the primary and secondary market of St. Petersburg fell by 10.9% and 12.2%, respectively. Prices on construction cement fell during January-April 2009 by 16.5% compared to December 2008; bricks became 10.4% cheaper during the same period of time. The second trend is the sector's *inner inertia*: the production cycle in construction is comparatively long, and present output is mainly a result of pre-crisis construction activity. Assuming this, one can conclude, that in two years shortages of supply might

occur at the regional real estate market. That might lead in future to reverse price trend: apartments and houses might become more expensive. Moreover, real estate might become attractive as an investment target for a number of conservative investors. This category of money holders is not inclined to invest in securities and other risky assets, while keeping their resources in the form of cash or bank deposits became less attractive since March 2009: the basic currency for savings, traditionally US Dollars, lost a part of its value in April-May 2009, forcing the conservative investors to seek out another "safe-haven".

Foreign trade: deep fall

The first quarter of 2009 resulted in a dramatic fall of regional foreign trade. In January-March 2009 regional exports decreased by 49.7% y-o-y, and imports went down by 42.6%. The reason for this unprecedented deep fall of exports was the contraction of fuel prices and fuel consumption in EU, the basic export market for the region. The share of mineral fuel in regional exports in the first quarter of 2009 exceeded 74%, making these exports very sensitive towards the international fuel market's dynamics.

Imports to St. Petersburg: commodity structure, %



Source: Petrostat, 2009

The structure of imports to St. Petersburg changed in the first quarter of 2009: the share of food exceeded this of machinery, equipment and other durables. Consequently, regional imports within this period served to satisfy mostly the primary needs of local consumers.

Some business highlights

- The Thirteenth St. Petersburg Annual Economic Forum was held in the city in early June 2009. Over 3.5 thousand participants from 83 states, including high-level politicians and business-leaders. This Forum had a much smaller financial result, compared to a similar Forum a year before; however, and that was quite logical for these times of crisis.
- Rosatom, the Russian state-owned nuclear energy monopoly, announced its plans to contract several large St. Petersburg-based machine-building plants to produce engineering equipment for its nuclear stations. A three-year purchase programme of Rosatom includes contracts with a total sum of EUR 2.3 billion.
- On June 2, 2009, an automobile plant of the Nissan Motor Company was launched in St. Petersburg. The plant became the third automaker in the regional automobile cluster after those of Toyota and General Motors. Nissan's investment in this new production facility exceeded EUR 150 million.

St. Petersburg - main economic indicators	2001	2002	2003	2004	2005	2006	2007	2008	2009	as of
Regional GDP (y-o-y %-growth, constant prices)	4.5	17.7	8.4	7.2	8.4	8.4	9.1	8.7	n/a	1-12/2008
Industrial production (y-o-y %-growth)	0.2	31.4	5.8	14.1	4.2	-7.0	10.0	4.1	-18.6	1-4/2009
Regional inflation (CPI, y-o-y %-change)	16.3	16.6	13.0	12.7	12.0	10.0	10.9	14.9	16.1	1-4/2009
Gross average wage (monthly, EUR)	n/a	217	209	285	345	407	510	667	527	3/2009
Unemployment (% average annual)	4.4	3.5	4.3	2.8	2.4	2.4	2.0	2.0	3.8	Q1/2009
Exports (EUR million, current prices)	2134	1839	2429	3210	3954	5499	12978	16055	2068	Q1/2009
Imports (EUR million, current prices)	4423	5158	5123	5560	8081	10299	15093	17475	2349	Q1/2009
FDI inflow (EUR million, current prices)	127	89	62	90	201	512	567	581	162	Q1/2009

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

Economy: signs of improvement

In the first four months of 2009 Leningrad province had a much better economic performance than other Russian regions, e.g., St. Petersburg, or the country as a whole. Some economic indicators were quite positive, despite the general crisis environment. Industrial production dropped 7.7% y-o-y in January-April 2009; construction decreased its monetary output by 2.8% y-o-y. Among the most important branches of the regional manufacturing sector transport machine-building became the main outsider, losing 22.9% of its output in January-April 2009 y-o-y. This branch is totally dependent on one single car producer, namely Ford Vsevolozhsk, which due to the crisis shifted to a four-day-week working schedule in an attempt to sustain employment despite the fall in sales. Pulp and paper production, another important branch of the regional industrial sector, experienced a 7.3% y-o-y decrease, which almost coincided with the average for the whole sector. A positive sign was shown by the largest branch of regional industry, namely food production: it raised its output during January-April 2009 by 7.0% y-o-y. This phenomenon could be partly explained by a contraction of imports in the first quarter of 2009, which gave space to local food producers. The transport sector in the first four months of 2009 went up by 5.3% y-o-y, and communication grew 14.2% y-o-y. Only a part of this growth could be linked to raising tariffs by local monopolies in these sectors. For example, regional cargo turnover in physical volumes went up by 5.6% in January-April 2009, y-o-y. Another growing sector was agriculture: its output in the reviewed period increased by 6.3% compared to January-April 2008. Some negative impact of lowering personal incomes was perceived in catering and the retail trade: catering lost 5.3% in the first four months of 2009, y-o-y, while trade turnover in the region remained the same as a year before.

Investment: rise of FDI

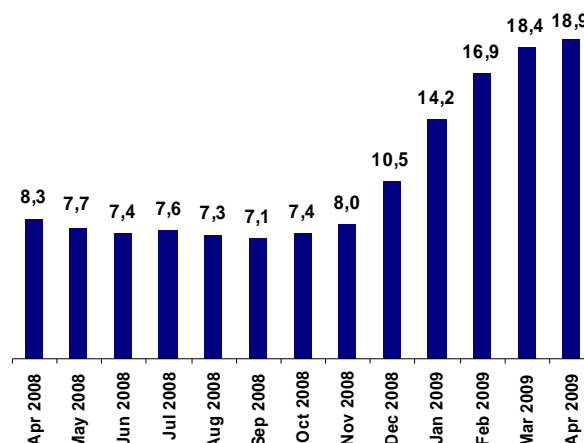
In January-April 2009 Leningrad province achieved impressive results in attracting investment, especially of foreign origin. Total investment in the non-financial sector of the regional economy rose by 15.4% y-o-y. The biggest contribution to this growth was made by foreign investors, whereas domestic ones even cancelled certain projects. Foreign investors in the first quarter of 2009 had set a historical record for the region by bringing EUR 412.6 million, more than for the whole year ever. From this amount 84.0% was FDI, and the remaining 16.0% was other investment, mostly in a form of long-term loans. However, one of the reasons for this huge increase was the investment of the Ford Motor Company in expanding its future production, despite the crisis. The USA thus was responsible for 73.8% of all foreign investment of the region, followed by Finland with 8.9%, and Austria with 6.3%.

Social indicators: contradictory performance

In the first quarter of 2009 unemployment went up in Leningrad province. According to ILO standards, the level of unemployment in the region reached a threatening level of 9.0%. This figure, however, needs certain explanation. The location of the region close to the big labour market of neighbouring St. Petersburg in a pre-crisis era led to huge migration of Leningrad province's residents towards the city. St. Petersburg's labour market offered much higher salaries and better career opportunities compared to those in the province. The current economic crisis led to large-

scale retirements at many of St. Petersburg's companies. This forced a migration of employees back to Leningrad province. Moreover, these migrants started to register at the regional Employment Service (ES) in order to receive social allowances. As a result, the amount of state-registered unemployed increased fast, up to 1.8% of the labour force in the region.

Unemployment registered by regional ES, (thousand people)



Source: Petrostat, 2008, 2009

High inflation led to a reduction of real wages: salaries in Leningrad province in March 2009 on average were 6.8% lower than in March 2008. Nevertheless, in March-April 2009 consumer prices' inflation started to slow down, reaching a monthly minimum of 0.7% month-on-month in April. According to many experts, the economic recession might lead, if not to deflation in Russia and in its regions, at least to already much lower inflation in the second half of 2009. Personal incomes in Leningrad province also decreased by 4.2% y-o-y in the first quarter of 2009.

Some business highlights

- Spanish company Gestamp Automocion launched a new plant near Vsevolozhsk, Leningrad province. The Spanish investor would produce metallic items for Ford's car factory in Vsevolozhsk and GM's new plant near St. Petersburg. Investment in this project by May 2009 totalled EUR 65 million.
- European producer of aeroconcrete, namely H+H International, launched a new concrete plant in Kikerino, Leningrad province. The company invested EUR 40 million in this production facility, and plans to supply aeroconcrete to the construction companies of the region.
- Social tensions in Pikalevo, Leningrad province, continued to increase. These tensions appeared due to mass retirements from a local cement plant, the biggest employer in the town. To avoid mass protests, the Government of Leningrad province appealed to federal authorities, asking for financial help.
- In January-April 2009 the amount of foreigners seeking a job in Leningrad province doubled compared to a corresponding period of 2008. After restricting quotas for foreign employees in Moscow and St. Petersburg these labour migrants moved to other regions; Leningrad province became one of such regions.

Leningrad region - main economic indicators	2001	2002	2003	2004	2005	2006	2007	2008	2009	as of
Regional GDP (y-o-y %-growth, constant prices)	8.5	16.3	14.6	8.8	8.3	8.1	8.5	7.6	n/a	1-12/2008
Industrial production (y-o-y %-growth)	10.7	35.6	20.9	10.3	5.9	26.9	2.6	1.0	-7.7	1-4/2009
Regional inflation (CPI, y-o-y %-change)	19.6	14.8	13.0	14.9	12.0	9.9	9.3	15.5	16.4	1-4/2009
Gross average wage (monthly, EUR)	141	152	173	190	259	324	403	492	404	3/2009
Unemployment (% average annual)	10.8	9.6	9.2	7.5	7.8	6.2	3.3	3.2	9.0	Q1/2009
Exports (EUR million, current prices)	2350	2301	2580	3887	4862	5443	6088	7870	1078	Q1/2009
Imports (EUR million, current prices)	810	939	1061	1372	2561	2858	4759	5932	700	Q1/2009
FDI inflow (EUR million, current prices)	266.0	121.9	104.5	106.6	178.7	288.0	277.0	258	347	Q1/2009

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

In 2000-2008 average wage is for November of corresponding year

Kaliningrad region

Slide in industrial production continues

In April, industrial production in Kaliningrad fell by a whopping 56%. However, a large part of this decline came from a temporary shutdown of the Kaliningrad's largest power station (CHPP-2) for maintenance work. As a result, generation of electricity fell by 97% in April y-o-y. Manufacturing continued to fall but the rate of decline decreased substantially in March and April. Oil production remained at approximately the same level as in 2008. On the whole, in the first four months of 2009 the performance of Kaliningrad's industry closely mirrored that of Russia: industrial production in Kaliningrad fell by 14% vs. 14.9% in Russia; in manufacturing, production dropped by 22.4% and 22% respectively.

Growth rates by sectors, y-o-y, %

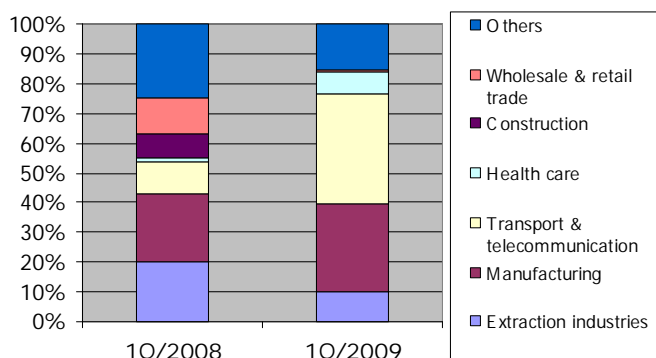
	2009 Jan-Apr	2008 Jan-Apr
Industrial production	-14.0	6.2
Extraction industries	-0.6	0.3
Manufacturing	-22.4	22.0
Electricity, gas and water	-17.3	-0.1
Construction	-24.1	29.9
Retail trade	-4.5	16.1

Source: Kaliningradstat (2008-2009)

Fixed investment remains resistant

Surprisingly, investment in fixed assets remained more resistant to the negative impact of the crisis than many other economic indicators: in the first quarter of 2009 it stayed at the same level as in Q1 2008 (normally investment falls more during a recession than production or consumption). Not surprisingly, bank activity in financing investment declined by two thirds and companies had to rely more on internal funds. Distribution of investment by sectors also changed significantly: if fixed investment in retail trade and construction dropped almost to nothing, in transport, telecommunication and the public sector it rose substantially.

Investment in fixed assets by sector, % of total



Source: Kaliningradstat (2009)

The situation was not this positive with foreign investment: inward foreign investment dropped by 73% in Q1 y-o-y (in USD). Foreign direct investment (FDI) fell less – by 61% – but this was mainly a result of one large investment (of \$14.4 million) from Cyprus in the wholesale sector. Trade credits and bank loans, normally the largest component of foreign investment inflow, declined 93%. The construction sector continued to contract rapidly in the first four months of 2009: the volume of construction works fell by 24.1% and the area of completed housing – by 23.2% year-on-year.

Corporate finance: net loss

In the first quarter of 2009 the net financial result (profits minus losses) of Kaliningrad's companies became negative. The extraction industries and the utility sector were one of the few major industrial sectors that managed to remain profitable. Interestingly, despite well publicised financial difficulties of the retail sector, it even increased its profits, y-o-y. However, all other major sectors either moved from profits to losses or had substantially higher losses. The number of loss making companies almost equaled the number of profitable companies.

Wages and labour market

The deteriorating economic situation has had a negative impact on wages and employment. Real wages declined by 8.1% in March y-o-y. The largest declines took place in banking, retail trade, consumer electronics and car manufacturing – the sectors that suffered more than the others during this crisis. In the public sector, wages and salaries generally either increased or stayed roughly constant. Public pensions were 10% higher in March 2009 than in 2008.

Unemployment in the first four months of 2009 continued to grow rapidly. Data for general unemployment was unavailable but the number of officially registered unemployed grew by approximately 3,000 each month in February – April. The registered unemployment rate jumped to 3.5% in April – an increase of 200% over April 2008.

Some business highlights

- Problems at the Kaliningrad's airline, KD-Avia, continued: it had to stop its flights for one day in early April because of its mounting debt problems. In order to save the airline it was decided that the Kaliningrad regional government will invest RUB 4 billion (EUR 92 million) in KD-Avia to become a majority shareholder. The funds will be provided by the federal government.
- Miratorg, a Russian agricultural holding company, will buy its Brazilian partner, Sadia SA, out in their Kaliningrad's meat processing joint venture, Konkordia. Sadia has a 60% equity stake in the joint venture. Total investment in the joint venture amounted to USD140 million.
- Neman pulp and paper mill was declared bankrupt in May and its assets will be put on sale.
- Lithuanian sauce producer, Vesiga, decided to invest EUR 4.5 million in the construction of a sauce factory in Kaliningrad. It is expected to start production in spring 2010 and it will be the company's second plant in Kaliningrad.
- Inter RAO UES and German power company, EnBW, signed a memorandum of cooperation. One possible aspect of their cooperation is the construction of the Kaliningrad nuclear power plant and marketing of electricity produced by the plant.

Kaliningrad region - main economic indicators	2001	2002	2003	2004	2005	2006	2007	2008	2009	as of
Regional GDP (y-o-y %-growth, constant prices)	3.4	9.5	9.3	12.6	3.6	11.6	24.7	n/a	n/a	1-12/2007
Industrial production (y-o-y %-growth)	12.9	4.2	4.7	22.5	27.4	66.6	34.8	2.5	-14.0	1-4/2009
Inflation (CPI, end of period, y-o-y %-change)	21.0	9.8	17.5	11.7	11.1	7.9	11.2	15.2	15.3	4/2008
Gross wage (period average, EUR)	99	125	137	155	193	285	358	430	340	Q1/2009
Unemployment (% end of period, LFS data)	10.6	7.2	7.6	6.5	6.6	4.5	3.4	8.7	n/a	Q4/2008
Exports (EUR million, current prices)	508	497	507	876	1470	2025	3666	765	n/a	1-12/2008
Imports (EUR million, current prices)	1169	1701	1894	2419	3283	4275	5714	6564	n/a	1-12/2008
Exports (sales) to Russia (EUR million, current prices)	691	802	989	1449	1901	2471	3901	2240	n/a	H1/2008
FDI inflow (EUR million, current prices)	3.6	6.3	12.4	18.0	15.1	16.9	117.9	109.4	11.3	Q1/2009

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

A strategic partnership with Russia remains our goal

By Jan Fischer

One need not spend a long time proving that the history of Europe inseparably blends with the history of Russia. The economic and cultural interconnectedness of both great civilizations is no less intensive and close now than it has been in the past. Due to factors of common history and mutual economic-security reliance, there is no reasonable alternative to the building of a strategic partnership between the European Union and the Russian Federation. It must, of course, be founded on mutual respect, common interests and an acknowledgement of universal values and the norms of international law. Various EU countries may have various bilateral experiences with Russia – just as they have them among each other – but the EU as a whole must not allow its talks to be controlled by historic resentments or the particular interests of individual members. Russia's territorial expanse, geographic proximity and international importance are simply too large for Europe to ignore. It is therefore only natural to jointly endeavour for strong, mutually advantageous and well-structured relations.

Of course all 27 EU member states are endeavouring for such relations with Russia in the framework of numerous international organisations: The UN, OSCE and Council of Europe. Their bilateral cooperation with the Russian Federation may also be more or less fruitful. But the political weight of even the largest European players will always be only a fraction of the total weight of the European Union – one of the most important and largest communities in the world. Perhaps in no other place has the need for a common European foreign, security and energy policy been shown as urgently and visibly as in the search for a *modus vivendi* with Russia. Recent experiences also suggest that in talks with the Russian Federation, the EU can be successful only insofar as it speaks with one voice. Any fragmenting of the EU-27's position worsens chances for a permanently good and correct relationship with Russia, and consequently decreases the chances of positively influencing its direction.

The EU has long endeavoured for a united position toward the Russian Federation. In 1994, the then EU-15 signed the Partnership and Co-operation Agreement (PCA), which created the basic legal framework for relations with Russia. After its ratification in 1997, its validity was set for 10 years with an automatic one-year extension every year unless one of the parties withdraws. On the basis of this agreement, an EU-Russia summit is held twice a year, and the Permanent Co-operation Council also functions. The agreement includes political dialogue, cooperation in economic areas, justice, interior and culture, and also in financial-technical cooperation. At the present time, the Agreement is the subject of renegotiations that are far from easy. In negotiations on new forms of strategic partnership, decreasing the frequency of summits and other incremental changes are being considered, which should correspond better to the situation on the continent today. Both sides of the partnership find themselves in a completely different situation than in the period from 1992 to 1994 when the agreement was signed. At that time, Russia was going through the initial phases of a deep systemic transformation. Its economic, societal and constitutional rebirth objectively influenced its economic and political potential. At that time, the EU only had 15 member states. Enlargement to include the states of Central and Eastern Europe not only brought it territorially closer to Russia, but also brought a new dimension to relations. The prepared agreement should bring these relations to a corresponding level.

In the past, the EU and the Russian Federation have successfully found common denominators which enabled them to utilise the enormous potential of bilaterally advantageous cooperation. The concept of building the Four Common Spaces for cooperation was approved at the St. Petersburg summit in 2003:

- a/ The common economic space
- b/ The common space of freedom, security and justice
- c/ The common space of external security
- d/ The common space of science and research, education and culture.

The gas crisis in January 2009 showed the foresight of signing additional sector agreements on establishing a so-called "energy dialogue." In accordance with an agreement from 2000, an expert panel meets for regular talks to assess new investments into infrastructure, trade issues and energy efficiency. Energy raw materials policy is a very important part of Russian foreign policy, and issues of energy security are again a vitally important interest of the EU. EU member states import a total of 30 % of their oil needs from Russia. Half of all European natural gas imports come from Russia. January's interruption in natural gas deliveries demonstrated with all clarity the degree to which certain EU members are dependent on imports of this raw material from Russia. On the other hand, the European common market is the largest in the world, and it is therefore in the interest of the Russian Federation to maintain good business relations, part of which also includes strict adherence to the supplier commitments that have been negotiated.

Today, Russia is the EU's third-largest partner. On the other hand, the EU is the main source of foreign investment – making up three-quarters of all foreign investment in Russia. This mutual economic reliance and interconnectedness is complemented by no less important common interests in the area of global security, the fight against terrorism, alleviating climate change and migration.

Improving relations with Europe also has a truly crucial importance for Russia, and not only because it can learn about the functioning of social mechanisms and the technologies of state administration. The European Union is made up of a large number of subjects with an unequal level of economic development, and it has decent experience in levelling out regional differences under conditions of stiff international competition. A European orientation not only does not threaten Russia's civilisational independence, but is on the contrary its guarantee and insurance policy. The Judeo-Christian values which lie at the foundations of European civilisation are also markedly organic for Russia. Despite all of its integration, the continent remains a Europe of homelands, a Europe of civil societies that are markedly tolerant of every independence. Many events on a global scale call directly for Euro-Atlantic/Russian cooperation for reasons that do not need to be expanded upon here. A clearly declared European orientation for Russia, confirmed by practice, would take the wind out of the sails of those who would like to dig a ditch between Russia and Europe, making an intentional line marking Europe's edge on the eastern borders of the Baltic states and Ukraine. History itself is the last instance in the resolution of issues of civilisational borders. It is also worth it for the West to fight for the European component of Russia's identity. It will require a wide and structured dialogue which includes both the aforementioned areas of common interest, as well as potential points of dispute. The goal remains to reach a permanent strategic partnership founded on mutual respect. The road to this goal may be thorny, but the Czech EU presidency is of the opinion that it is the only reasonable road worth taking.

Jan Fischer

Prime Minister

The Czech Republic



The Baltic Sea is to remain a safe and attractive place

By Astrid Thors

On the World Environment Day, the 5th of June, the Government of Finland introduced a white paper on our policy on the Baltic Sea. The aim of our white paper is to ensure that the Baltic Sea is a safe and attractive place. – Ahead of us is a huge challenge – knowing that the Baltic Sea is the most polluted sea in Europe, but also taking into account the implications of the financial crisis in the Baltic Sea states.

Not long ago the countries in this area were considered to be Europe's economic tigers and our economic growth and competitiveness was one of the best on the continent. Open economies with a well-educated population were magnets for foreign direct investment.

Unfortunately the picture is not the same at the moment; but that must not make us lose sight of what must be the long term perspective. That must be, among other things, to improve our innovation capacity. Competitiveness through lower wages is not a long-term solution.

Increased use of the Internal Market and of other European instruments will also in the future be paramount to the prosperity of the Baltic Sea region.

This double crisis – economic and financial turmoil at the same time as the climate challenge lies ahead – will create new opportunities, however. There are many studies around giving indications of what the greening of the economy will mean for the growth of jobs and opportunities. One made on behalf of the European Commission is pointing to big opportunities in biomass production for many of Baltic Sea states, not to talk about hydro power and wind energy opportunities. Or as a Danish consortium put it: We here in the north can be the green energy valley of Europe.

However, one of the prerequisites is that the energy markets around the Baltic Sea would be both better integrated and really functioning as a market. The first steps have been taken and further engagement is to be agreed in the margins of the European Council this summer. More capacity for transmissions is needed in order to stop isolation of several countries.

The transportation of energy is related to the new Baltic Energy Market Interconnection Plan – and it poses one of the biggest challenges to our aquatic environment today. Transport of oil has increased tremendously since early 1990s and it is not excluded that the transported amounts soon will reach over 200 million tons.

We cannot exclude the risk of an accident, no matter how well we succeed in developing surveillance and monitoring systems. We need increased cooperation between maritime authorities and better reporting and identification of vessels. Finland is ready to take the lead role for the actions in this area in the soon to be adopted EU Strategy for the Baltic Sea Region.

The European Maritime Safety Agency monitors the accident response capacity in member states. A quick look at the capacity in the Baltic shows that many parts of the region fall short. Therefore work under both the auspices of Helcom and the Council of the Baltic Sea States must lead to concrete plans to have efficient response plans in case of an accident.

As all readers of this paper know, the dire situation of the Baltic cannot be blamed on a lack of institutions and papers – all trying to improve the state of the sea. The problem is, on the one hand, that some regulations are not binding, just representing a good will, and, on the other hand, that we have situations where one country is to bear the costs of the actions while it is another country benefiting from them.

But in some respects the situation has changed for the better. With the EU enlargement in 2004 the Baltic Sea became an inner water of the EU, and through this, the parameters for development of measures and instruments are the binding regulations of the EU. The Water Framework Directive for example requires at least a good state of the waters by the year 2015. During 2009 Finland will approve plans in this respect. Another tool is the Marine Strategy Directive, in which the Baltic Sea could become a pilot area, using the Helcom Baltic Sea Action Plan as the framework.

So there is reason to remain hopeful; we can still save the Baltic.

Astrid Thors

*Minister of Migration and
European Affairs*

Finland



The Baltic Sea Region – A bridge between EU and Russia? – EU energy strategy and the Nord Stream gas pipeline

By Henrik Lax

It is in the clear interest of the European Union to create a functioning internal energy market. The EU should not be dependant on energy from the outside but should be self sufficient in that area. The ongoing gas crisis between Ukraine and Russia has highlighted and reminded the Union of the fragility of its energy supply. The ones who believe that the Nord Stream pipeline is the solution are utterly wrong.

The current state of the EU policy and strategies on energy are reflected primarily in the following proposals and decisions: the initial proposal from the commission in 2007, the decision in the Energy Council in October 2008 and the vote in the European Parliament in April 2009.

A European single market for electricity and gas allowing free exchange of energy within the Union would make it much less vulnerable to disruptions in energy supply from external sources and to political pressure. Such a market would depoliticize the trade in favour of commercial considerations.. Russian gas counts in fact for only 6,5 per cent of the Union's consumption of primary energy.

One of the very key issues in the negotiations on a new cooperation agreement between EU and Russia is what rules shall govern the energy trade. The negotiations have hardly begun and results are only expected to materialize slowly. It is still an open question what the ultimate intentions of Russia are. Deep lack of trust is hampering progress on many issues to be dealt with.

During his recent visit to Finland the Russian president Dmitri Medvedev clearly stated that Russia, albeit a signatory of the European Energy Charter, does not regard itself bound by it, and he reiterated this during the EU-Russia summit in Habarovsk a short time later. Ironically Prime Minister Vladimir Putin urged Ukraine to respect the same charter during the crisis early this year. – Common rules for the energy market and the trade of gas and electricity between EU and Russia are lacking.

Moreover the Member States of the EU are divided on the energy policy. Had it not been for the gas crisis between Russia and Ukraine in 2006, the new Article 176A would never have been included in the Lisbon Treaty. This article envisages a common energy policy for the EU. The aim is to harmonize EU's energy policy and to allow the Union to establish new measures.

Member states would be allowed to adopt legislation only if the Union has not already done so. In other words, national governments would only be able to legislate on policy areas on which the EU has decided not to. Currently creating a common single energy market has proved difficult since there are 27 different regulatory frameworks.

The policy of the European Union in regard to energy is to ensure both the functioning of the energy market and the security of the energy supply. The policy also endeavours to promote energy efficiency and energy saving as well as to develop new and renewable forms of energy. The European Parliament has continuously expressed its worry regarding Europe's energy supplies and has examined different ways in which to ensure that there will be no threat of discontinued access to energy by utility companies.

In 2007 a *third country clause* was proposed by the European Commission in order to protect the EU's energy market from third countries. This clause requires any company from a third country to comply with the same rules as any EU company. In practise this means that a company that

produces energy may not transmit energy or own companies that do so.

This clause, sometimes referred to as the Gazprom clause, because some consider it to be directly aimed at the Russian energy giant Gazprom, is intended to function as a reciprocity clause, but was eventually watered down by the Council of Ministers in October 2008. The current version only requires the member state and third country to bilaterally agree in order to allow a third country to invest in EU's energy infrastructure. However the main ratio of the clause, demanding companies from third countries to comply unequivocally with the same requirements as EU companies, remains fully valid. The third energy package, including the third country clause, got its final approval by the European Parliament in a vote in plenary in April 2009.

Will this clause be sufficient to prevent third country actors playing according to their own rules from blocking the establishment of a single energy market for the EU? It is evident that Gazprom is a tool of the Kremlin for fulfilling Russian foreign policy. Indeed, it was prime minister Putin who ordered the gas deliveries to be stopped to Ukraine and was negotiating the pricing of the gas with his Ukrainian counterpart. Ex-Chancellor Gerhard Schröder was wrong in asserting that Gazprom is a purely commercial company.

Having said this it is questionable whether it is in the interest of the EU to have the Nord Stream pipeline constructed before common rules for the gas market have been agreed upon with Russia. This question is even more pertinent as it seems to be highly unlikely that Gazprom will have any possibilities to increase its gas deliveries to Europe within a foreseeable future.

The outcome of the discussion in the European Parliament early this year concerning the Second strategic energy review, that is one of the main strategies within the European Energy Policy, was a call for a greater cooperation between member states regarding the energy market and for a greater diversification of supply routes. EU need to "speak with a single voice" and work towards energy solidarity.

It is in this context, I would like to raise the role of the Baltic Sea Region. In June, the Commission will officially make public a first version of the much longed-for strategy for this region. This Strategy, if properly implemented, will give the region a new role and impact, but this will happen only as long as key political figures are deeply committed to the strategy. Therefore, I would welcome a Summit during the Swedish presidency of the EU, with the presence of all political leaders who have proved their interest in developing the Baltic Sea Region into a strong actor. A political and economic consolidation is the only way the Baltic Sea Region can have a say in the future, and it is the only way the region can enhance its position as a bridge between the EU and Russia. Solving the question marks relating to the Nord Stream pipeline has a high priority in this respect.

Henrik Lax

Member of the European
Parliament

Finland

The Baltic Sea needs reform of European Union agricultural subsidies

By Janina Andersson

The Baltic Sea is a unique marine ecosystem. There are nine coastal countries and millions of people who consider it as their own sea. But Baltic Sea is now one of the most threatened marine ecosystems on the planet due to overfishing, unsustainable shipping practices, industrial and urban wastewater and agricultural run-off.

One of the most serious difficulty is the eutrophication. Eutrophication is a process where water receives excess nutrients that stimulate excessive plant growth. This enhanced plant growth, often called an algal bloom, reduces dissolved oxygen in the water. This affects the whole ecosystem. About 80% of all nutrients in the sea come from land-based activities, including sewage, industrial and municipal waste and agricultural run-off.

According to the recent study by Fredrik Wulff, professor in Marine Systems Ecology in Stockholm University, the pollution to the Baltic Sea has been diminished for the first time. The pollution has been diminishing in almost every country. There was only one exception: the pollution from Finland hasn't been decreasing. On the contrary, it has increased.

European Union is preparing a strategy for the Baltic Sea Region. Agricultural subsidies should be included into this strategy. EU agricultural subsidies were launched for two reasons. They aimed to work as an income subsidies and as an environmental subsidies. Nowadays they are ineffective as an environmental subsidies. System is also bureaucratic and expensive. The administration of the system takes over the half of the whole costs of the agricultural supervision, almost 30 million euros per year.

We need to differentiate the drainage basin area of the Baltic Sea from the agricultural subsidies. The subsidies for the drainage basin of the Baltic Sea should be addressed especially for sloping seacoast fields. It is known that the biggest problems are the fields of gradient level more than 6 %.

It is essential to address the agricultural subsidies to specific operations. A good example of this kind of actions is the Finnish TEHO project (2008-2010). TEHO project is focused on agricultural water protection issues in southwest Finland. The primary sources of the project funding are the Ministry of Agriculture and Forestry, and the Ministry of the Environment. Southwest Finland Regional Environment Centre and two regional unions of the Central Union of Agricultural Producers and Forest Owners are taking care of the implementation. The project takes place in Southwest Finland with around 12 000 farms

and 20 % of Finnish arable land. The project is concentrated in four more defined areas characterized by intensive crop production agriculture and/or animal husbandry.

The farmers' knowledge and skills are vital and they will be utilized in the project as well as local environmental conditions, farm resources and prevailing practices are taken into account. The aim is to find farm-specific, the most suitable water protection measures, in close co-operation with farmers and to develop environmental protection handbook for the use of the farm.

As well known, changes in agricultural practices is reflected to the water quality with a delay, which complicates environmental impact assessment. Automatic water quality sensor stations are established in order to monitor effects on waters. Moreover, effectiveness of measures will be estimated using modeling. The results, conclusions and experience will be utilized in the preparation of the third Agri-Environmental Program in Finland (2014 -).

And finally.

We don't have much time to wait for these changes in the agricultural subsidies from EU. Especially the new member states as Poland should be able to minimize the run-off from their fields before their agriculture has been changed into intensive and massive farming systems instead of smaller family farming.

The climate change may shorten period of frozen soil and increase precipitation during winters, which leads to more run-off waters from the fields also in the winter time. This is probably the reason why the Finnish figures look bad in the recent research. Because of this it is even more important than earlier to have something growing on the fields all year around near the rivers. For example energy plants would be a good solution for these difficult areas. So we need a quick change in the financial subsidies to the agriculture in the Baltic Sea area if we want to save our sea.

Janina Andersson

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International sea surveillance co-operation in the Baltic Sea region

By Juhani Kaskeala

Maritime traffic on the Baltic Sea

Increased co-operation within the Baltic Sea region, the expansion in trade and higher living standards have led to a significant swell in maritime traffic. This rise in maritime traffic is currently the biggest in the world. The amount of oil transportations in the Gulf of Finland has grown seven-fold in the past ten years. In 2008, nearly 150 million tonnes of various oil products were transported via the Gulf of Finland. On average 10 fully loaded tankers set off from the Gulf of Finland daily, and this trend is expected to continue in the foreseeable future. Experts predict that once the new oil terminals will have been completed the amount of oil transportations in the Gulf of Finland will surpass the 200 million tonne benchmark already in 2015.

Picture (see end of article): The main task of the Finnish Navy is to secure sea routes

The fact of the matter is that Finland has always been — and still is — like an island in the remote waters of the Baltic Sea. Eighty-three per cent of Finland's imports and exports rely on maritime routes.

The main task of the Finnish Navy is to secure these maritime routes. Changed threat scenarios and the significance of maritime connections to the national economy have determined the Navy's priorities: everything the Navy does must support this task which is paramount.

Finland's dependency on unobstructed maritime traffic set the conditions for sea surveillance both in normal and exceptional circumstances. The maritime picture is a result of seamless co-operation between different authorities and highly automatised data processing.

Whereas earlier all sea surveillance could muster was a limited maritime picture from a single surveillance station, radar and vessel, today maritime pictures provide a comprehensive report on the areas that are of particular interest to Finland using an array of sensors. Since the beginning of 1994, maritime authorities (the Defence Forces, the Border Guard and the Finnish Maritime Administration) have combined their resources to improve the maritime picture and to save resources. This co-operation has generated a smoothly operating sea surveillance system. Fifteen years of co-operation between authorities has been a success in Finland, and this has not gone unnoticed internationally.

Sea surveillance is becoming more international, focused and it combines data from different sensors and authorities. We are shifting from a national maritime situation report to an international situational awareness of the events and circumstances out at sea.

Expanding the maritime picture

Finland has actively developed a maritime picture based on international exchange*. In the early 2000's, Finland and Sweden initiated the Sea Surveillance Co-operation Finland Sweden (SUCFIS) Project. The aim was to merge two independent national sea surveillance systems electronically. In addition to the automatised exchange of information, another significant step was the adoption of common practices and establishing points of contact between the sea surveillance centres. SUCFIS has been operational since the summer of 2006.



Picture: SUCFIS has been in operational use since the summer of 2006.

In September 2008, Finland and Sweden proposed the exchange of sea surveillance information to cover the entire Baltic Sea region. The proposition was put forward to all the littoral states of the Baltic Sea, Norway and various organisations operating in the area. The idea was met with considerable interest. The Sea Surveillance Co-operation Baltic Sea (SUCBAS) was initiated with a Letter of Intent at a meeting held in Finland in spring 2009. SUCBAS co-operation is based on the principle that each state decides for itself what parts of its recognised maritime picture (RMP) it wants to share with other states. The exchange of information between the contracting parties' (Finland, Estonia, Lithuania, Sweden, Denmark, Germany) sea surveillance operators began already on 2 April 2009, as planned. In future SUCBAS can be merged into a European-wide RMP exchange programme.

Within the European Union, the Finnish Navy leads a working group called Project Team Sea Surveillance Working Group 1. The group designs solutions and methods for the exchange of sea surveillance information between 15 EU member states and maritime authorities and stakeholders operating within Europe. So far, the project has agreed on what the aims of cooperation are. At this stage the group is putting forward for approval the first technical requirements for the exchange of information. The European Defence Agency (EDA) is responsible for this project.

In addition, Finland, together with several stakeholders and countries, such as the United States of America, Sweden, Spain, Singapore, Poland, Germany and NATO, develops technology and processing models related to the exchange of sea surveillance information and analysis. The main focus is on technology and the work is part of a series of multi-national experiments that the Finnish Navy has been involved in since 2006.

Finland's aims in international sea surveillance

Finland supports the goal of the EU maritime policy to create an EU-wide recognised maritime picture. Finland actively participates in ongoing projects and seeks to steer things in such a direction that they enhance co-operation between Finnish sea surveillance authorities. Finland supports the initiative to produce technical and practical

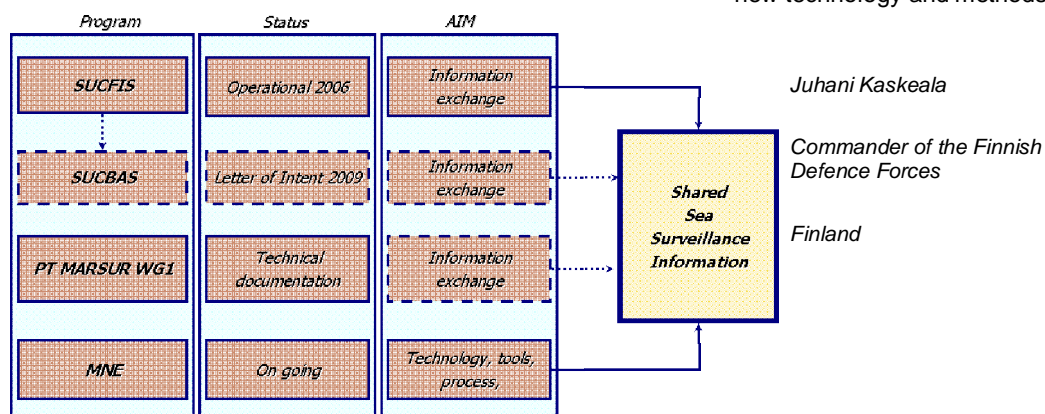
solutions that enable European navies (MARSUR/EDA), border guard authorities (EUROSUR/FRONTEX), and maritime authorities (SAFESEANET/EMSA) to exchange maritime pictures.

International RMP projects further Finnish interests and provide more opportunities to increase maritime safety. An expanding situational awareness enhances international and national co-operation between authorities in repelling large-scale security threats. An integrated effort in RMP co-operation strengthens national crisis management capabilities and lays the foundations for international exercises.

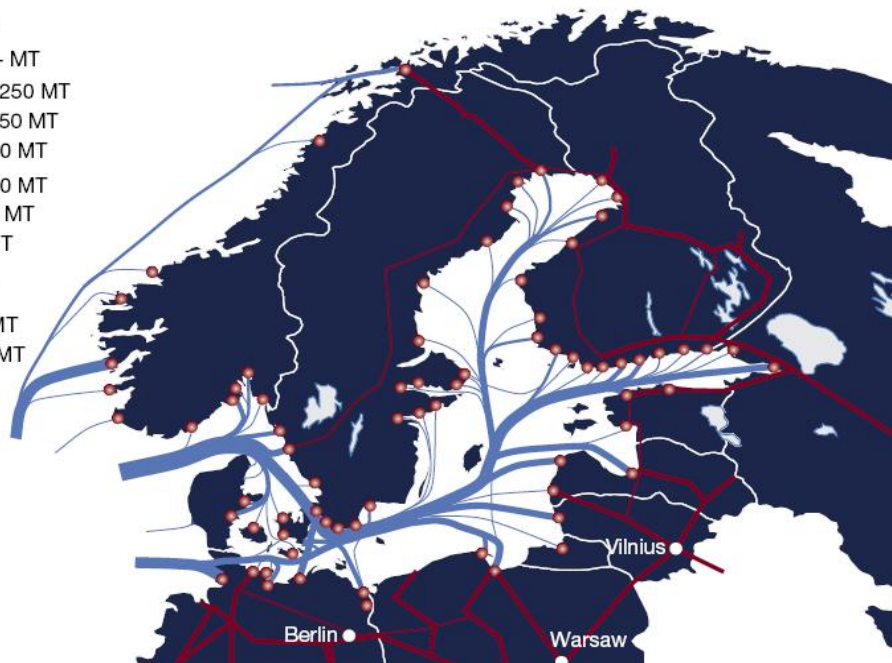
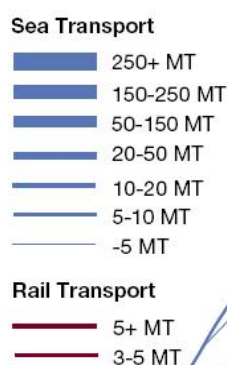
We currently know exactly who are in or close to our territorial waters. The increased maritime traffic and information puts our systems and surveillance personnel under considerable strain.

Finland participates in international sea surveillance co-operation to exchange sea surveillance information with other countries and stakeholders and to develop national sea surveillance capabilities.

Our aim is that we not only see the recognised maritime picture but that we also understand what is happening out at sea. This can only be achieved by sharing sea surveillance information and by developing new technology and methods.



Picture: International sea surveillance co-operation the Finnish Navy is involved in.



Picture: The main task of the Finnish Navy is to secure sea routes

The future of Russia-US relations

By Stephen Blank

Once the Obama Administration metaphorically pushed the reset button on US-Russia relations it generated numerous comments at home and abroad. Moscow and Europe as a whole have openly welcomed the changed atmosphere of bilateral relations while American conservatives have launched a media blitz decrying them as a sellout of US policies or allies. In fact, a closer look suggests that the Administration has merely cleared the air so that a genuine dialogue on the bilateral agenda can begin.¹ It also has launched an ambitious attempt to expand that agenda to find more avenues where cooperation might be possible. This ambition is clearly reflected in the bilateral communique from the Obama-Medvedev meeting in London on April 1.² Nevertheless improved atmospherics, though valuable, hardly denote harmony or détente.

Actually, close examination of what this writer has called the agenda of discord, suggests that cooperation will be limited to issues pertaining to strategic nuclear weapons, namely a treaty to reduce strategic nuclear weapons and proliferation questions.³ This treaty is itself part of that agenda of discord but evidently progress is occurring as serious negotiations are underway. Admittedly Washington decided to postpone discussion of the issue of tactical or non-strategic nuclear weapons in Europe and will count both warheads and launchers in a gesture to Russia.⁴ But following President Obama's speech in Prague the US will not surrender missile defenses and Russia's insistence upon tying offensive reductions to terminating defenses and thus preserving the old Cold War mutual hostage relationship and its concept of strategic stability where both sides are shackled together like scorpions in a bottle, is unlikely to prevail.⁵

Another part of that agenda of discord is the two sides' divergence on nuclear proliferation.⁶ While progress may

well occur on issues like new regimes for countering nuclear proliferation and Russia wants to restore the so called 123 treaty on nuclear exports, cooperation is unlikely to go much further than that. Russia still maintains that Iran shows no sign of building a nuclear bomb or missiles that it can use to strike Europe or even Russia, though its military has long since acknowledged this threat.⁷ Similarly Moscow clearly holds the US accountable for the breakdown of the six-party talks on North Korea's nuclear program and opposes meaningful UN sanctions upon it or Iran despite Russian talk of the UN's primacy.⁸

When we turn to regional issues on this agenda Russia's intransigent position clearly derives from its presupposition of an inherently conflicted relationship with an adversarial West and America. These issues demonstrate how much Russian policies are driven by what domestic and foreign commentators acknowledge to be an inveterate anti-Americanism.⁹ Moscow loses no opportunity to demand a privileged sphere of influence for itself in the CIS while its ambassadors routinely disparage those states' sovereignty.¹⁰ Moscow's furious reaction to the EU's new Eastern partnership and threats of realignment and walkouts from cooperation with NATO over its exercises in Georgia shows that Russia cannot and will not accept the European status quo and the rights of its members, including those in Central and Eastern Europe, anytime soon.

Moscow's desire to retain the capability to threaten Europe with nuclear weapons underscores its opposition to US missile defenses there.¹¹ Indeed it has already broken the Bush-Yeltsin Presidential Nuclear Initiatives of 1991-92 concerning the removal of tactical nuclear weapons from

¹ This term was coined by Samuel Charap in a lecture at the Finnish embassy in Washington, on May 8, 2009

² Joint Statement by President Dmitry Medvedev of the Russian Federation and President Barack Obama of the United States of America, April 1, 2009, www.whitehouse.gov; Joint Statement by Dmitry A. Medvedev, President of the Russian Federation, and Barack Obama, President of the United States of America, Regarding Negotiations on Further Reductions in Strategic Offensive Arms, April 1, 2009, www.whitehouse.gov

³ Stephen Blank, *Towards a New Russia Policy*, Strategic Studies Institute, US Army War College, Carlisle Barracks, PA. February 2008

⁴ U.S. Assistant Secretary of State Rose Gottemoeller Outlines the U.S. Position On a New Strategic Arms Reduction Treaty With Russia," *Interfax*, May 4, 2009, <http://www.interfax.com/17/491670/Interview.aspx>

⁵ REMARKS BY PRESIDENT BARACK OBAMA, Hradcany Square, Prague, Czech Republic, April 5, 2009, www.whitehouse.gov; Stephen Blank, *Russia and Arms Control: Are There Opportunities For the Obama Administration?* Carlisle Barracks, PA: Strategic Studies Institute, US Army War College, 2009, pp. 17-24

⁶ Alexei Arbatov, "Terms of Engagement: WMD Proliferation and US-Russian Relations," Paper prepared for the US Army War College conference "US and Russian: Post-Elections Security Challenges. Carlisle Barracks, PA, March 6-7, 2008, in Stephen J. Blank, Ed., *Prospects for US-Russian Security Cooperation*, Carlisle Barracks, PA: Strategic Studies Institute, US Army War

College, 2009, pp. 147-149; Stephen Blank, "Prospects for Russo-American Cooperation in Halting Nuclear Proliferation," Stephen J. Blank Ed., *Prospects for US-Russian Security Cooperation*, Carlisle Barracks, PA: Strategic Studies Institute, US Army War College, 2009, pp. 169-284

⁷ Stephen Blank, *Missile Defenses in Eastern Europe: Who Threatens Whom and Why?* Forthcoming from the American Enterprise Institute; *RUSSIA-U.S. RELATIONS: PERSPECTIVES AND PROSPECTS FOR THE NEW AGENDA* SERGEY LAVROV, MINISTER OF FOREIGN AFFAIRS, THE RUSSIAN FEDERATION THURSDAY, MAY 7, 2009, Carnegie Endowment on International Peace, Washington, D.C., www.ceip.org (Henceforth Lavrov, Speech)

⁸ *Ibid.*

⁹ Cathy Young, "From Russia With Loathing," *New York Times*, November 21, 2008, www.nytimes.com; Vladimir Shlapentokh, "Are Today's Authoritarian Leaders Doomed to Be Indicted When They Leave Office? The Russian and Other Post-Soviet Cases," *Communist and Post-Communist Studies*, XXXIX, No. 2, Autumn, 2006, pp. 462-463

¹⁰ Stephen Blank, "The Values Gap Between Moscow and the West: the Sovereignty issue," *Acque et Terre*, No. 6, 2007, pp. 9-14 (Italian), 90-95 (English) "Interview given by Dmitry Medvedev to Television Channels Channel One, Russia, NTV, "August 31, 2008, http://www.kremlin.ru/eng/speeches/2008/08/31/1850_type82916_206003.shtml;

¹¹ Blank, *Missile Defenses in Eastern Europe: Who Threatens Whom and Why?*

ships in the Baltic sea.¹² Likewise, it refuses to sign an energy charter with the EU and continues using energy as a means to blackmail and intimidate its consumers throughout Central and Eastern Europe. Beyond that it uses energy revenues to corrupt and subvert all those governments as attested to by numerous sources.¹³ Likewise, Russia is pushing a European security initiative that aims to give it a free hand in the CIS while eliminating or undermining the OSCE and NATO as functioning organizations.¹⁴ Finally in Central Asia Moscow orchestrated the expulsion of the US from its base in Kyrgyzstan -- a strange way of showing solidarity in the fight against the Taliban unless one realizes that Moscow's main aim is consolidating this sphere of influence, not helping the US. Indeed, it is hedging against a Taliban victory by angling for a sphere of influence in Northern Afghanistan, a constant Russian aim since 2001 if not earlier.¹⁵

This anti-Americanism also appears in Russia and China's effort to effectuate a massive reorganization of the international financial status quo where it gains the right to use the ruble as a regional reserve currency. Not only does this aim at Washington, but it also entails creating a ruble bloc in the CIS that will undermine the financial sovereignty of all its members, and replicates the similarly intended policies of Nazi Germany in Eastern Europe in 1933-39.¹⁶ Thus Moscow wants a free hand in the CIS like

the one it enjoys at home, i.e. an autocracy that does not answer to anyone for its actions. Russian analysts have long known that such a regime is inherently imperialist in its nature, outlook, and policy. Therefore it cannot accept the status quo in Europe or be a true partner for the West.¹⁷ For these and many other reasons whatever agreements that ensue will be partial and limited though valuable in and of themselves.

Therefore we can probably expect a treaty on strategic nuclear weapons and some progress on non-proliferation. But realistically we should not expect too much from this new dialogue even if we should be grateful for improved atmospherics. After all, a state whose avowed aim is revising the status quo, whose methods are intimidation and subversion, and whose ideological mantra is "sovereign democracy" cannot accept genuine partnership with the West for it believes, as would Bismarck, that in such a partnership it will be the horse and Washington the rider. As Gogol aptly reminds us, if Russia is to be likened to a horse and team, then it prefers to be a troika running off under its own or else nobody's control.

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The views expressed here do not represent those of the US Army, Defense Department, or the US Government.

¹² "Bildt Plays Down Russian Nuclear Threat," *The Local*, August 18, 2008, <http://www.thelocal.se/13780/20080818>; Mark Franchetti, "Russia's New Nuclear Challenge to Europe," *Timesonline*, August 17, 2008, www.timesonline.co.uk/tol/news/world/europe/article4547883.ece

¹³ Author's conversations with members of European foreign ministries and intelligence services, 2008; Anita Orban, *Power, Energy, and the New Russian Imperialism*, Washington, D.C.: Praeger, 2008; Edward Lucas, *The New Cold War: Putin's Russia and the Threat to the West*, London: Palgrave Macmillan, 2008; Robert Larsson, "Nord Stream, Sweden and Baltic Sea Security," Stockholm Swedish Defense Research Agency, 2007; Robert Larsson, *Russia's Energy Policy: Security Dimensions and Russia's Reliability as an Energy Supplier*, Stockholm: Swedish Defense Research Agency, 2006; Janusz, Bugajski *Cold Peace: Russia's New Imperialism*, Washington, D.C.: Center for Strategic and International Studies, Praeger, 2004, passim; Richard Krickus, *Iron Troikas*, Carlisle Barracks, PA: Strategic Studies Institute of the US Army War College, 2006; Keith C. Smith, *Russian Energy Politics in the Baltics, Poland, and the Ukraine: A New Stealth Imperialism?*, Washington, D.C.: Center for Strategic and International Studies, 2004; Valery Ratchev, "Bulgaria and the Future of European Security," paper presented to the SSI-ROA Conference, "Eurasian Security in the Era of NATO Enlargement," Prague, 4-5 August 1997; Laszlo Valki, "Hungary and the Future of European Security," *Ibid.*; Stefan Pavlov, "Bulgaria in a Vise," *Bulletin of the Atomic Scientists*, January-February 1998, pp. 28-31; Moscow, *Izvestiya*, in Russian, 19 June 1997, in *FBIS SOV*, 97-169, 18 June 1997; Sofia, *Novinar*, in Bulgarian, 10 April 1998, in *Foreign Broadcast Information Service, Eastern Europe* (hereafter *FBIS EEU*), 98-100, 13 April 1998.

¹⁴ Speech at a Meeting With German Political, Parliamentary, and Civic Leaders, Berlin, June 5, 2008, http://www.kremlin.ru/eng/speeches/2008/06/05/2203_type82912t_ype82914type84779_202153.shtml

¹⁵ Sergei Rogov, *The New Russian-American Security Agenda. How to Build a Cooperative Relationship Between Russia and the United States*, Carnegie Endowment for International Peace, Washington, D.C., January 13, 2009

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¹⁷ Maura Reynolds, "Moscow Has Chechnya Back--Now What,?" *Los Angeles Times*, June 19, 2000; Boris Rumer, *Central Asia: At the End of the Transition*, Boris Rumer Ed., *Central Asia At the End of Transition*, Armonk, NY: M.E. Sharpe & Co. Inc., 2005, p. 47

The Baltic Sea – model for well functioning cooperation and simultaneously a challenge from the Frontex' point of view

By Ilkka Laitinen

Frontex is a European Agency which coordinates the operational cooperation at the external borders of the Member States of the European Union. European Council Regulation stipulates that Frontex' objective is to facilitate and render more effective the application of existing and future measures of the European Community relating to the management of external borders. Frontex is doing so by ensuring the coordination of Member States' actions in the implementation of those measures. In that way Frontex is contributing to an efficient, high and uniform level of control on persons and surveillance of the external borders of Member States.

The vision is that Frontex is the anchor stone of the European concept of Integrated Border Management, promoting the highest level of professionalism, interoperability, integrity and mutual respect of stakeholders involved. One of the values of Frontex, interoperability, is crucial for the effective management of activities at the European external borders. The effective management calls for interoperability at national, European and international levels. Frontex aims to be the central player for promoting harmonisation of doctrines, needs, operational and administrative procedures, and technical solutions supporting effective management of the EU external borders.

Aiming to promote interoperability and effectiveness, Frontex will actively support and liaise with the regional border control cooperation structures including Member States and Third Countries (non-EU Member States). Working closely together with the law enforcement authorities of Third Countries will bring the authorities "on the same side of the border" leaving the other side for criminal organizations. In this respect, based on the risk analysis, the main focus of Frontex will be on the Mediterranean Sea area, Western Balkans and Eastern European Countries, followed by the Black -and Baltic Sea Regions.

All countries around the Baltic Sea have a long experience on the comprehensive and secure exchange of information and experiences with an emphasis on continuous monitoring and management of irregularities affecting in their security. The Third Country of the Baltic Sea Region, Russian Federation, was the first non-EU Member State which signed a working arrangement with Frontex in 2006 formalising the ways of cooperation. Based on that agreement Russia can participate in the operational cooperation coordinated by Frontex. During the first quarter of 2009 Frontex coordinated a joint operation on the Kaliningrad area. Border Guard Service of the Federal Security Service of Russian Federation took part in the operation.

The Baltic Sea is a small and confined sea that is almost entirely enclosed by land. Vessel traffic has increased significantly in recent years and the growth is expected to continue in the future. At the moment the risks on the Baltic Sea area are more related to other aspects than to the illegal immigration, like environmental protection. However, the cooperation between the various border control authorities in the Baltic Sea region has proven to be a success both operatively and politically and has influenced border security in all of the Europe. It can be said that the operational cooperation on the Baltic Sea Region is unique, even by European scale. Cooperation between the countries around the Baltic Sea has in a way been an export article. It can be indicated by the popularity of the Baltic Sea cooperation model. The applications of the Baltic Sea cooperation have had a clearly visible effect. Both in the Black Sea and even in the Pacific Ocean, border control authorities from different countries have organised their cooperation along the same main lines. The work coordinated by Frontex in the Mediterranean region has brought countries few steps closer to the similar model of cooperation.

Today we are in a position to declare that cross-border cooperation across the external borders of the EU between Member States and non-EU Member States can be organised effectively. This cooperation is expressly non-military and professional in nature with the legal competence to resolve special situations at different sea areas of the Europe.

Frontex is strongly encouraging the Member States to more actively deploy vessels, aircrafts and other means to joint operations for safeguarding the external borders of EU based on the risk analysis and needs of the Member States mainly affected by illegal immigration. One of the challenges of Frontex is to scrutinise different ways to get Member States to utilise their assets more often for common European operational activities, especially at the Southern Maritime borders of the EU. When talking about the surveillance of the external borders of EU, it is important to remember that no one is stronger than its weakest link. International cooperation is vital to tackle the challenges which the EU is facing. The development of different EU bodies including Frontex needs commitment of the Member States, so that the citizens of Europe can harvest the benefits from it.

The Member States around the Baltic Sea have modern and effective multi-purpose vessels and aircrafts which would bring added value to common European activities in case the Baltic Sea States would be willing to deploy them regularly to joint European operations. Taking into account the long distance from the Baltic Sea to the hot spots in the Mediterranean Region, the technical assets would have to be deployed for a quite long duration in order to guarantee the cost-effectiveness of the operations. One of the solutions could be to use the technical means of the Member States from the Baltic Sea region half of the year for joint European operations coordinated by Frontex and the other part of the year for national purposes in the territorial waters of the home Member States of the assets.

Frontex is putting a lot of efforts to accomplish a following scenario in the future also in the Mediterranean Sea: "Border guard surveillance aircrafts will fly common European surveillance missions covering the hot spots of the Mediterranean Sea. A broad variety of operational information collected by the technical means and fixed surveillance networks will be exchanged on a continual basis with all the relevant authorities of the area and additional assets provided by other supporting Member States. Border control authorities are in daily contact with one another and by doing that, have a common overview of all the vessels and other targets of interest sailing in the Mediterranean Sea giving enough response time for European law enforcement authorities to react and to handle the situation in appropriate manner."

This will result in improved quality of management of joint European operations and increase the level of security of European citizens. It is important to remember that irregular migration is a challenge for the whole Europe, not only to the Member States mostly affected by it at the moment. Mutual trust and solidarity can be considered as a life-insurance for the Schengen area.

Ilkka Laitinen

Executive Director

Frontex



Crisis modernisation – lessons of the past and tasks for the future

By Vladimir Mau

In the same way that generals prepare by analysing past wars, economists and politicians prepare by analysing past economic crises. On the whole, this makes sense, and it is not even a bad thing. It makes sense that we can only seriously analyse what is known. It is not a bad thing, as learning lessons from the past allows us to avoid the same pitfalls, but this can never be guaranteed in any country. Over the last one hundred years, many countries, with surprising obstinacy, continue to repeat the same blunders and have been hit repeatedly by the same economic crises – history has no limits and is ready to set the same lessons until they have been grasped by nations and the elite. However, the lessons learnt from the past do not ensure against new challenges (and, in relation to this, new mistakes) – history loves setting new puzzles, the minimum condition for, it would seem, tasks already solved.

One of the key questions for Russia now is the possibility of uniting an anti-crisis agenda with the agenda for modernisation. The last eight years have shown that in economic boom conditions, structural renewal of the Russian economy exists (and even starts). Now we will see if we understand whether this adds to the crisis conditions.

Modernisation is undoubtedly important for the strategic goals of Russian politicians. The experience of our country over the past three hundred years shows that successful and stable modernisation only occurs when it affects all the areas of vital activity of the given society. In the past, Russia periodically succeeded in deciding on individual modernisation projects; however, they were always unstable and were quickly set back. The problem was that the focus was on military, technological or social achievement, whilst ignoring political and economic aspects of modernisation or even taking these into consideration. Modernisation cannot solve the tasks before it if it focuses on some areas and neglects others. The logic of “step by step modernisation”: first the army and defence industry, then, perhaps, politics and social relations, does not provide stable results.

Already, for producing an anti-crisis agenda, it is important to formulate this in a modernisation context. There are two aspects to this problem. On the one hand, priority attention is devoted to measures to resist the crisis, which at the same time promote the renewal of the Russian economy. On the other hand, producing a set of our own modernisation actions which can exist in crisis conditions.

The list below shows some components of the anti-crisis modernisation agenda.

It starts by securing macroeconomic stability. For our budget and money systems there has come a time of complex testing. And we need to come out of this saving our “macroeconomic face”; that is to say without a breakdown in the vicious infinity of budgetary obligations, inflation, default and bartering. For a very long time, and at a painful rate, we got out of all of this in the 1990s; moreover, there was then a certain justification due to the revolutionary destruction of the old system and a deep crisis of state power. Now a return to the situation of monetary and financial collapse would be catastrophic for the future of the country.

With these come the links and contours of the financial policies. It should be built in consideration of the prospects of conversion of the rouble into a regional back-up currency. Even if this task now seems fanciful to anyone, a

solution in the medium term is a total reality, if it is not done in the current period of serious foolishness and errors. Establishing financial policy in crisis conditions does not mean doing what may only distance this prospect (above all having, in terms of a spin off, uncontrolled inflation or introducing currency control). It already makes sense to now develop a programme of steps to strengthen the international position of the rouble with a definition of stages which are not linked to a certain date but naturally and logically follow from one to another.

It is essential, when defining a policy, to reinforce the role of internal demand by promoting economic growth. It is in sectors which promote steady and multiplicative internal demand where all the limited resources that the budget will have should be centred. This type of sector includes residential and industrial construction and also education and health care. Moreover, the author suggests quickly starting to flood them with money. Modernisation requires, above all, institutional renewal of these sectors, which has been discussed to any extent for nearly a decade. Without institutional renewal, financing does not lead to growth in the quality of the goods and services provided, which means to growth in the internal market.

Hence, it would seem that demonopolisation is vital. All attempts to stimulate demand by us up to now have not led to growth of supply and quality but to an increase in prices. Therefore, a distinct and serious programme of demonopolisation (including the developer sector and intrinsic monopolies) is still one of the most important components of modernisation of the agenda. Without demonopolisation of a whole range of anti-crisis measures, it is simply not possible.

When considering the problems of the non-financial sector it is important to understand that serious changes are awaited here. It is not possible to help all companies to stay afloat. As is well known, “strategic” companies are specially monitored by the state. However, the main point of this attention should not be to occasionally (or regularly) give them money, but to not allow them to add to social and economic instability. Moreover, one of the forms of support for these companies by the state should be legal and other help when needed for their financial recovery.

When implementing measures for social stability, it is vital to follow one principle: the state helps people and not companies, not their top managers or owners. Moreover, supporting people should not only result in paying out unemployment benefits: it is vital to have the active involvement of them in different educational projects, targeting professional conversion training or increasing qualifications. The requirement of support of companies (particularly big ones) is often motivated by the amount of employees working in them. However, the aim of structural renewal of the economy does not mean preserving the entire range of existing companies. Here, the support of employees made redundant is a vital part of modernisation policy.

What is needed is staggered reform of the banking system, targeting the creation of a network of stable and effective private banks. Here, it would be very important to preserve a high level of competition in the banking sector, to stop a market crisis, which a few major banks would dominate.

* * *

Modernisation is sometimes related to the theme of prospects which open up for national producers due to the devaluation of the national currency. The low rate of the rouble may give a boost to economic growth. But without the powerful input of oil dollars, this would not work, and the solution for modernisation focusing on the consumers of internal demand is not import substitution. Considering the experience from 1999-2001, this development model for many economists is completely realistic.

A worsening of foreign economic situations is now present, and the amount of oil dollars has considerably dropped. However, major activation of business activity should not be expected. The crisis has arrived, negative trends have appeared, and the rouble has been devalued. However, this other crisis is fundamentally different to that of 1998, and it would be strange to expect the same trends as in the last decade.

It is possible to outline several important features which limit the effect of devaluation on the functioning of the contemporary Russian economy.

First, contemporary Russia is in the investment stage of economic growth, in conditions where growth requires the input of additional capital. In simpler terms: in Russia now, there is practically no free capacity in which one could operate for free. The abundance of unused capacity in 1998 provided a powerful stimulus for economic recovery, especially in the private sector. This was accomplished with practically minimal capital investment (or with minimum investment). Political and macroeconomic stabilisation significantly increased with the safety of individuals and property, and already this (coupled with liberalisation of domestic activity) was enough to spark an economic rebound. Now, despite the crisis, investment is needed which would provide stability for the Russian economy and determine the usual term "modernisation". Investors are nervous about the uncertainty of demand and the lack of low-cost money on the market. Moreover, high interest rates in Russian are now at a level of 12%, which has led to high inflation.

Secondly, the global character of the current crisis. At the end of the 1990s, the crisis was a national one, but characteristic of developing markets. The continued unstable growth of global economies (developing market economies) has generated powerful demand; therefore, even a certain improvement in the macroeconomic parameters and corporate relations in crisis countries quickly led to new growth. Furthermore, as regards developing markets, these were staggered over time – 1997 – Asia, 1998 – Russia, 1999-2000 in Brazil and Argentina. With these crises, thanks to global growth and experience of combating the crisis amassed at the same time occurred in each country at a different time, one crisis began in one region of the world at practically the same time as another region came out of the crisis. In other words, devaluation against a backdrop of global crisis is not the same thing at all as devaluation in conditions of economic upswing.

Third, this devaluation is less severe than it was in 1998. This time, the exchange rate of the rouble dropped more than the second and is now at a rate of 40 percent. Thus, the scale of its influence on the economy will be less important.

To some extent, this may even be a good thing; whereas, *fourthly*, the result of almost a decade of boom has been its dependence of parts of the national non-financial sector on the supply of foreign components and equipment. This was the price of the transfer from reconstructive growth (on the basis of the involvement of unused capacities) to investment growth. The integration of Russia had continued in global economic relations, the inflow of foreign capital has promoted the development of *know-how* and an increase in the productivity of labour. However, this means an increase in wages for the production of the associated goods.

Fifthly, devaluation in relation to the US dollar has happened not only in Russia, but practically all the currencies of the major trade partners of Russia in Eastern Europe and other former Soviet republics fell. Therefore, they have also increased their competitiveness, and Russian commodities are not as attractive in terms of price in comparison with them. Moreover, the rouble fell less in relation to the Euro, whilst a significant portion of Russia's imports are purchased in this currency.

These arguments do not mean that a lower exchange rate will not exert a positive influence on the economy. In the last few months, many importers have been feeling a lot better. Benefits of the weakened rouble have slowed the pace of the recession and we have already seen increased activity in February and March among some companies operating on the domestic market.

The pace and consequences of the 2009 devaluation show significant weakening in its ability to offer a favourable impact on the condition and dynamics of the Russian economy. We can no longer hope for a repetition of the "1998 Miracle". The conclusion is simple: Russia cannot achieve the strategic tasks in future without fundamental modernisation of its economy. And that reformation must be started now in the midst of a global crisis.

Vladimir Mau

Rector

Academy of National Economy under the Government of the Russian Federation

Russia

Security as a competitiveness booster in the Baltic Sea Region

By Erkki Hämäläinen

Do we consider the Baltic Sea a safe and secure region to live or run a business? Or should we do more? Maybe it would be possible to devise Security as a competitiveness booster for the industry and commerce of the Baltic Sea Region and create an attractive area for people, customers and workers by developing the security of the region? My point of view is the fight against crime and security against damages caused by organised crime and terrorism.

In increasing globalisation, business location must be highly competitive to back up the economical growth of companies. Competitiveness influences business location decisions. A secure operating environment is widely considered an important location factor for businesses alongside the attractiveness of the region, the availability of labour, the proximity of markets and good transport connections. In this respect security is a significant factor of competitiveness not only for individual municipalities, but also for countries and groups of countries.

Although the Baltic Sea Region seems to be rather safe area in Europe, it is not self-evident that the situation will remain unchanged. According to Europol organised crime threat assessments, some OC groups are already showing a significant use of legal business structures in EU to facilitate criminal activities and to launder criminal proceeds and get established in legal business. They are also prepared to use influence and corruption in the EU both in the public and private contexts.

The Northeast region of the EU seems to present attractive opportunities for organised crime from the Baltic region and for OC groups originating from the neighbouring countries such as Russia, Ukraine and Belarus. A further facilitator for trade fraud in this region is the large volume of transports across the borders and other vulnerabilities of the logistics sector.

The use of illegal labour being one of the criminal phenomena that is the most detrimental to competition, is a serious challenge to the business sector. Illegal labour originates increasingly from countries outside the EU. OC groups, which combine legal and illegal businesses, often manage the supply and use of illegal labour in a way that harms the rest of the business community.

The growing value of the sea transportation of oil and other products in the Baltic Sea as well as the large passenger ferries could be tempting targets also for illegal activists or terrorist groups.

The currently ongoing process of producing a Strategy for the Baltic Sea is highly welcome not only for the maritime environment, maritime safety reasons or for energy and transport networks but also for the maintenance of and increase in security in the region. The citizens of the Baltic Sea region have their right to anticipate secure and safe environment to live, travel and work. The security is essential also for the competitiveness of the region in order to attract business investments.

Preventing and combating OC and terrorism should therefore be an essential element in the Baltic Sea Strategy. Crime prevention could not happen by the law enforcement means only. Close co-operation with other authorities and in particular in partnerships with the private sector such as transport, harbour, logistics and other businesses as well as with the civil societies.

There are already trans-border law enforcement structures in place such as Europol, The Baltic Sea Region Task Force on OC (BSTF), Nordic Police and Customs co-operation as well as a bilateral co-operation.

The Baltic Sea law enforcement co-operation could be built on the groundwork laid by the BSTF. However, the BSTF is still a temporary structure. Stronger political support will therefore be needed in order to guarantee the stability and permanency of joint law enforcement co-operations in the Region.

Well functioning direct and practical mutual law enforcement co-operation between the Nordic countries could be a good practice to be applied more widely round the Baltic Sea region. Immediate mutual law enforcement co-operation gives much better possibilities to tackle crimes or criminals that affect at least two countries at the same time.

The OC groups operating in Russia and surrounding countries such as Ukraine and Belarus and having close connections with the active OC groups in the Baltic Sea region affect the security of the region. The external dimension of the Baltic Sea Strategy is therefore essential.

There are no sufficient or comprehensive mechanisms, structures or frames for joint crime prevention activities in the Baltic Sea region or for closer co-operation of all relevant public and private stakeholders (PPP).

Maybe it would be possible to create, in the framework of the Baltic Sea Strategy, a coherent Baltic Sea Security Program in order to identify and manage the main crime risks in the Baltic Sea area. The Program would bring together the key players of the public and private sector in the Baltic Sea States. Together, they should identify and prioritize the main crime risks in the region, agree on the means of managing risks and launch practical co-operation and partnerships for crime prevention.

The Program could consist of a solid security concept for the most critical functions in the region such as logistical chains of transportation, business networks and supply chains, financial transactions and the critical infrastructure of the region.

Yes. We could booster and facilitate the competitiveness of the Baltic Sea by strengthening the Security of the Region. We must not forget that the security against crimes and other intentional wrongdoings is and should be an important section of the comprehensive safety and security concept of the Baltic Sea Strategy.

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*Detective Chief Superintendent
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Finland



Involvement of the City of Tampere in the Baltic Sea cooperation

By Timo P. Nieminen

As the cradle of Finnish industry, Tampere has always been strongly oriented towards international trade and cooperation. From the rise of Tampere into one of the leading industrial centres of Northern Europe in the 19th century, all the way to today's global businesses and the EU cooperation, the Baltic Sea region has provided a key framework for Tampere's international activities. In addition to a large number of export oriented companies – many of which are global market leaders in their respective fields – Tampere's world-class universities, cultural institutions and festivals make Tampere a recognized centre in the Baltic Sea region – one of the region's leading "regiopolises".

By its part, the City of Tampere actively participates in the various forms of local and regional level Baltic Sea cooperation. The city administration's contribution to and involvement in the Baltic Sea cooperation is based on the following four elements: A comprehensive twin city network, international organizations for local governments, EU projects, and the Baltic Institute of Finland – established and owned by the City of Tampere.

Tampere has numerous twin cities in the Baltic Sea region. In a "Nordic platform" – based on reciprocal twin city agreements - Tampere collaborates with the cities of Norrköping, Odense, Trondheim, Kopavogur and Klaksvik. In the Baltic states, Tampere has twin city agreements with Tartu and Kaunas - the second cities of Estonia and Lithuania. Cooperation between Tartu and Tampere is very active in various sectors, and it has broadened beyond local governments. With Kaunas, Tampere has participated in various joint EU projects for example in the field of eGovernment. In Poland, Tampere is proud to have the second city of Lodz as its twin city. With similarities and shared interests in industrial heritage and culture related issues, there are plenty of cooperation opportunities between Lodz and Tampere. Tampere's German twin cities, Essen and Chemnitz, complement Tampere's exhaustive twin city network in the Baltic Sea region, even though the German twin cities are located slightly outside of the Baltic parts of Germany.

In addition to its Baltic Sea region twin cities, Tampere has close cooperation with the City of St. Petersburg based on two cooperation agreements from 1994 and 2002. Joint projects with St. Petersburg encompass a variety of both bilateral and multilateral cooperation activities from innovation to environment protection, and from eGovernment to culture. Furthermore, Tampere is a partner in Helsinki Centre, a joint representation of the cities of Helsinki, Tampere and Kotka in St. Petersburg opened in 2008.

As regards international organizations, Tampere has been a member of the Union of the Baltic Cities (UBC) since 1995. Tampere, through the Baltic Institute of Finland, coordinates the UBC Commission on Information Society, and participates actively in UBC commissions in other sectors as well, such as environment, culture and urban planning.

Tampere makes its strongest mark in the Baltic Sea cooperation through the Baltic Institute of Finland which is based in Tampere. The establishment of the Institute in 1994 was one of the first and main Finnish responses to

the new situation of the Baltic Sea region emerged in early 1990s. The central aim of the Baltic Institute of Finland is to promote the launch of tangible collaboration projects in the Baltic Sea region and to facilitate the participation of Finnish organisations in these initiatives.

The Institute has established itself as one of the region's leading expert organizations for practical Baltic Sea cooperation with its high quality standards in international project planning and management. In Finland, the Institute operates nationwide, with prominent partners from all over the country. As a network-based organisation, the Institute initiates and implements practical, development-oriented projects, promotes trade and networking and raises awareness and distributes information on the current issues of the Baltic Sea region. In 2007 and 2008 alone, the institute was responsible for more than twenty collaborative projects in the Baltic Sea region and organised dozens of events in the Baltic Sea region and in Brussels.

The institute's geographical operating area covers the entire Baltic Sea region – the Nordic Countries, the Baltic States, Northwest Russia and the northern parts of Poland and Germany. As for the scope of activities, the key themes featured in the institute's projects include the development of the information society, environmental cooperation and the promotion of innovation and export.

For the City of Tampere, the founder and owner of the Foundation for the Baltic Institute of Finland, the Institute is a highly important partner and instrument in the implementation and development of the city's international relations strategy. The Baltic Institute of Finland is a valuable partner and resource for the City of Tampere and other local stakeholders especially as regards the preparation and management of the EU funded projects, as well as related networking and partner search. Tampere's extensive twin city network in the Baltic Sea region and the Union of the Baltic Cities provide a functional platform and partner base for the Institute's projects. The cities of Kaunas and Tartu have been especially important partners for the Institute.

The ongoing boom of the Baltic Sea cooperation and the coming EU Strategy for the Baltic Sea region underline the importance of the Baltic Sea region as a priority area for Tampere's international relations. There are various new interesting cooperation opportunities arising for Tampere in the Baltic Sea region, also concerning tourism and investments. Tampere's twin cities, as well as Helsinki, St. Petersburg and other metropolitan cities in the region, are our closest and the most natural partners and reference cities.

Timo P. Nieminen

Mayor

The City of Tampere

Finland



Vyborg Industrial Park

By Vasily Osipov

At the end of 2007 Lappeenranta and Vyborg have agreed on a mutual strategic purpose, to realize a project of industrial park on the territory of Vyborg district which will help to introduce enterprises of Lappeenranta and Southern Karelia into the Russia's market, will allow to use effectively area of 150 hectares, to create about 1000 work places and about 500 000 m² of buildings and structures with connected infrastructure and dedicated to different purposes.



Beside industrial park in Gorelovo, there are no other projects in Leningrad Region or Saint- Petersburg conception of activity of which would meet the presented model of the industrial park. Probably, the only industrial park of a large scale which is well known and more or less resembles our project is the industrial park of Kaluga which is located 200 km from Moscow.

Compared with Saint - Petersburg and its neighboring districts Vyborg has some most valuable advantage - lower cost of land. Vyborg also is considered to be a competitive place for building industrial enterprises very near to border and requiring less labor force.

In order to implement the project on the territory of or. Svetloe of Vyborg district a certain piece of land has been identified. It is located near the federal highway Saint- Petersburg, 20 km from the state border and 150 km from saint - Petersburg.

Feasibility study was financed by TACIS in the amount of 250 000 Euros.

It is planned to establish a joint venture for managing the project.

Shareholders of this venture will be: authorized companies of the cities - participants, enterprises responsible for infrastructure of the industrial park, construction companies - participants, "steam locomotive" companies that are planning to be located in this territory.

Principle owners will be responsible for financing estimated for the industrial park. The industrial park will be constructed in stages but the infrastructure should be designed according to final size of the project. In this respect at the initial stage of investments into the infrastructure a long period for financing, approximately 5-7 years, will be envisaged and calculation of profitability will be presented: if expenses for land use or for infrastructure are too high then it will not be possible to carry out construction projects competitively.

It is supposed that during the first stage about 27 000 m² of buildings will be built which will require about 400 workers. The following Table shows fields of activity of the enterprises that will participate in the first stage of the project (see table below).

Period of fulfillment of the first stage of the project: 2010-2011. Total period of the project fulfillment is 7-10 years. The project development team believe that the project will be interesting not only for Russian and Finnish businessmen but also will attract representatives of business structures from other Baltic countries.

Vasily Osipov

The Head of Vyborg City Administration

Vyborg

Russia

Field of activity	Need in premises (m ²)	Need in work force (people)
Assembly of power equipment	3000	30
Power and mechanical devices and equipment	3000	30
Power equipment for power engineering	1500	25
Metal works	3000	20
Network of subcontracting enterprises for metal- working	5000	10"x15
Metal and other furniture	1500	15
Surface finishing and treatment	1000	10
Designer's furniture	1000	10
Industrial valves	1000	15
Manufacture of metal trolleys	2000	25
Manufacture of boat equipment	1500	20
Excavators	1000	8
Surface treatment for stone-processing industry	1000	10
Carriage	1500	20
TOTAL	27 000	About 390

Rauma - Unesco world heritage town

By Arno Miettinen

Rauma is Finland's third oldest town. The coastal town with a population of around 40 000 is located in Western Finland, on the Gulf of Bothnia. Rauma is a popular seaside town, where modern industry provides employment and brings prosperity. Rauma is home to two Unesco World Heritage sites – the wooden Old Town area in the heart of the town and the Sammallahtenmäki burial site, which dates back to the Finnish Bronze Age (1500-500 BC). There are very few other culturally significant towns in Europe, or indeed in the world, that boast two World Heritage sites.

Multinational companies in the area have made Rauma an important export centre. Rauma has always been a shipbuilding town, and the STX shipbuilding yard, Rolls Royce propeller manufacturing plant and the Tampere Technical University hydraulics research centre are all in Rauma. The town is also host to major players in the paper industry; the UPM-Kymmene factory in Rauma is the second largest such facility in Europe, and the Metsä-Botnia pulp mill is the most modern in Finland.

The Forchem tall oil refinery is also among the largest of its kind in the world. The Oras factory in Rauma is one of Europe's largest tap and shower manufacturing facilities. The town's education offering and research expertise reflect the changing needs of commerce in the area.

The Port of Rauma

With 20 berths, the Port of Rauma offers comprehensive facilities for import, export and transit traffic. A reputation for excellent service and competitiveness has made the Port of Rauma Finland's primary harbour for the paper industry and the largest container port on the west coast. Its location on Finland's western coast gives the port excellent connections, and it can be accessed along 10 metre or 7.5 metre deep access channels.

As well as being a strong export harbour, particularly due to the pulp and paper industry, the Port of Rauma also has a large capacity for cost-effective import traffic. The port handles 18 departures a week sailing to European harbours, two sailings a week to the Mediterranean, and 7 sailings per month to the USA.

Combined traffic through the Port of Rauma was 7.1 million tonnes in 2008 – 3.6 million tonnes more than the previous year. This increase was entirely due to growing volumes of import traffic. Nearly 172,000 container units (TEU) were transported through Rauma in 2008, and a total of 1724 ships visited the port in the same year.

The Port of Rauma has:

- 115 hectares (1 150 000 m²) of field space
- 260 000 m² of covered facilities for general cargo
- 30 000 m² of heated warehouse space
- 230 000 m³ warehouse space for bulk cargo
- 175 000 tons of silo capacity
- 560 000 m³ of chemical and oil tank space

The Bothnian Sea National Park

The Town of Rauma has campaigned for many years and led the way in planning a national park scheme to protect the Bothnian Sea archipelago. The proposal is also mentioned in the programme of the current Finnish

government. Rauma Council has already made the decision to include areas owned by the town in the planned national park. The law giving a special role to local authorities is being used for the first time in Finland. As the first authority to take such a role, the Town of Rauma has been finding ways to co-operate with state officials. In the future the Town of Rauma will make its own decisions, through which it will carry some of the global responsibility for the conservation of nature and cultural values and for bringing them into the public eye. As the home of two World Heritage sites, Rauma is well qualified to carry such a responsibility.

The Bothnian Sea national park conservation area consists of a number of rugged islands near the open sea and the water surrounding them. In Rauma the area extends inwards to islands closer to the mainland, including the Kylmäpihlaja lighthouse island and the Kuuskajaskari island fortification. These islands offer good opportunities for visitors, and the founding of the national park also aims to help the tourism industry.

The Bothnian Sea national park is part of the European Natura 2000 programme. Nature is valued highly, and the forming of a national park brings tools for its conservation, use and awareness. The Town of Rauma is actively involved in the implementation of the Natura 2000 programme through the Baltic Sea project.

The Bothnian Sea national park is an ideal arena to share information and raise awareness to the plight of the sea. The Town of Rauma played a leading role in a co-operative project in the form of a book which asked: "How Are You Feeling, Bothnian Sea?" We are currently partnering in a study to establish the impact of climate change on the Bothnian Sea. The Town of Rauma's latest practical step in water conservation is the combining of public sewage treatment facilities with the treatment of waste water created by the forest industry, which has resulted in reduced nitrogen levels. Next on the agenda are water conservation measures for the region's beaches.

The Bothnian Sea is a strategic priority for Rauma. The Town of Rauma works for the good of the Baltic Sea in both its own decisions and in co-operative networks – also internationally.

In Finland, Rauma is involved in joint work along the Turku-Uusikaupunki-Rauma-Pori coast that has a strong focus on marine expertise. The Town of Rauma strives to co-operate with other Baltic coastal towns and research bodies, profitably and in a way that respects the sea, to improve the living environment for all of us.

Arno Miettinen

Mayor

Rauma

Finland



Five years in the European Union

By Solomon Ginzburg

Five years ago, on 1 May 2004, the EU welcomed ten new countries, including our neighbours Lithuania and Poland. The Kaliningrad area was the epicentre of geopolitical and geoeconomic games, linked with the enlisted power of a united Europe; which, according to economic indicators, can be compared with the USA, with over one and a half times its population.

Factor for a new partnership agreement.

On 30 November 2007, the partnership and cooperation agreement between the RF and the EU expired. This was an important document defining relations between the two parties. Therefore, the RF-EU summit, which took place last year in Khanty Mansisk, was the start of negotiations on a new basis for an agreement between the RF and the EU. It was very important to mention the Kaliningrad subject. A section on Kaliningrad should be present in the new international treaty, either in the basic text of the document or in the appendices.

After ratification of the agreement, it will have a framework-type character and will determine the conception of relations between the RF and the EU.

In the Kaliningrad section, there should be three parts: economy, freedom and security, education and science.

Economy. This section could cover issues related to federal, regional and European legislation; for example, how a federal law "on SEZ in the Kaliningrad region" is associated with one of the principles of the EU and not granting benefits according to the territorial principle. This should also logically include issues of common regulations and norms to promote close cooperation, the balancing out of competitive conditions and the free movement of goods, services and capital.

The issue related to legislation is a well-known problem. For a region in this programme, the experience of Switzerland, which is not part of the EU, is interesting.

The problem of the convergence of legislation in the economic area is an extremely current one. Otherwise, convergence with the EU is made not so much in depth but in width, in the scope of four general regions, which comprise, at first glance, everything, but in reality nothing. In this case, dialogue continues in conditions laid down for communication, which in interesting company and also at the expense of the state, may last for decades. However, this situation rightly reminds us of the never-ending negotiations on disarmament in the final years of the Brezhnev era.

The economy is a central link that is the basis for political, legal and humanitarian contacts. In the beginning, it is necessary to identify investment and trade links. Then the parties agree on the need to create and develop the corresponding legal basis.

Integration is a process and not a result. When opening markets, the economy always finds sizeable and

additional resources and benefits. The issue of convergence of legislation suggests unification. This concerns not the mechanical adoption of individual European norms and the instantaneous pseudosolution of difficult problems, but the use of the state arsenal of legal policies and practices to obtain coordinated goals in the interests of the people of Kaliningrad.

Freedom and safety. In this section, it is necessary to add norms regarding the provision of the inhabitants of the Kaliningrad region with free Schengen multi-entry visas.

Here again, it is vital to establish the position on freedom of inhabitants and employment, including the professional activity of citizens from the EU and people from Kaliningrad, the constant cooperation of legal bodies, especially in the fight against crossborder organised crime, illegal immigrants, drug trafficking, cooperation in the military field, and the carrying out of joint environmental and aid actions.

In the region and the EU countries, a single criminal area is taking shape. Organised crime is active wherever there are high-yield sectors of economy, the pull of investment, guaranteed production distribution, export directivity, the presence of a system of calculating cash circulations and the possibility of including illegally obtained capital in legal circulation. Special meaning is given to the problem when it occurs in a global recession situation.

Education and science. This section must contain the norms on long-term framework programmes, the joint financing of them, the creation of favourable conditions for cultural exchanges and mutual study of national history and the history of the European people. Training in the general educational field is possible on the basis of the Bologna process, which suggests the active exchange of teachers, pupils, students and those associated with the education sector and the mutual conversion of diplomas for higher education.

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Russia



Ust-Luga Sea Merchant port – a strategic port of Russia

By Maxim Shirokov

Changing over cargo flows in the interests of the Russian economy is one of the most discussed issues in mass media. A significant role in this process is assigned by the Russian government to the Ust-Luga Sea Merchant port under construction in the Luga Bay of the Gulf of Finland.

The idea of building a new sea merchant port at the Baltic Sea has sound historical preconditions. Zbigniew Brzezinski, an American politologist, former national security adviser of US President Carter, denounced that Russia would disappear in the darkness and ice as its major ports found themselves in other states. At the time of the Soviet Union we were really a maritime power. The access to the sea was provided by 75 ports, most of them going over to former union republics after the collapse of the Soviet Union. Russia lost its maritime infrastructure and became directly dependent on transit countries. It is in the early 90-ies that we understood that development of the country's economy demanded building new links of a logistic chain. This is how "Ust-Luga Company" JSC was formed to fulfill the task of building an up-to-date multipurpose port and transforming the territory adjacent to it. Development of the new Russian port at the Baltic Sea was included in the Federal Target Programme "Modernization of the Russian transport system" and the scheme of the state and business interaction implemented in the port construction is one of the first examples of public private partnership in Russia.

The choice of the place for building the port was nonrandom. It was determined by the advantageous geographic position. The Leningrad region is a junction point of the international transport corridor connecting Europe with Southeast Asia. The port is situated in the Luga Bay 100 km away from Petersburg (130 km of navigable pass) in the south-western part of the Gulf of Finland and stretches 20 km into the coast between the Kurgalsky Cape in the west and the Kolgapnya Cape in the east. Due to the natural conditions of navigation in this area of the Gulf of Finland the port can operate all year round, with a relatively short ice channeling period.

The Luga Bay water area is very deep. In 2012 it is supposed to be brought to 17.5 m. This will correspond to the maximum values of the Baltic Sea. Given all these factors Ust-Luga will be able to admit dry cargo vessels of the deadweight of up to 75 thous. tons and to handle liquid carriers (tankers of various types) of the deadweight of up to 120 thous. tons. Besides, the port has a short ship channel of 3.7 km, which makes the ship passage much quicker.

A serious competitive advantage of Ust-Luga port is the availability of large territories adjacent to the port. They ensure development of the port-related logistic activities and creation of an industrial cluster naturally attached to the sea port as a large transport hub.

It is also important that the Leningrad nuclear power plant, a source of inexpensive electric power, is located next to the port.

The currently operating facilities of the port include the Coal terminal, Universal Transloading complex, technical sulfur transshipment terminal, motor-railway ferry complex (with the operating Ust-Luga – Baltiysk – Sassnitz (Germany) line), the Yug-2 Multipurpose Transloading Complex and the Factor Timber terminal. A container terminal is being built and a bulk cargo complex is supposed to be commissioned before the end of the year. Work is under way to create a complex of liquefied hydrocarbon gas transshipment and a complex of

liquefied gas condensate transshipment in the general cargo area. Ust-Luga port will become the terminal point of the route of the Baltic Pipeline System-2 for oil supply. The construction works are expected to start in summer 2009.

All the terminals are high-technology and are built in accordance with the world standards. For example, the Coal terminal is considered to be one of the most up-to-date coal transshipment complexes of the world. The quality of transloading of new imported cars at the Yug-2 MTC was marked very high by specialists of the Toyota Motors Company who officially announced that they wanted to make Ust-Luga port an anchor port for transloading of their cars.

The Yug-2 MTC is intended for transloading of rolling machinery, container and general cargoes of various nomenclature. But the priority cargo is new imported cars. Today this is the first and so far the only specialized car terminal in Russia meeting the world standards. It has obvious advantages over similar terminals of other Baltic ports. The area of the Yug-2 MTC is 97.8 hectares. Today the terminal grounds can simultaneously accommodate up to 5 100 cars and their number will increase up to 13 thous. cars after commissioning of the second stage. The first startup complex for 100 thous. cars per year is working now. When the terminal reaches its full capacity of 6 mln. tons export-import cargoes, it will be able to transload up to 360 thous. cars. It is important that working through Ust-Luga port rather than foreign Baltic ports a cargo handling company economizes up to 300 Euros on every car.

An undeniable advantage of the Yug-2 MTC and Ust-Luga port in general will be the Warehousing logistic center (WLC) taking the area of 115 hectares between the container terminal and the Yug-2 MTC. The WLC will provide a comprehensive range of services of outside cargo storage and indoor storage in controlled temperature conditions. The technical center of the WLC will render car retrofit services: installation of options in cars, washing off the protective transportation coat, PDI – Pre-Delivery Inspection.

Although the crisis has changed the time frames of construction of some terminals, Ust-Luga Sea Merchant port keeps developing. The main thing for Ust-Luga Company, the port construction management company, is proper attachment of priorities to lay the basis for future dynamic development, to preserve its competitiveness, including creation of new possibilities for investors and additional services for carriers.

In 2008 almost 7 mln. tons of cargoes passed through Ust-Luga Sea Merchant port.

In the first quarter of 2009 the cargo turnover of Ust-Luga port increased by 20% from the same period last year.

In 2015 the port capacity is to amount to about 170 mln. tons of various cargoes per year with account of the BTC-2.

Maxim Shirokov,

General Director

Ust-Luga Company, JSC

Russia



Russia: the loss of reserves and inflationary consequences of devaluation – the myth and the reality

By Alexei Moisseev

Russia's international reserves dropped \$173bn from 1 Oct 2008 to 1 Apr 2009. The rapid fall in 4Q08-1Q09 has been cited as a weakness in the Russian economy and its financial system. It has been argued that, despite the high volume of reserves accumulated before the beginning of the crisis, almost one-third was spent within six months, and if the rate of spending persists, the reserves will be exhausted by the end of the year.

Nevertheless, we note that, in reality, for the most part, currency reserves never left Russia, but changed hands domestically. As a result, a large proportion of currency assets has been transferred from the CBR's accounts to the accounts of companies and individuals that have increased the share of foreign currency assets in their savings. In this respect, we note that the devaluation that the CBR conducted in a gradual manner, has really accounted to balancing the aggregate short-dollar position of the private sector, including state-owned banks and corporate, at the expense of reducing the aggregate dollar long of the government. Below is where we found the reserves did go:

- **Differences in foreign currency translation:** International reserves are not held exclusively in dollars but also in euros, sterling and yen, therefore fluctuations in the dollar rate vs these currencies lead to changes in the value of international reserves measured in dollars. From 1 Oct 2008 to 1 Apr 2009, the dollar appreciated against the euro by approximately 6% and against sterling by almost 20%. Based on the indicative structure of international reserves, the **effect of the currency revaluation amounted to \$25bn**.
- **Cash currency operations:** The balance of individuals' currency acquisitions and withdrawals (deposit) to/from banking accounts during this period reached \$37bn.
- **Deposit conversion from roubles to foreign currency.** In the past six months, corporate and retail clients have been converting funds in their rouble deposits to foreign currency, especially in December and January. As a result, the balance of foreign currency deposits has increased \$46bn.
- **External debt redemption.** In 4Q08-1Q09, banks redeemed over \$40bn in loans, and government agencies and monetary authorities redeemed about \$11bn. These sums are cash flow based, and since the end of 2008, as banks have been aggressively buying out their debt, traded at considerable discounts, we believe that the reduction in the banking system's external debt was more significant than \$40bn (CBR statistics show a \$50bn reduction of banks' external debt).
- **Speculative open currency positions.** Banks continue to hold speculative positions vs the rouble, which we estimate at approximately \$30bn as of 1 Apr 2009. At some point in time they will have to sell them back to the CBR.

Within the international reserves balance, we note that the CBR continues to record commercial banks' accounts held with the CBR in foreign currency, which totalled about \$35bn as of 1 Apr 2009. Thus, in reality, international reserves fell \$205bn from 1 Oct, rather than \$170bn. We estimate \$20bn flowed out of the 'other segment', which we believe is a kind of real capital outflow. Nevertheless, we reiterate that most of the total fall in international reserves is not an irreversible capital outflow, but represents a conversion of corporate and individual savings to foreign currency and the redemption of external debt. Moreover, as a result of converting clients' funds to foreign currency, banks have accumulated large currency holdings that exceed, according to our estimates, \$100bn. This liquidity cushion can be used for further redemption of external liabilities of the banking and corporate

segments without turning to direct or indirect use of international reserves.

A material risk related to pro-active government policy in managing the economic and banking crises is inflation, especially in a country like Russia which has high inflationary expectations. Nevertheless, there are also plenty of historical examples that indicate the lack of government liquidity could deepen the economic downturn. The Russian monetary authorities provided the banks with over RUB2.5trn as of 1 May 2009; however, monetary policy has been excessively tight, in our view – the money supply decreased 20% and only then did it stabilise.

While the way the CBR has conducted the devaluation may have been a blessing as far as the external solvency of corporate Russia is concerned, it has also had a very negative connotations for the real economy. I guess it is fair to say that the more rigid the foreign exchange has been coming into the crisis, the greater is the decline in the real economy due to the procyclical nature of fx bands and similar arrangements.

Russia's monetary policy has been some of the tightest in the world, with real policy rates exceeding 5%, and, with the obvious problems of the banking system, real cost of credit to the real economy exceeding 20%. It appears that the recent devaluation is actually the only factor spurring inflation, while final demand is obviously extremely low. Weekly CPI values grew materially when rouble devaluation reached its peak; however, in the past few weeks, weekly CPI changes have been decreasing rapidly. If we extrapolate the inflation registered in the past two weeks, its annual level would equal a mere 5.3%. Clearly, this extrapolation is unrepresentative due to a complex set of factors, such as seasonality, and an insufficient observation period, but one could argue that inflation is obviously on a downtrend, and a further drop in the indicator cannot be ruled out. Moreover, in Apr 2008, the weekly inflation level was three times higher (0.3% vs 0.1% in Apr 2009). Thus, we believe monetary policy is excessively tight, which has resulted in an economic squeeze.

On 29 Apr, President Dmitry Medvedev signed a bill on the 2009 federal budget, stipulating a RUB3trn deficit. About RUB2.7trn will be financed by the Reserve Fund, which will be achieved through printing money. The CBR will buy foreign currency from the Ministry of Finance for newly printed money, which is, in fact, equal to issuing money. Nevertheless, we do not think that this issuance will contribute to inflation, at least not in 2009. On the contrary, it will compensate for the reduced money supply caused by devaluation. One could argue that, with the economy being squeezed, there is no need for the same volume of money supply, but in other countries with transitional economies, the money supply has grown since the beginning of the crisis. In real terms, these figures are even more telling.

Finally, even if inflationary pressures resume, there is still an opportunity to quickly reduce the money supply by limiting CBR bank loans to banks that mature in the short term and whose total volume is close to the size of the target budget deficit. In this light we believe that the growth in the money supply should be limited when inflation has stabilised rather than when it is falling rapidly.

Alexei Moisseev

Head of Fixed Income Research

Chief Economist for Renaissance Capital

Russia

The second wave of the banking crisis – to be or not to be?

By Natalia Orlova

After experiencing some turbulence on the interbank market, the Russian financial system felt the first significant effects of the international financial crisis in the second half of 2008. The first wave of the banking crisis was accompanied by a liquidity squeeze, unstable exchange rate and significant withdrawal of bank deposits. However, since there had been a similar run on the largest banks in summer 2004, these developments were neither new nor particularly ominous. Having learned from previous experience, the Central Bank took action by cutting banks' reserve requirements and expanding refinancing options to provide banks with the needed liquidity.

A greater threat to Russia's banking sector is the question of nonperforming debt that looms on the horizon. This debt is particularly dangerous for Russian banks because they do not have experience working with bad loans. In the 1990s, all banking sector activity was focused on the currency market and later moved on to the state bond market. Prior to 1998, loans made up only 40 percent of bank assets — compared with the current level of 60 percent — and were concentrated on interconnected borrowers. Thus, in 1998, bad loans in a number of cases reflected bank owners' decision to sacrifice their banking business in order to save the productive assets of the group.

Lending began to grow in Russia in 2003 and 2004, fueled by greater penetration of foreign banks into the local market as well as the wider availability of foreign capital. In the period from 2002 to 2008, corporate loans as a proportion of gross domestic product grew from 15 to 30 percent, and the retail lending market sprouted from a ridiculously low 1 percent of GDP in 2002 to 9 percent in 2008. During the recent years of high economic growth, bad loans — particularly bad corporate debt — were not an issue for the banking sector. In the first half of 2008, the level of nonperforming loans under Russian accounting standards accounted for only about 1 percent of banks' lending portfolios.

Today, however, Russian banks are vulnerable to one overarching risk — the palpable decline of economic activity that is affecting all sectors of the country's economy. Russia's GDP fell 9.5% y-o-y in 1Q09, and in April it dropped by 10.5% y-o-y. The current economic downturn means that all banks will see an increase in nonperforming loans to one degree or another. Exporters are suffering from the decline in global demand and the unavailability of foreign capital, so they will certainly face liquidity problems. Furthermore, the decline in the country's construction sector suggests that the credit quality of companies operating in the manufacturing, transportation and trade sectors will deteriorate. The dramatic drop in equity and real estate prices has reduced the value of collateral used by borrowers. Retail clients will also have trouble servicing their long-term debt.

Another concern is the short maturity of Russia's debt. Companies need to redeem around \$220 billion by the end of this year. Half of this amount is denominated in foreign currency, which imposes an additional financial burden considering the significant depreciation of the ruble since September. The \$220 billion debt figure is equal to roughly 20 percent of Russia's current GDP. Given today's environment of declining global and local demand, it is indeed difficult to imagine that the real sector of the economy will be able to generate the necessary revenue

flows to service its outstanding debt. Nonperforming loans can be expected to peak in the third quarter, at which point Russia will experience the "second wave" of the crisis.

Because \$220 billion in debt has to be paid this year, a level of bad loans of 15 percent looks inevitable, and a "domino effect" of bad debt could push nonperforming loans to as high as 30 percent. Banks are clearly working to reduce their exposure to troubled borrowers in order to keep bad loans in check. This, in turn, is exacerbating the situation for struggling companies that face severe liquidity problems, making it likely that some will become insolvent.

During periods of economic trouble, the issue of corporate governance often comes to the fore. If financial markets remain closed for a long time, borrowers may decide to restructure the principal part of their debt without making any effort to honor the initial schedule or play by the rules of the market. For this reason, creditors readily agree to almost any proposed restructuring scheme in order to keep the company from entering bankruptcy, which could result in a very low recovery ratio. Needless to say, this leads to the appearance of "ghost" companies that continue to exist without performing any economic activity.

Another obvious risk is a decline in the transparency of Russian banks. In the last six months, the largest Russian banks have restructured around 5-10% of their loan book in response to clients' liquidity problems. These loans were usually restructured ahead of their maturity date and so were not reported as NPLs and did not require additional provisions. However, with companies' liquidity problem quickly turning into a solvency problem, these hidden NPLs must be detected through stress tests performed by the Russian regulator. Thus, the second wave of the banking crisis could also be triggered by NPLs reported from these restructured loans.

There is, however, some reason for optimism. First, the Russian economy as a whole is not highly leveraged by global standards. Russian companies' debt amounts to around \$800 billion, or 50 percent of last year's GDP. By way of comparison, in the East Asian economies that were overwhelmed by the crisis of 1997, corporate debt accounted for up to 150 percent of GDP. After bad loans peak in the second half of this year, the Russian economy could restart growth by expanding leverage. Thus, the downside potential of the Russian economy appears limited. The question is whether it will be able to generate growth.

Second, this crisis offers an excellent opportunity for a much-needed consolidation in the banking sector. At present, 200 banks control about 90 percent of the country's banking sector. This suggests that there is significant scope for smaller banks to improve the efficiency of their business through consolidation and by finding synergies to address the current crisis. Consolidation would also make the Central Bank's task of monitoring banks a lot easier.

Natalia Orlova

Chief Economist

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Russia

Russia on the Baltic

By Timo Vihavainen

Russia is in many ways the quintessential continental country, whose outlets to the sea are few and mostly unfit for large scale trade. However, the dearth of sea routes has made the remaining ones all the more important.

In the Middle Ages Novgorod was already integrated into the Hanseatic League. After the rise of Muscovy, the Russian tsars, most remarkably Ivan the Terrible, tried to gain the mastery of the Baltic, but was defeated.

During the Time of Troubles Poland and Sweden were able to put Russia to its knees. In the 1617 treaty of Stolbovo Sweden enlarged its territory deep to the east

On the early 18th century Peter the Great, of course, thoroughly changed this situation. Since the peace of Nystad (Uusikaupunki) in 1721, Russia was a serious naval power, especially on the Baltic. But this did not mean that its mastery of the sea was unchallenged. On the Baltic Sea, a couple of remarkable naval powers could overweigh Russia's Baltic Navy. More than that, Sweden alone could try to do this at a moment when Russia was tied in a war elsewhere.

This was what happened in 1788. Sweden was not happy with its defeats in 1721 and 1743. It allocated huge amount of resources for building up its sea power. Partly Sweden was helped by France, which financed the building of the sea fortress Sveaborg. Sveaborg did not have just defensive role, it could also be used as a place d'armes, a base for offensive warfare.

When Gustav III invaded Russia in 1788, it was his aim to take the Russian navy by surprise and to proceed to St. Petersburg. The main forces of the Russian army were then tied to a war with Turkey and with the Baltic Sea in Swedish hands the Russians could in principle be overpowered by the Swedes.

Gustav's *blitzkrieg* came to nothing for several reasons. However, the shock of the invasion was so great in St. Petersburg that Russia sent its foremost general, Alexander Suvorov to build a formidable chain of fortresses on the Russo-Swedish border, which then went along the river Kymmene (Kymijoki). Once again, money was not spared and the Russian fortresses Ruotsinsalmi, Kymminlinna, Hamina, Utti, Taavetti (Davyvovo), Lappeenranta, Savonlinna and several minor outposts formed together a fortified line, which can be compared only to the next Russian system of fortifications, which was built during WWI.

This latter system was called the Fortress of Peter the Great and together with the fortifications around Helsinki it was supposed to be able to shut the Gulf of Finland from the German navy. The system of fortifications consisted of heavy artillery on Finnish and Estonian coasts and also a circle of smaller fortresses, especially around Helsinki, armed with hundreds of artillery pieces and machine guns. Completed with sea mines, submarines and surface vessels this seemed to be enough to save St. Petersburg from invaders.

In fact, the German navy was able to come to Finland only after the Bolshevik revolution had destroyed the Russian war-machine.

The idea of closing the Gulf of Finland in order to prevent attacks against Saint-Petersburg remained important also from the Soviet strategists. When both Estonia and Finland were independent, they could also try to prohibit the Soviet navy from getting out of the pit of the

Gulf of Finland. For this they could use the remaining heavy artillery of the fortress of Peter the Great complemented with submarines and sea-mines. This weaponry was effective enough to form a mortal danger for any kind of warships.

As we know, after the Molotov-Ribbentrop pact of 1939 the Soviet government took to its hands military bases on both sides of the Gulf of Finland in the year 1940. In fact this strategic position proved to be of little use, when the German attack reached Estonia and when Finland joined the war on German side in 1941. Hanko, which had been taken from Finland at the tremendous cost of the Winter War, proved quite useless for the defense of St. Petersburg and the Soviets also had to evacuate Tallinn by sea, which cost terrible losses in terms of ships and human lives. During most of WWII, the Soviet fleet was closed into the pit of the Gulf of Finland.

After WWII the position of the Soviet Union on the Baltic Sea was so dominating that, from its point of view, it was quite logical to call it "the sea of peace". Even after the return of the Porkkala naval base back to Finland in 1955, the Soviet hold of the Baltic Sea was firm, with the entire eastern coast in its hands.

After the collapse of the Soviet Union the situation has changed. Only a narrow corridor in the middle of the Gulf of Finland is now international territory, where Russian vessels and airplanes are free to operate. The Kaliningrad oblast in the south is a Russian exclave surrounded by foreign countries, which belong to the NATO.

In our days, fears concerning the security of Saint Petersburg against a naval invasion through the Gulf of Finland would make little sense. On the other hand, the Baltic Sea now is an even more important economic artery than it used to be when Russia was almost autarchic. Russia has nowadays very little even of economic maneuvering space in the Baltic Sea. This concerns especially its vitally important products, oil and gas. The Gulf of Finland is now almost totally in the hands of respectively Estonia and Finland and if both these countries would like to make trouble for the construction of the Nord stream pipeline, for instance, their joint effort could seriously threaten Russia's vital interests. So far, Finland seems to prefer avoiding confrontation with Russia in this question, while Estonia has adopted more negative attitude.

Mastery of the Gulf of Finland has been a high priority to Russia for centuries and this can not be expected to change in the foreseeable future. The shallow waters of the Baltic Sea may once again turn into a field of struggle, where vital national interests are concerned.

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The post-western world – implications for Russia and the West

By Andrei P. Tsygankov

The second half of 2008 has revealed that the world is entering a principally new stage of development. While the global economic crisis has severely undermined the West-centered model of global economic expansion, the Russia-Georgia war ended the West's monopoly for unilateral use of force previously demonstrated by NATO's military attacks on Yugoslavia and the United States' invasion of Iraq. That Russia choose to use force in the Caucasus in defiance of the West implies de-centralization of hard power usage and promises serious difficulties for Western nations with continuous expansion of NATO's geopolitical responsibilities at the expense of political arrangements, such as Shanghai Cooperation Organization and Collective Security Treaty Organization.

It is becoming clear that attempts to dominate others by using tools of military and economic coercion are going to be increasingly de-centralized and undertaken without consultation with Western nations. Observers are increasingly aware that the West-centered world is beginning to unravel. Structurally, it is still the familiar world of American primacy with the Western – especially American – military predominance and the West's global superiority in political, economic and cultural dimensions. But dynamically the world is moving away from its West-centeredness even though the exact direction and result of the identified trajectory remains unclear.

At this point in history, Russians need to develop a coherent response to changing structural conditions of the international system. In the post-Western world, Russia's development will continue to be complicated by the expansion of Western military infrastructure and the rise of China. The latter will increasingly present Russia with the challenge of progressive power differentials. As Russia continues to supply China with energy and weapons, and as China grows at a considerably higher rate than its northern neighbor, the risk of Moscow becoming a junior partner in a Beijing-led coalition increases. Although the two's relations are good, there are signs of China's increasing assertiveness. They may include Russia's unwillingness to press environmental claims against its neighbor when it polluted the Amur River, the recently demarcated borders with several territories going to China, and Beijing's efforts to negotiate energy supplies below market prices. Finally, there is a challenge of oil markets, as Russia remains dependent on their stability for its continued modernization.

In response to challenges presented by the post-Western world, Russia should seek to devise collective security and collective prosperity systems across the world, rather than to merely normalize relations with the West. The international legitimacy of such a strategy may be accomplished, in part, by participation in multilateral arrangements. As a member of several important organizations, Russia may take full advantage of being an international participant. In a post-Western world, security alliances increasingly lose their traditional significance, making it imperative to rely on soft balancing tactics. Issue-specific international engagement is a way to make such tactics more effective, and Russia ought to become more active in regional institution-building. For example, unable on its own to effectively respond to security challenges

from NATO, Russia should continue to develop soft balancing coalitions with selected European countries, China and Iran. However, Russia should also continue to build ties with European Union, United States, India, South Korea and Japan as soft balancing tactics to address the issue of rising China. Similar flexible engagements may be relevant for addressing issues of weapons proliferation, terrorism, energy and drug trafficking.

Arrival of the new post-Western world also has important implications for the United States and European nations. Rather than trying to secure the 21st century as another American or Western century, Washington and Brussels will do well to acknowledge the irreversible – albeit gradual – nature of Western decline and prepare for an honorable retreat from the position of global hegemony. In application to relations with Russia, the latter attitude means the need to act in concert and consultation with the Kremlin, rather than out of expectation of it being helpful in executing the West's grand plans. Although many in the United States and Europe are skeptical of a serious improvement in relations with Russia, their interests are compatible not just in fighting terrorism and arms control, but also in areas of historical perceptions, energy relations and political development.

If the Western nations continue to act on unilateral and imperial temptations, new challenges will inevitably arise, as the George W. Bush's era has demonstrated all too well. In this case, the non-Western nations beginning with Russia will act in defiance by unilaterally asserting what they see as their strategic and economic interests. In the absence of sufficiently strong international institutions, such interaction is likely to result in new conflicts across the world. On the other hand, the post-Western world promises new opportunities to those who are willing and able to seize them. A gradual retreat of the West does not have to be accompanied by growing destabilization across the globe, but instead may create an international environment for reducing arsenals of deadly weapons, devising more socially egalitarian and politically responsive institutions, and developing greater cultural sensitivity in the world. The still predominant West would then need to lead by example showing the way not to the new "Western century" but to a controlled disarmament, a new economic order, assistance with regional political institutions, and initiation of innovative cross-cultural learning programs across the world.

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Green valley on top of Europe – new and strong initiative can boost energy co-operation in the Baltic Sea Region

By Hans Brask

- The Baltic Sea Region (BSR) benefits both economically and environmentally from closer co-operation in energy planning. This has been substantiated by an analysis of countries' energy systems, building on hard data and transparent analytical instruments.
- A shared regional energy agenda is not easily set and the benefits are not easily exploited. Most stakeholders in the region share, however, the same objectives regarding reduction of Green House Gasses, increase of renewable energies and energy efficiency and the promotion of green tech solutions.
- The EU and the European Commission provide new vitality to the regional energy co-operation. Nordic Council of Ministers is also helping in setting higher ambitions. But regional actors need to exploit the new possibilities.

These are the three main conclusions that Baltic Development Forum presented at the opening of the energy seminar *Creating a "Green Valley" of Europe - Different Scenarios*. The seminar was held in connection with the meeting of Foreign Ministers of the Baltic Sea Region, 4 June in Elsinore.

The conclusions are based on the energy project that Baltic Development Forum has advanced during the last 18 months. The project has two objectives: 1) to promote a common energy agenda for the BSR through the involvement of all relevant stakeholders 2) to provide a solid basis for discussions on how to fulfil the EU's new energy targets through collective action and better use of the region's many energy resources/energy-mix. The final report of the study *Enhanced Regional Energy Co-operation in the Baltic Sea Region*¹ will be ready by the end of the year but the preliminary results are available in June 2009.

As regards the first objective, the conclusion is that the involvement of various stakeholders on different levels does contribute to a better and shared understanding of the benefits from a more integrated energy co-operation. So far a Joint Energy and Climate Platform² for BSR organizations has successfully been created, giving full support to the project. Now it seems necessary to go further by establishing an energy stakeholder forum that includes also ministers and representatives of the private sector. Combating climate change is a hugely complex exercise that requires the involvement of actors both cross-level and cross-sector. Baltic Development Forum proposed that such an energy forum was organized at the

last ministerial meeting of Baltic Sea Region Energy Co-operation (BASREC) in February. It was favourably received by the chair.

But unfortunately, the BASREC ministerial meeting did not produce results that will help bringing new vitality to the regional energy co-operation. New initiatives will mainly have to come from the EU and Brussels – not from the regional organisations. The Commission's recent proposals for a European Energy Programme for Recovery, a Baltic Interconnection Plan and an EU Strategy for the Baltic Sea Region are promising policy frameworks that can create stronger regional energy co-operation and investments in an energy infrastructure development. It will also help making better use of the many energy competences that this region possesses.

The EU Strategy suggests establishing a list of priority projects in the framework of the Baltic Energy Market Interconnection Plan. If this is done successfully, the BSR will become a larger and more efficiently working energy market. It is very encouraging and such projects will surely advance positive effects from regional integration.

Today, the BSR has also a very strong position on environmental technologies, accounting for more than 10% of patents filed in the US and Japan in renewable energies. In other areas, the position is also strong. In 2008, an International Cluster Mapping Project identified that the BSR has drastically improved its global market share in the area of power and power generated equipment.³ The BSR has a chance to position itself further as an interesting place for investors and traders. It will require, however, agreement on an overall vision that all stakeholders can relate to. Baltic Development Forum proposes that the vision should be to create *A Green Valley of Europe* in order to mobilize the strong traditions in the region for public-private co-operation. The former Danish Prime Minister presented this vision for the first time at Baltic Development Forum's Summit 1-2 December 2008 in Copenhagen-Malmö.

In 2009, global attention is firmly directed towards the BSR due to the UN Climate Summit in Copenhagen in December and the Swedish EU Presidency. These high-level events are unique opportunities for the countries in the region to brand themselves individually. Therefore, it has been rather difficult to advance regional approaches to branding. It has simply been too tempting to choose national branding strategies. Maybe it will be easier to work together on a regional level in 2010 when the global attention is moving away. The Nordic Prime Ministers have decided to set a common and ambitious energy and climate agenda for the Nordic co-operation. It could be a very useful tool for advancing the wider co-operation in the BSR, involving also the three big countries – Germany, Poland and Russia. Individually, each of the countries and the markets of the Region are too small to penetrate globally, therefore a common approach seems obvious.

Finally, the stakeholder process has revealed a need for common training programmes in order improve a better understanding of the potential benefits from regional collaboration in energy planning. A regional energy agenda

¹ The energy project is mainly supported financially by Nordic Council of Ministers and the analysis is carried out by Ea Energy Analysis. The report and results can be found at www.bdforum.org

² Joint Platform on Energy and Climate consists of the Union of Baltic Sea States (UBC), Baltic Sea States Sub-regional Co-operation (BSSSC), Baltic Sea Parliamentary Conference (BSPC), Nordic Council and Baltic Development Forum. One objective of the platform is to improve co-ordination of the different activities in the energy field and promote a shared agenda.

³ See Baltic Development Forum's State of the Region Report 2008, Sustaining growth at the Top of Europe

is not only politically defined. It is also defined by national energy experts and by local and national traditions. Therefore, common training exercises can provoke out-of-the-box thinking and help to see new opportunities. Such programmes should also aim at developing the exchange of experiences and best practices among officials at local and national level.

As regard the second objective of the project, interesting conclusions can – so far – be drawn from the study, demonstrating clear benefits from regional energy co-operation. Some of them deserve particular attention:

First of all, BSR possesses many different renewable energy resources that are sufficient to achieve a regional target of at least 50 % CO₂ reduction in year 2030 compared to 1990.

Secondly, there are significant economic effects and benefits through a stronger co-ordination of the energy policies across the region. The countries are simply better off, if they decide to work together. Energy diversification and security of energy supply would increase in parallel.

Thirdly, there is a huge potential for cost-efficient energy savings and energy efficiency measures by end-users (private household and business) and at power generation facilities. A lot of “low-hanging fruits” are waiting to be picked.

The study also shows that an increase in the use of combined heat and power generation and the reduction of electric heating will lead to very substantial reductions in primary energy consumption and CO₂ emissions.

It confirms furthermore that there are many benefits from building new transmission grids for electricity in the Region. In particular, the benefits exist in linking the

thermal power based systems in Poland and Germany and the Nordic power system dominated by hydro power. Similarly, there are attractive benefits from strengthening the electricity connections between the Baltic countries and the Nordic countries.

Finally, integrated off-shore wind grids could serve a twofold purpose: connecting the wind farms to the transmission grid at shore as well as linking the electricity markets in the region closer together.

The off-shore windmill park at Kriegers Flak – a relatively shallow-water area in the Baltic Sea – could be a very strong pilot project for other integrated offshore grids. The region needs such demonstration facilities as showcases for comprehensive and sustainable energy systems.

The final result of the energy project will be presented at the end of the year. Baltic Development Forum Summit in Stockholm 5-6 October will further promote a common regional energy agenda and present the advantages of joint initiatives.

Hans Brask

Director

Baltic Development Forum

Denmark

The Baltic University – a network for sustainable development

By Lars-Christer Lundin

Started in a different world

The Baltic University Programme (BUP) started in 1991, when the Baltic Sea was still a barrier between the people of the Baltic. The end of the Cold War era created new possibilities for international cooperation and the interest from the universities around the Baltic Sea was large. Already during the first year 70 universities joined the network. Initially, the common ground was environmental issues, whereas democracy and human rights were off limits. The first common undertaking was thus a course on the Baltic Sea environment, attracting some 3,600 students in ten nations. The growing trust and the rapid political developments made it possible to give a course on history, democracy and security, called Peoples of the Baltic, already in 1992. Sustainability was introduced as a concept in 1997 and in 1999 the first master level course, on sustainable water management, was run. During the early days, satellite TV broadcasts were the means of connecting the students and teachers in the region, followed more and more by the Internet. In 2003 the first e-learning course was given. Today the almost 70,000 students (presently some 10,000 per year) from the 220 member universities that have been fostered and educated in sustainable development issues make BUP one of the largest networks of its kind in the world.

A regional network

The aim of universities is to develop the societies they serve. BUP promotes development in the Baltic Sea region. The region is delimited by the water divide of the Baltic Sea, a rather novel concept at the time, gathering all nations that contribute rainwater to the Baltic Sea. Later, the EU Water Framework Directive's focus on catchments and water divides made the choice of delimitation even more rational. The region thus includes Sweden, Finland, Russia (Northwest), Estonia, Latvia, Lithuania, Belarus, Poland, Ukraine, Czech Republic, Slovakia, Germany, Denmark and Norway. Already from the start, the region was an open region, incorporating teachers and scientists also from the US, the Netherlands and other countries.

The main activity of BUP is the production of undergraduate and master courses and course material on various aspects of sustainable development but research related activities, capacity building, in cooperation with industry, authorities, NGOs and public outreach are also on the agenda.

Courses and course formats

The main outcome of the network activities are the so called higher education course formats, the term format being borrowed from the media world. A course format consists of course material (textbooks, teacher's guide, films, examination coordination, course homepage, etc), a model curriculum, regular teacher training, and course coordination. Each format is promoted by a mentor, an experienced teacher. Any member university can thus with minimal effort start a local course and get support to the teacher responsible for it. The Baltic University Press offers more than 40 titles and has made some 40 video productions, most of them in support of some of the course formats. Currently there are eight course formats available: Area Studies, Education for Change, Environmental Management, Environmental Science, Sustainable Community Development, Sustainable Development, Sustainable Water Management and Education for Change.

The principle is that courses are run at the member universities and coordinated by the secretariat, organizing common videoconferences or some other cooperative activity. Typically some 250-300 courses are run every year, involving some 350 teachers.

Organization and funding

BUP originated as an initiative from Uppsala University and was for its first 15 years run by its originator Prof. Lars Rydén. Activities were very much centred on the secretariat in Uppsala although regional centres were formed already in 1994. Today the secretariat, headed by Christine Jakobsson, is a part of the Centre

for Sustainable Development Uppsala (CSDU) and is an integrated part of the sustainability work at Uppsala University. Members of the network were initially loosely tied but are now signing bilateral agreements with Uppsala University, still being the network host. The network is headed by an international board, with representation from the member universities. The biannual student's conferences gather students from the courses, elect student board members, and treat some topic in the form of an intensive course.

Financial support has been given mainly from the Swedish Institute and Sida. Regular base support has been given by Uppsala University and since 2001 also directly by the Swedish Government. Together with other project support the total turnover is close to €1million. In addition to this, member universities contribute, mainly with personal resources, and some of the regional centres are sponsored nationally, e.g., the Finnish centre that has received direct grants from the Finnish Government.

Networks for sustainable development

The concept of networking is as such highly relevant today. Networking enables rapid responses to a changing world, quick exchange of experiences and ideas and gives a social or societal context to its members. BUP is a regional network, with a common unique intra continental sea in focus. The main asset of the network is its teachers and its students. History and culture differ but relations of the people go back to the Viking age. Today the Baltic region is under influence of globalization and the perhaps most unique feature of BUP is the network itself. Presently the network concept is being discussed in the Lake Victoria region, in the eastern Mediterranean region, and in the Great Lakes region in US and Canada, where the BUP serves as a model and mentor network. I believe there is a mission for similar networks in other regions of the world, either centred on a clear hub, supervising the satellites, or peer-to-peer networks, working with different aspects of sustainable development. It could involve universities and education for sustainable development or authorities for sustainable management.

Future prospects

The future for the Baltic Sea region looks bright today despite the present economical recession. It is an open region, most countries being EU Member States. The agenda of sustainable development will last for years to come but the possible avenues to pursue it will increase, giving more competition to networks like the BUP. I thus believe that the agenda must be both elaborated and extended. One interesting aspect is the network concept itself, aiming at a network of regional networks, together addressing global aspects of sustainable development, perhaps in combination with developing local networks; universities working together with local authorities, municipalities, schools, and industry to address local sustainable development.

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Times are also hard for Russia forecasters

By Jouko Rautava

Forecasting economic crisis is known and proven to be an unforgiving task. According to a study on the accuracy of forecasts with an emphasis on so-called consensus estimates, out of the 26 crises experienced in industrial countries and major emerging economies over the past few decades, only two were successfully forecast a year in advance. Furthermore, forecasters are particularly cautious in changing their view of the economic situation, and in many cases, a crisis is not detected until it is upon us. The present crisis has again shown that the accuracy of growth estimates is at its weakest when one needs them the most. Forecasts on Russia are no exception.

All forecasts revised sharply downwards

As recently as last October, the International Monetary Fund (IMF) forecast slight growth in the euro area and the United States for 2009, but following repeated revisions, its April forecasts are now deep in negative territory. For Russia, the change of view has been even more pronounced – expectations of a 6% growth in October had turned to a decline of 6% by April. Private sector forecasters have not succeeded any better. The consensus estimate for 2009 in October predicted 5% growth in Russia, while in April it stood at a decline of 3%. Subsequently, many forecasters have revised their estimates further on the clearly more negative side.

The variation in forecasts on Russia is considerable. Although Russian total output sank in the first quarter over 9%, the most optimistic pundits expect a rapid economic turnaround and believe GDP growth in the last quarter of 2009 will reach the levels of the end of 2008. According to the gloomiest current forecasts, output will sink by 8% this year. Both extreme ends of forecasts are found among Russian forecasting agencies. Although the extreme ends of the various forecasts are disparate, the majority of forecast agencies presently believe the Russian economy will contract by 3–5% in 2009, while almost all of them believe the Russian economy will grow in 2010.

Oil price assumption does not explain differences in forecasts

A majority of forecasts published on Russia are based on simple deduction and very rough calculations. Few institutions publish all main components of aggregate demand, and in some cases the forecasts are clearly internally inconsistent. Although the comparison of forecasts is somewhat difficult, they do show unmistakable common characteristics. Views concerning the government's fiscal policy in terms of the budget deficit are relatively consistent, as a majority of the forecasts are based on the government's budget deficit target of about 7–8%. Also with respect to the current account, the views are similar as most expect the current account to stay slightly in the surplus in 2009. At the end of the year, inflation is commonly expected to remain in the 10–15% range and the exchange rate at 34–36 roubles per dollar.

It is interesting that the oil price assumption in the most recent forecasts on Russia ranges from USD 40 to 55 per barrel, but expectations of oil price developments only explain differences in GDP growth estimates weakly. The slowest economic growth is forecasted at an oil price of

USD 40 per barrel, but even the most optimistic forecast is based on a price of only USD 45.

The differences in forecasts on Russian GDP highlight how the crisis is expected to be reflected in different demand components. In these calculations, private consumption has the highest weight, since its proportion of total demand is two thirds, with investments accounting to about a quarter. Differences in views about the development of private consumption and investments are also reflected on import forecasts, according to which import volume will decrease 13–33% this year. In contrast, the volume of commodity-based exports is believed to contract relatively slightly.

Often more interesting than the forecast figures are the risks seen in the developments. Even up to the past few months, forecasters have emphasised that the risks lie on the downside, which has also materialised in forecasts revisions in May. Deterioration of the international situation and the related potential decrease in prices of energy and commodities are at the top of the list of uncertainties. Observers of the Russian economy also emphasise that consumption has only recently began to react to the decline of income and employment, which means that the situation may still be heading downhill. The potential weakening of the overall situation would in turn lead to an increase in banks' non-performing loans, undermining economic recovery. Although views on inflation and exchange rate developments are reasonably consistent, published forecasts also include views of inflation reaching a level close to 20%, leading to a devaluation of the rouble, in breach of the limits set by the central bank.

Despite their deficiencies, forecasts help decision making

Differences in the forecasts on Russia show that there is competition in the field which is beneficial for users. However, considering the deficiencies of forecast methodologies and uncertainties of the situation, it is certain that the publication of forecasts to the tenths of a per cent is futile. Considering the high variations in Russian growth rates one may doubt whether even differences of a couple of per cent in forecasts would have any practical significance to the users of the forecasts.

Not all forecasts can be right but they can all be wrong. Every agent will nevertheless seek to form a view of the future, one way or another. The advantage of traditional forecasts is that they force one to think about the possibilities and risks as well as policy coordination in some consistent manner. If business and policies are based on rumours, this undermines the stability and predictability which are particularly needed in crisis situations.

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Russia's crisis budget

By Philip Hanson

Russia's public finances are stronger than those of most countries, but the rate of deterioration recently has been striking. The Russian government has had to make dramatic revisions to its budgetary plans for this year. Those revisions, made in February-March 2009, may not be the last such changes that have to be made. In late April it emerged that the Ministry of Finance (MinFin) was considering some new sovereign borrowing, both domestic and foreign.

The political leadership was late in grasping that Russia would be hit by the global crisis. The federal budget for 2009 was put into law on optimistic assumptions as late as November 2008. There would be yet another budget surplus, based on high oil prices and continuing Russian GDP growth. But the budget was already under pressure. The Urals oil price, reckoned as a monthly average, had already peaked at \$130.8/barrel in July and fell to a low of \$38.1/barrel in December. MinFin's Economic Expert Group has estimated that oil and gas revenues to the federal budget were running at 12% of GDP in July 2008 but had fallen to 7% of GDP by December.

The fall in oil prices was not the only bad news for Russia, but it ranks high in a list of adverse events. There was also a flight of investors from emerging markets in general; a slowdown in Russian industry after mid-2007, turning into a slump in fourth-quarter 2008; and early signs of difficult domestic credit conditions from late 2007. But the oil price was a big part of the story. The expected budgetary loss from falling commodity prices in 2009, according to the IMF's Fiscal Affairs Department, would be far higher in Saudi Arabia (26.8% of GDP, against 6.4% projected for Russia), but Russia's prospects are now judged in most forecasts to be a good deal worse than those of the Saudis. This is partly because the Russian economy is more open than the Saudi economy.

This year's federal budget, at all events, had to be drastically revised. The government cut its GDP forecast for 2009 to a fall: -2.2% year on year. Recently the Ministry of Economic Development has revised this down again, to a range of -6 to -7.4%. For the moment, however, the federal budget is based on the 2.2% projected decline in GDP, an average Urals oil price over the year of \$41/barrel and an average exchange rate of Roubles 35.1 to the US dollar.

In the revised federal budget, compared with the outcome for 2008, total revenue goes from 22.3% of GDP to 16.6% of a slightly smaller real GDP. Of these revenues, oil and gas taxation is planned to provide the equivalent of 5.1% of GDP, against 10.5% last year. In contrast, expenditure is now supposed to increase to 24.0% of GDP, compared with 18.2% in 2008. This produces the projected change from a surplus equal to 4.1% of GDP to a deficit of 7.4%. That is a bigger fiscal turnaround than is anticipated in most countries.

Russia's policymakers have opted for a substantial assistance package, by global standards. It is hard to make a firm distinction between that part of a fiscal stimulus that arises semi-automatically from the effect of a recession in squeezing revenues and pushing up social-spending obligations (more recipients of unemployment benefits and the like) and that part which can be classified as discretionary. MinFin has cut previously-planned spending, including on defence and security, by R943 billion (2.3% of GDP) and increased planned spending

under other headings by R1611bn (4.0% of GDP). The identifiable spending increases designed as assistance to banks, other businesses and social support come to 3.0% of GDP. That is a discretionary spending package that is higher than the equivalent figures for most other countries.

The budget deficit this year should, if all goes according to plan, be covered by running down the Reserve Fund (\$121bn at 1 April 2009) by about half. Propping up the budget when the oil price falls is precisely what the Reserve Fund was designed for. But Finance Minister Aleksei Kudrin is a far more serious devotee of fiscal prudence than Gordon Brown ever was in the UK; he plainly fears things could go worse than plan; and in any case he does not want to see the Reserve Fund run down fast, because of the effect on confidence. Therefore he has spoken of plans to borrow a modest amount abroad in 2010 and further modest amounts domestically in 2009-11: \$5bn of sovereign foreign borrowing and a total of domestic borrowing provisionally equivalent to around \$46bn over three years.

If all this borrowing were to happen, Russia would still be a strikingly under-borrowed country. Its sovereign foreign debt is now below 3% of GDP and domestic sovereign debt is about 3.5% of GDP. If we omit the very provisional sum mooted for 2011, the new lending would bring total state debt, domestic and external, to a little over 10% of projected 2009 GDP: barely visible by the standards of most modern states.

Commentators have drawn attention to the rapid rise in foreign borrowing by Russian banks and companies. It is certainly the case that many Russian oil, gas and metals companies have borrowed abroad in foreign currencies and are now caught by falling revenues and the almost-two-fifths fall in the rouble against the dollar. Some of the assets, particularly foreign assets, acquired on credit have been relinquished to settle the loans and others are for sale on a falling market. But at the start of 2009 total Russian foreign debt, public and private, was only just over 40% of GDP. Eleven of that 40% was attributable to state-controlled companies (but not to the state in the strict sense). This looks manageable in aggregate, even if some big names lose quite badly.

Thus Russian macro-economic management under Kudrin continues to be highly cautious and conservative as the crisis hits. It may indeed be over-cautious. The puzzle is quite why the macro forecasts for Russia are almost all so dire. What if the rare, contrarian optimists like Evgenii Gavrilov of Troika Dialog turn out to be right after all? Perhaps then the Russian state could go on a spending spree, and even the Ministry of Finance would not be able to object.

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The history of the Baltic States – a minefield

By Anu Mai Kõll

It is exciting to be a historian of the Baltic Sea area. Here, history often stands at the centre of debates - in politics, rhetorically, in newspaper headlines and every-day discussions. There are even occasional street-fights over how to interpret history.

History never stands still. Today's concerns always determine the relative relevance of historical themes. Among post-89 Baltic states, centre stage is held by World War II. The first task has been to rediscover parts of the past. Of this, the Molotov-Ribbentrop Pact is probably the best example, but so are the (somewhat idealised) stories of the so-called forest brother's resistance to the Soviet take-over. Here, also, one finds history-writing on Soviet repression. It was begun in the 1960s, during the thaw that followed Stalin's death; unhindered access to historical sources allows its fulfilment.

The Baltic States EU accession has entailed new historical confrontations. West Europeans did not share the image prevalent in the Soviet Block – that of being abandoned by the West, sacrificed in exchange for post-war peace. In Europe, and not least in Sweden, there was a discourse on Nazism and the Holocaust, pointing out that much of the latter had occurred in East Europe. Confront your own history, they exhorted East Europeans. Competing images of victimisation were thus established.

The Baltic States are a rich source for those studying the increasingly popular topic of "the public use of history". Many pages have been written on the attempt to raise a statue to Baltic members of the Waffen-SS, to be celebrated as warriors for Europe's freedom. Still more attention was given the fight over Tallinn's Bronze Soldier. This struggle over symbols has deep roots in the Baltic resistance movement, part of which consisted of a militant home-history movement which uncovered and re-established memorials to the independent republics of the inter-war period.

One of the first steps taken by the post-89 Baltic States was to abolish Soviet history textbooks and start work on replacements. Many of the textbooks I have seen are based on professional historical work. They are factually accurate - certainly more so than the textbooks they replace. It is, however, evident that their first purpose is to promote identity-creation. Their national stories do not allow for much critical analysis. The space allotted women is infinitesimal. The account of the national movement overshadows other social movements. The stories of minorities are glossed over, as if ethnic contradictions were non-existent; and so on.

The Baltic States have established History Commissions, whose task it is to identify and investigate crimes against humanity that took place during World War II. They are not meant to interpret history, but to answer legal questions on crimes against international law and norms. In the process, however, the Commissions work through and illuminate a good deal of unexamined archival material, quantifying and defining. Although not their ostensible purpose, their wide-ranging and useful work will certainly contribute new historical interpretations.

Elsewhere, commissions are working more directly on "conflicting history-writing". The model for this was elaborated after World War II, when French and German historians were asked to help uproot myths on the causes of the war and to harmonise the two countries' history-writing. One could describe the result as negotiated history. Today, comparable work is being done on the ethnic cleansing of the Polish-German borders. In Transylvania, Hungarian and Rumanian historians are collaborating on a similar basis, with similar goals. "Is there no such collaboration between Russians and Estonians, Latvians and Lithuanians?" I am asked with surprise. There is no pressure to do so from the European Union - which, one is compelled to admit, was the precondition for existing collaborative efforts.

But is it possible, or even desirable, to write completely impartial history, one which tells the same story to Latvians and Russians, Hungarians and Rumanians? Professional historians often encounter histories which methodically present only one side or perspective, in order to make a moral or exculpating point. The interesting thing, here, is the search for what has been excluded. Where are the Nazis in the Estonian version of the battles over Tallinn's Bronze Soldier? Where are the Baltic peoples and their rights in the Russian narratives of the Great Patriotic War? What place do the Jews have in the stories of the repression of Ukraine and Lithuania?

The antidote to one-sided history cannot be history which includes absolutely everything – a map exactly as large as the territory represented. Rather, its opposite is to focus on the historical issues which cause contention. One must acknowledge the existence of different perspectives, approach the conflict from both sides and test different versions critically. Only then can history become a tool for analysis rather than for struggles. But we should not be too sanguine in hoping that this approach will solve the real contradictions which first led to the use of historical interpretations as weapons.

Europe's history should, probably, be as multi-vocal as Europe itself. Up to now, the history of Central and East Europe has been sadly absent from Scandinavian school and university education. Until the eighteenth century, Europe was a whole. Thereafter, it is as if the earth's tilt altered, hiding the eastern side from view. This should be changed by us.

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Look back – and learn

By Aarno Kotilainen

Nowadays we use a lot of time and effort on planning the future, trying to think of what we should do to get the best possible results. However, quite often it is useful to look back. Who knows - we might learn something.

You can look back at your personal life and try to figure out what you did right or wrong, like in raising kids. This is a current issue in many homes at this time when kids finish their schools and come back with their school reports. Also sportsmen/-women look back when analyzing their success or failure in big events. It is important to look back in history so that mistakes done earlier would never repeat themselves again, like in politics. Or you can look far back in time, into geological history, trying to understand past changes in the Earth's environmental history.

There is no doubt that humans have affected the Baltic Sea and its environment in several ways during the past years and decades, or even longer, for centuries. And the list is long; we have enhanced eutrophication, increased chemical pollution, and we have even provided better possibilities for alien species to enter the Baltic Sea basin. More alarmingly, the present climate change, that is partly human induced, will probably increase sea surface temperatures and winter precipitation, as well as decrease the length of the ice season in the Baltic Sea. In this way, human influence on the Baltic Sea is greater than ever. These changes affect hydrography and biogeochemical processes in the Baltic Sea, and thus the whole Baltic Sea ecosystem.

Warmer climate conditions are not a totally new thing in the Baltic Sea region. The history of this sea is geologically very short – the Baltic Sea has developed into its present state during and after the latest deglaciation in the past 16 000 years. During warmer phases, the Baltic Sea has experienced environmentally deteriorated times. We can see that in geological records, in the Baltic Sea sediment archives, which provide information on past environmental changes. For example a carefully selected 10 meter long sediment core from the Gotland Deep, one of the deepest basins in the Baltic Sea, provides almost continuous information from the whole Baltic Sea history. All changes are recorded in those archives, older freshwater or more saline water phases, or even the Chernobyl nuclear power plant accident that can be seen in the surface part of sediment core. The long sediment cores from the seafloor of the Baltic Sea indicate that environmental problems like eutrophication together with intense algal blooms and anoxic seafloor conditions have occurred also earlier, but at that time naturally with very little if any anthropogenic loading.

Around 1 000 years ago, during a climate phase called the Medieval Warm Period, the climate in the Baltic Sea region was a few Celsius degrees warmer than today. The sea level might also have been slightly higher. During those days the Vikings were sailing through the seas, to Greenland, to North America, and around Europe - also in the Baltic Sea. It is most probable that those brave seamen did see thick algal blooms on the sea surface and were wondering about it, as their beautifully carved wooden ships left trails on the greenish water. They did not know what that strange green slimy stuff was, or even less, why it occurred there.

Today, when we are sailing through the same waters, or having sauna by the sea, we can also experience that

similar unpleasant phenomena, intense algal blooms. But what makes the difference between us and those earlier Baltic inhabitants? We do know what that phenomenon is, and at least partly know the reasons for them. For the first time in the history of mankind, we know what we should do to improve the state of the environment.

Efforts towards a better Baltic Sea have been made for decades. Waste water treatment has improved and nutrient loadings have decreased efficiently. Also safety of marine traffic has enhanced dramatically. HELCOM and other policy tools and instruments have guided us towards a better future of the seas. However, we have not finished our mission yet.

Coastal and marine activities have increased worldwide, thus pressure to use marine resources are today higher than ever. This is valid also for the Baltic Sea. In addition, lessons from the past indicate that present climate warming does not necessarily provide a better forecast for the future development of the Baltic Sea. It is evident that environmental problems, like anoxic periods at the seafloor, have occurred in the past too. However, together with increased human activities, anthropogenic loading and climate change, the effect on the Baltic Sea ecosystem is greater than ever. That is the reason why we need to continue our work towards a healthier Baltic Sea. The already taken measures are not enough. The heat – and pressure – is on.

That work needs cooperation on different levels. Practical actions include reducing the nutrient loads from agriculture and a total ban on sewage discharges from ships sailing in the Baltic Sea. Beside actions, we also need to deepen our scientific knowledge on e.g. what are the mechanisms behind environmental changes in the Baltic Sea. We also lack marine (abiotic and biotic) data, or if it exists, it is too difficult to get. That knowledge and information will provide basis for improved management and implementation of policy strategies regarding the Baltic Sea environmental issues. But we are on a good track: the new EU instruments such as the Marine Strategy and the new programmes like BONUS - The Joint Baltic Sea Research Programme - are tools that enable us to produce required information for a better and sustainable use of the seas.

We need to act wisely so that people of the future would say that it was us, the people of the 21st century, who were the first to know what to do. And that we did it. We did save the Baltic Sea for the future generations.

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Policy platforms for regionalizing EU-Russia energy relations

By Pami Aalto

When speaking of the present realities and future prospects of EU-Russia relations, we often end up stressing the role of energy issues simultaneously as a source of conflict and the glue of the whole relationship. This is because EU member states are so divided over the issue, in a situation where there are not many driving forces in sight that could easily bring them onto the same page.

Some EU member states have a solid and mutually positively viewed energy relationship with Russia. In the very minimum, these member states seek to maintain the present volumes of imports from Russia whilst they also have to think of what sort of a package of political and economic measures might best ensure that (e.g. Germany, Finland, Italy, France). Some import all of their natural gas from Russia, making it account for up to one third of their total primary energy consumption, on top of importing substantial amounts of oil from Russia. These states increasingly view the imports as leading to too high vulnerability and look for alternatives without much hope of a rapid turnaround (e.g. Poland, the Baltic states, the Czech Republic). Some are drifting into more intense energy relations with Russia (e.g. the Netherlands, UK). Some are unlikely to ever import much from Russia. They are hence largely disinterested bystanders in what by now are regular disagreements over gas supplies in the relations between the EU, Russia and Ukraine (e.g. Spain, Portugal).

The combination of the divisions on the EU side, and the highly differentiated bilateral energy relations that Russia is building with its customers in the north, east and south of the EU area, will most likely mean that the relations are becoming more regionalized. Transit of natural gas and oil is shifting towards the northern and southern routes in the Baltic Sea, Barents Sea, Black Sea and the wider Balkans at the expense of the east and central European pipelines. The latter are either ageing and operating at below full capacity, or in the short to medium term unlikely to attract much further investment as a result of political differences in sectors other than energy and for reasons of transit avoidance. This more regionalized landscape may lead to coalition-building on the EU side and is likely in any case to represent a better option than the current combination of Russian unilateralism and European bilateralism.

In these conditions we need to determine what policy platforms there are that can bring a substantial number of EU member states into the same table with Russia so as to reduce the problem of the commons in EU-Russia energy relations. Such policy platforms should be defined by sufficiently strong common interests and relatively few political controversies that today are increasingly related to energy when it is perceived as a 'high politics' issue.

First, *market access* represents a policy area where several economic actors on both sides call for policy measures in an era where economic nationalism is raising its head. In fact, we need to think much less in terms of economic interests on 'our' and 'their' side than we conventionally do. The practical operators in energy policy are companies and international financial institutions. Many of them are stock market listed companies and hence part owned by private investors and funds on both sides; or they are otherwise cross-owned. This applies to Lukoil, Rosneft and Gazprom just as it does to E.ON Ruhrgas and the Finnish natural gas distributor Gasum.

Another shift required in thinking is to acknowledge the marriage between states, companies and markets across the wider European area. This is as normal for Russia as it is to Norway. The needed big investments; research, development and education; and demand for regulation in this sector of policy often mean that energy companies and markets need government support and scrutiny. An increasing share of energy globally is becoming produced by state owned, part state owned or otherwise state bound companies. Governments, companies and market actors also need to work together due to the complexity involved in the building and maintenance of energy chains. Here technical, environmental and financial challenges are conjoined by the need to increase the knowledge base and build institutions and agreements augmenting the problems ensuing from energy chains transgressing state borders.

Improving market access hence means cross-investments and asset swaps among companies, and clear rules for how and where such arrangements can be made, in order to pile resources for financial and human capital intensive energy projects. The relations between German and Russian energy companies – involving swaps of gas field access for the German party to shares of companies operating in the consumer market for the Russian party – represent a good example. Allowing Gazprom's involvement in consumer sales gives it part of the profits in the downstream sector and makes it unwilling to lose those profits. In the very long term, European states and companies in particular need to think hard what is the added value they can offer to the Russian party compared to what Russia's Asian partners can offer.

Second, the question of added value brings us back to how mere energy relations – exchange of goods and raw materials for an agreed price – can be transformed into concrete policies of common benefit. Here technology transfers, joint knowledge production and education projects in the area of *energy efficiency, energy savings and renewable energy* can well hold the keys. These issues have climbed higher on Russia's energy policy agenda during the past decade. They are in fact set to become ever further highlighted due to the economic crisis, most likely rising energy prices in the medium to long term, and the need to reserve enough fossil fuels to export to generate profits supporting Russia's economy. Reducing the wasting of energy together with Russia's energy intensity are areas where there is a lot of room for progress without even needing to go for expensive high-tech measures.

Peat ranks high in Russia's energy strategy right after the conventional fossil fuels natural gas, oil and coal, and hydropower and nuclear power. Peat and wood burning can provide local sources of energy in non-fossil fuel producing regions and can simultaneously generate employment in impoverished remote areas of Russia. In this sector for example Finnish and Swedish actors can offer knowledge, finance and technology, and simultaneously make themselves more interesting energy customers to Russia. German and Danish actors have good experience in the construction and operation of large-scale windmill parks where the Russian party lacks expertise. Iceland utilises extensively geo-thermal energy and works on wave energy.

Third, creating a *pan-European electricity market* can help to overcome capacity problems, problems of grid strength and the black-outs that occasionally take place on both sides. Much like sustainable energy, this sector is not very politicized. Structural reforms for unbundling the generation, transmission and consumer sales sides of electricity chains are underway on both sides. The decent economic rationality, pooling of resources and adjustment of the differences in seasonal capacity that prevail in the Nordic electricity market can be replicated on a wider pan-European scale. That can add an element of positive interdependence. In a word, in conditions of more regionalized EU-Russia energy relations, there are many policy platforms where we can shift the debate beyond images of the Russian bear closing off the natural gas taps.

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State enterprises are still a problem for common markets

By Aki Koponen

Blinkered analysts have seen the current economic crisis as a failure of the free market economy. These kind of quick conclusions have also led to demands for more market regulation. While these demands have been vocal in political rhetorics, some recent reforms give hope that Finnish regulation develops to be more market friendly even in the near future. This article reviews some recent planned and also decided regulatory reforms in Finland.

On 28 May 2009 Council of State of Finland decided that all retail stores can be open on Sundays through the year. According to the new act, the small shops can mainly decide freely their opening hours while the big markets will be still under the old regulation with exception of Sundays.

The reform of opening hours regulation is not the only decision concerning economic freedom. Also the operations of state or municipality owned organizations, especially State Enterprises, have been seen problematic in competitive markets.

State enterprises drew attention to them starting a couple of years ago, when European Commission started to investigate the state aid to Tieliikelaitos (currently Destia Ltd), the successor to the national road service. The organization was set up as a State Enterprise, when Finland opened its road service market to competition. As a result of the investigation, the Commission requested the Finnish government to put an end to the certain privileges that Tieliikelaitos enjoyed. The main privileges were the non-application of normal bankruptcy and corporate income tax legislation. The absent risk of bankruptcy decreases the risk premiums of loans and gives competitive advantage over private companies finance acquisition.

In the Destia case the privileges were formally eliminated by organizational change from state enterprise to limited liability, albeit the state of Finland is the sole owner of the Destia. Even this case has been solved in a way satisfying the Commission, the problem is still topical in Finland. Previously mentioned privileges are still applicable for five state enterprises under the control of the state and for unclear number of organizations owned by municipalities.

In order to solve the of state enterprises there have been two working groups: one appointed by Ministry of Trade and Industry (MTI) had a special focus on municipalities and Ministry of Finance has led a working group focused on the state enterprises governed by the state.

Working groups have concluded along with the decision of the Commission that the state enterprise as an organizational form is not compatible with the common market. The state (or municipal) enterprise is an organizational form which can be used for operations

internal to public sector. Otherwise common corporate forms should be applied.

These conclusions are quite a good start as such, but organizational restructuring do not eliminate the market distortions created by state aid or more generally, by operations of public organizations in competitive market. As the working group of MTI has put it "differences in the conditions and baselines for engaging in business activity inevitably result in problems in terms of competition neutrality and the functionality of the markets".

There have been actually already some hints of market distortions besides the most obvious dominant position cases (e.g. Itella). In some cases required returns on investments are even lower than current ECB steering interest rates. This kind of behavior can be seen as a tax-funded economic subsidy affecting on the competitiveness of the private companies in the markets. Actually rivals of the Destia have very recently accused Destia for dumping prices.

The real problem is not therefore the organizational form, but the existence of publicly owned companies in free markets. And believe me or not, it is not so likely that municipality or state owned companies are let to go bankrupt – no matter of the organizational form.

Altogether, there is a visible silver lining around the dark cloud of the regulation in Finland – government really shows some interest on the free enterprise. But as a cynic, I see the cloud itself more clearly, made even darker by the lining. The danger of the reform is that state owned organization will continue to distort markets, but even in a more opaque manner as limited liability corporations.

Even this writing focused on Finnish case, the problem is universal. Along with the arising populist tendencies of protectionism such corporations will hinder the favorable development of European common markets. As a friend of free market economy, I hope that European Competition authorities including European Commission will be empowered and willing to intervene effectively on competition restrictions generated by publicly owned companies.

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