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# Stability, partnership, responsibility – Latvia's way out of the global financial crisis\*

By Solvita Āboltiņa

Latvia has been increasingly praised in the international arena as an example of how to successfully overcome the ordeals caused by the economic crisis. This experience undoubtedly makes us feel proud of ourselves to a certain extent. However, it is more important for us to understand why Latvia suffered so severely from the global economic crisis. Likewise, we must understand what enabled our country to brace itself, stand up and avert insolvency. Understanding both of the aforementioned aspects is of great importance for Latvia and Europe.

The short answer to the question why Latvia suffered so heavily from the economic crisis is this: we found ourselves in a deep crisis as a result of ignoring the basic laws of economics and following thoughtless politics. The key factors that have turned Latvia into a success story include persistent work, along with adherence to the principles of stability, partnership and responsibility while forming the state budget for 2011.

## Preserving Financial Stability

This is the second government led by Valdis Dombrovskis, whose primary objective is to lead Latvia out of its deep economic and financial crisis. In beginning this work two years ago, one of the most urgent tasks of the government was to provide financial stability. The results of the elections held in October 2010 – the victory of the political union Unity and the repeated nomination of Valdis Dombrovskis for the post of Prime Minister by the President of Latvia – show that Latvian people appreciate what has been achieved so far. And once again, we feel proud of ourselves, but we are well aware that the difficult path towards stabilisation is still ahead of us.

The state budget for 2011 that was drafted by the government and adopted by the parliament at the very end of the previous year represents a clear turning point towards economic growth of Latvia. The previous two state budgets can be regarded as crisis budgets, whereas this is a stabilisation budget. I am truly gratified by the fact that in spite of cutting the government's spending, we still have managed to allocate one-fourth of the state budget specifically for development.

Now it is important for Latvia to balance its revenues and expenditures in order to stop living on credit. Latvia's economic indicators continue to improve, and the economy stabilisation programme is being implemented. The GDP growth has improved, the deficit has to be cut by a smaller amount than forecast, and the basis for the 2011 budget is much better than expected. These indicators will probably have a positive impact on the state's credit rating, which might be raised in the following months. This success story is the direct result of the perseverance of the two governments led by Valdis Dombrovskis, which did its work, step by step, in spite of scoffing, criticism and opposition.

## Involvement of Social and Cooperation Partners

In the 21st century, a modern public administration is characterised by partnership. NGOs, trade unions, local governments, professional associations – all these partners are an integral and necessary element in the process of shaping politics at any stage of economic development be it in times of growth or crisis.

In Latvia's current economic situation, the state budget for 2011 can be characterised as a stabilisation budget that has been drafted as a result of in-depth and high-quality discussions. In the budget drafting stage, the government consulted a wide range of social and cooperation partners and reached several significant compromises. This partnership

continued in the parliament in the form of cooperation with the Speaker of the Saeima and with parliamentary committees.

Partnership should also characterise subsequent development processes. Now that the 2011 budget has been adopted, the parliament has to involve social and cooperation partners in other discussions on the country's strategic goals. This makes it possible to achieve joint development goals more successfully and to narrow the gap between the government and society that is evident throughout Europe.

## Responsible attitude

The decision making which accompanies the process of economic recovery should also be responsible. One can already feel a tendency to give up austerity at the first positive signs. One can also see a revival of the illusion that after 2012 salaries in this country might reach the level of the boom years before the crisis. But they will not. I would even say that the real crisis occurred when all of Europe was living beyond its income; it was a crisis of values and of moderation. Therefore, I am glad that Latvia's budget for 2011 was prepared by looking several years ahead and by keeping in mind both immediate and future goals – primarily, adoption of the euro in 2014. At the same time, this budget protects pensioners, people with children and people with low or medium low income. Therefore, this is also a socially responsible budget.

We expected the principle of responsibility to be evident in the proposals that MPs, social partners, parliament's cooperation partners and other groups of society submitted regarding the 2011 budget. Successful partnership does not mean approving all proposals but rather detailed discussions and well-considered decisions permeated by a sense of responsibility towards all groups in society.

## From stability to growth

Despite previous economic development forecasts according to which the consolidation measures for 2011 budget amounted to more than LVL 400 million, the government of Valdis Dombrovskis managed to limit the necessary consolidation of the 2011 budget to LVL 280 million. This is the result of careful work and proof that the decisions adopted by the Latvian government were aimed at more successfully overcoming economic hardships.

Stability, partnership and responsibility are the key words describing the process of adopting the state budget for 2011 and Latvia's way out of the global economic crisis. I am gratified by the fact that Latvia is one of the few European countries that has managed to draft a stabilization budget for the year 2011. We have to join our efforts and do our best in order for the 2012 budget to be a development budget. And I wish the same to our European partners.

*Solvita Āboltiņa*

*Speaker*

*The Saeima*

*The Republic of Latvia*



\* This article has been written in January 2011.

## Working for revival of the European economy

By Olli Rehn

Europe is struggling to recover from the worst economic slump since the 1930s. The legacy of high public (and in many cases also private) debt, high unemployment and low investments act as a drag on growth for years to come. Moreover, over the past year or so, tensions in the European sovereign debt market have fuelled exceptional uncertainty and led to high interest rates for some Member States.

At the same time, unprecedented measures have been taken by Europe to contain financial market turbulence. While they have been effective in the sense of preventing financial chaos – there has been no Lehman type of catastrophe – more needs to be done.

In addition to making sure that financial backstops are strong enough for all eventualities, the policy response has to tackle the root causes of the current crisis. Crisis management cannot be separated from addressing the key structural weaknesses of the European economy, the scale of which has been starkly revealed by the financial shock.

The problems are well-known: lack of fiscal prudence in good times in many Member States; labour market practices and tax and benefit systems that are un-conducive to high rates of employment and swift reallocation of labour in the face of shocks; slow-moving and uncompetitive innovation system; and a still fragmented internal market.

To understand the European challenges, it is important to note that the issue is not just – and sometimes not at all – the average performance, but the great diversity. For example, as a whole, EU public finances are in a better shape than those of the US. This holds whether one uses general government deficit or debt as a measure. The specific EU problem is that in some countries public finances are in a really bad shape and this spills over to other countries in different ways.

To improve European competitiveness – the capacity to increase productivity and create jobs – one needs to do different things in different Member States. However, at the same time we must coordinate the actions to obtain the full benefits of synergies. Therefore, policy coordination is always a key element of European competitiveness policy.

The crisis has brought about a sea change in the European economic policy. First, there is a much broader understanding and acceptance that major reforms – many of which are painful in the short term – must be taken. Secondly, the willingness to coordinate economic policies is much higher than ever before.

The drastic fiscal and structural policy measures which have been taken Estonia, Latvia and Lithuania, and more recently by Greece, Ireland and Spain witness of the former. Many countries are encouraged by the success of the reforms in several countries of the Baltic Sea region over past years, the fruits of which are now clearly visible.

The legislative package for reinforced economic governance proposed by the Commission, which is currently under discussion in the European Parliament and the Council, is concrete evidence of changed attitudes towards coordination. In fact, we have already introduced the new architecture in the form of the European Semester, which was launched by the Commission's Annual Growth Survey on 12 January.

The proposals in the Annual Growth Survey form the basis for the European Council recommendations to Member States in March. The European Council of February gave clear and strong support to complete the legislative

package by summer, to conduct ambitious stress tests, and to strengthen the existing financial backstop, the EFSF.

The Treaty and the new economic governance provide the right framework for a truly European response, and can enable members of the euro area to go further on some issues to improve competitiveness if they wish. The policy objectives discussed in this context are in line with the Annual Growth Survey, which constitutes the blueprint for fiscal consolidation, structural reform and growth-enhancement, while the European Semester provides the framework for the work.

All this shows that a momentum is indeed building up for a step change in European policy making towards stronger promotion of sustainable growth and job creation. But to ensure that concrete actions follow on a broad basis, we must find an inclusive way of taking the process forward.

The Annual Growth Survey provides the Commission's assessment of the economic challenges, takes stock of the progress made in implementing the Europe 2020 growth strategy and spells out the Commission's priorities for urgent policy action. It is written in a blunt language, not always characteristic to the Commission's documents, and brings together 10 priority actions encompassing three main areas:

- rigorous fiscal consolidation to enhance macroeconomic stability;
- labour market reforms for higher employment;
- structural reforms to enhance sustainable growth.

As regards structural reforms, tapping the full potential of the Single Market is one of Europe 2020's priorities. Deepening the Single Market will have strong evidence-based economic underpinnings and focus on a limited number of actions, including:

- full implementation of the Services Directive,
- completing a European framework for intellectual property
- rapid and interoperable standard-setting including in ICT
- removing tax disincentives for trade or investment.

Shared determination will be the decisive element for pursuing this ambitious agenda and for paving the way for a more prosperous future for all of us. For Europe, 2010 was the year of crisis and survival. With shared determination 2011 can be made the year of reform and revival.

*Olli Rehn*

*Member of the European Commission responsible for Economic and Monetary Affairs*





## Regional policy ensures an intact future for the European Union

By Riikka Manner

Regional policy is a policy area that does not leave anyone cold in Finland. It has its passionate advocates and opponents. Personally, I am one of those that believe that there will be an even greater need for it in the 2010s.

Efficiency and competitiveness are the watchwords of the era that we are now living in, and which will in due course enter the annals as an economically epoch-making one. They are also the highest objectives of EU policy in this decade, entered in the Europe 2020 programme. Some people claim that regional policy is a monetary burden and an ideology of the past. The antithesis between so-called old and new policy areas is unnecessary and in itself old-fashioned. I am of the opinion that regional policy is one of the most important tools, if we are going to achieve the Europe 2020 objectives.

A stronger Europe calls for powerful regions striving from their own points of departure. The long existence of regional policy does not mean old age and political outmodedness but, rather, a ready system for promoting changing policy areas. Known most of all for its subsidies, regional policy is about solidarity and a broader way of thinking. Regional policy is a tool with which we are developing a Europe that is competitive and, at the same time, balanced and fair.

Regional policy is often associated with the economy and accordingly with what are termed tough policies. I myself consider that regional policy is not only about directly fostering entrepreneurship and regional development, but that it also has a profoundly human dimension and significance. Each region is made up of its inhabitants – people. The region's geography and people form a culture unique to that region. Each region is distinctive and valuable in itself. It is a strong ground for all the regions and their inhabitants having the most equal opportunities possible to develop their strengths. We permit difference, for example, in social policy, and there is no reason why we would not accept it in regional policy. It is more challenging for some regions to keep pace with development than it is for others, and supporting them is sensible and right.

The traditional core idea of regional policy is that the regions identify their own strengths, with support from public funds. When the regions harness their own strengths as efficiently as possible, the region's greatest benefit for the whole of society, too, is in the form of taxes paid. Without subsidies, the situation could evolve in such a way that the region would be left to depend on some other system of society, for example, unemployment subsidies. In my opinion, regional development subsidies are a positive alternative, and also humanly right. I regard regional subsidies as a kind of short-term loan granted by society. Repayment takes place through taxes.

The ideological debate on regional policy at European Union level has intensified owing to the new financing period commencing in 2014. Sharing the money pot between different policy areas, and the internal defining of the criteria for an individual policy area, renders political reasoning two-layered. Firstly, one has to affirm the significance and topicality of the policy area under pressure from other policies. Secondly, one considers the various challenges within the policy area side by side. The subsidy criteria of regional policy have traditionally related, for example, to the low level of gross domestic product, geographical handicaps or sparse population. These criteria will surely hold their own still, but, alongside them, other factors with a negative impact on regional development have also been identified.

Finland has actively brought demographic factors into this debate, and in particular ageing, which affects it most of all of the Union's member countries.

One must not focus over much on the absolute quantitative development of ageing but, rather, its relationship to the population of working age should be examined precisely regionally. This viewpoint is a decisive factor in determining whether ageing presents a challenge for the region at all. We are well aware of the fact that the elderly are also an active part of the population and the needs for their services are not a burden in regions where the population of working age is relatively large. As a consequence of ageing, the maintenance relationship also weakens. In Finland, ageing affects Eastern Finland in particular. Similar regions are found especially in Western and Central Europe; that is why the challenge is common to the whole of the Union.

Ageing is a good example of a criterion that would in a way be a factor that levels regional policy as a whole. Large economies inside the Union began to shun regional policy, because as a system it was ending up such that it was seen to be necessary to level out only the Union's internal development disparities. An individual country's internal development disparities are nevertheless just as relevant when it comes to improving the competitiveness of the regions of the entire Union. In countries that are important in terms of their gross domestic product, it is precisely geographical and demographical factors that slow down overall economic growth. It is possible that Eastern Europe, with its young population, perceives regional development differently from, say, Germany, with its high GDP. In my opinion, however, part of the idea of the European Union is that, in principle, each European can feel that the Union works precisely for him or her. The idea is hard to justify if, for example, a region in Finland undergoing intense structural change cannot obtain EU subsidies for its new business ideas, even though it is one of the Union's net contributors. At its best, regional policy is the field that gives the Union a face of objectivity and solidarity at the same time.

The European Union is currently grappling with major objectives. Regional policy is one example of how the supranational level with respect both to funding and criteria produces better end-results than the national level. We in Europe must keep going along this path. Each era calls for solutions of its own. The European Union started out as a peace project and nowadays solves global challenges relating to the economy and environmental protection. The Union has simultaneously promoted its internal integration and enhanced its global worth. Europe will be in demand in future, too, both internally and externally.

*Riikka Manner*

*Member of European Parliament (Centre Party)*

*Member of European Parliament Committee on Regional Development*



## Nordic cooperation – as important as ever

By Ulla-Maj Wideroos

Denmark, Finland, Iceland, Norway and Sweden, the Nordic countries, have always been strongly linked to each other. For centuries they were ruling each other from time to time, forming strong unions and being the kingdoms of the north. Over time they developed a common language, Scandinavian, which most of their people could understand. Their cultures were similar, but with differences, and they could easily interact with and understand each other.

During the past century they have all become independent countries with their own characteristics. But they are still closely connected to each other. They have been cooperating in the Nordic Council and later also the Nordic Council of Ministers for decades and they have been trying to eliminate all kinds of barriers between their countries. Each and every citizen of a Nordic country is, for example, able to work in any other Nordic country and to travel freely, without a passport, to all Nordic countries. These are just two small examples of what the Nordic cooperation has brought to the Nordic people.

But how is it today? Are the people interested in a Nordic dimension? Does the cooperation matter anymore? Is the cooperation important – or is it a boring relic from ancient times, without importance and of no use to the modern people in the Nordic countries? Do a common language and an ability to communicate in Scandinavian matter anymore or is English being the world language, taking over? Do we need a Nordic cooperation when we are already part of broader European, transatlantic and global organizations? Are we, the people of the Nordic countries, interested anymore?

These questions are of much importance and I truly believe that we should spend a moment considering each and every one of them. It is a matter of fact that the European Union has gained much power during the past decades. Three of the Nordic countries, namely Denmark, Finland and Sweden, are also members of the EU. But Iceland and Norway are not. Within the EU only Finland is a member of the eurozone, so far both Denmark and Sweden are standing outside the monetary union.

There are differences, but one thing is common for our Nordic EU members – they have all transferred some of the decision making and legal powers from the national level to the European Union. Another thing they have in common is that they are small EU members in a expanding union. This means that it is becoming more and more important to cooperate and to find your allies amongst the other members, otherwise you will hardly be able to influence the decision making. The other Nordic countries and also the Baltic countries are natural partners in this effort.

One of the arenas for Nordic cooperation may have changed a bit, but most of the partners are still the same. The Nordic countries are built on the same values – and we need to cooperate to be able to defend these values within the EU. At this point I would like to state that EU membership does not exclude excluding Nordic cooperation – instead it is showing the importance of Nordic cooperation – on all levels.

There are also other examples to be found, where the Nordic countries have chosen different roads. Denmark, Iceland and Norway are NATO-members, but Finland and Sweden are not. Despite cooperating with other organizations in slightly different ways, one choice has been clear from the beginning; the importance of the Nordic

Council and the Nordic Council of Ministers. There is still a lot to do within the region itself.

New agreements and exchanges between the Nordic countries are still needed. There are several problems to be solved, regarding, for example, social benefits and taxes, when people are working and living in another Nordic country. It is still necessary to decrease the bureaucracy needed when moving from one country to another. Despite having overcome most of the big obstacles, a lot of work still remains. And the goal is clear; to have equal opportunities and rights in each country. This leads to another question, which has been discussed a lot lately; do we need a new Nordic Union? Personally, I don't think we are ready for that yet, but I do think we could take steps towards a single Nordic market, towards increased cooperation in higher education and towards a single labour market.

In the work towards an even more integrated Nordic region, we need to remember the importance of languages. The language debate in Finland today is of much sorrow to me. We need more languages, not less, to be competitive in a global world. And we need close partners with similar values. There are no other countries as close to us as the Nordic countries and I strongly believe that we need to communicate in Scandinavian or Swedish with these neighbours of ours. If you speak Swedish your working and studying opportunities are much larger. The Nordic countries are an important and valuable labour market – we need to speak Swedish to be able to access that market. And I truly hope that we are speaking Swedish also in the future.

Our history links us together; I hope that our dreams for the future will follow the same path, forming an important region in northern Europe. That region should be taking care of its citizens and it should be known for its high standards on human rights, equality and democracy. That region should be a role model for good governance and environmentally friendly living. That region should be formed by its own citizens. Is that a region you would like to form and live in?

*Ulla-Maj Wideroos*

*Member of Parliament*

*Finland*



## The many faces of natural gas

By Arja Karhuvaara

### Europe's increasing energy demand

As the economy recovers and new EU member states' industries and infrastructure develop, the demand for energy in the EU will inevitably increase. At the same time, energy prices will have an increasing impact on the competitiveness of European production compared to competing production regions like Asia, Indonesia and India.

We must develop cleaner forms of energy and wide-ranging distribution solutions in order to protect our climate, nature and health. The all-encompassing EU single market helps to stabilise energy prices and complements peaks in demand, and it should also secure operating conditions for industries and the functionality of societies everywhere in Europe. The need to save energy in order to conserve our natural resources and the need to put a full stop to the use of fossil fuels are creating new markets and industries all over the world. Energy-efficient construction and the development of renewable energy sources gradually reduce the demand for fossil fuels.

One suggested solution for the transitional phase is the already widely used natural gas, consisting mainly of methane and a gaseous mixture of other light hydrocarbons. Natural gas does not contain sulphur, heavy metals or solid impurities from combustion. In addition, it can be transported easily either in liquid form on ships or through pipelines. Its price is linked to the price of oil, and it is often based on long-term supply agreements signed with individual countries. This causes conflicts and sub-optimisations in the development of a common EU energy policy. According to the European Commission's statistics, just over 40% of the natural gas imported into the EU is from Russia, 24% from Norway, and 18% from Algeria. Cartel-like features have been detected in agreements harmonising production and pricing between some oil and gas producing countries.

### Russia developing through partners

Russia is the world's largest natural gas producer. 60% of its export revenues come from the oil, coal, or gas trade, and around half of the government budget revenues come from production and export taxes and customs duties. Its economy has grown at a rate of about 7% in the 21st century. However, the mining and energy sector employs less than 3% of the working-age population.

Russia needs to undergo structural reform and develop its regional infrastructure. It needs foreign partners in reforming its economy and industry, but also in exploiting all areas where energy sources have yet to be tapped into because of challenging natural conditions or degenerated energy transmission networks. The country's own energy demand will also increase as its industry, economy, and citizens' wellbeing improve, as will its need of export revenues. Its national electricity and heat prices must remain attractive for foreign investors, but also at a reasonable level for individual citizens.

At the present rate, Russia's natural gas reserves will suffice for the next 80 years, and the government-owned natural gas company, Gazprom, gets 2/3 of its revenues from natural gas exported to the EU; a fourth of its entire production. Gazprom is actively seeking to expand its natural gas pipeline network in Europe. How profitable is this expansion now that there is already a supply of natural gas in the market, the spot market price of which, mainly in liquid form, is lower than that of a long-term supply agreement with Gazprom?

### Energy as a political weapon

Russia's active expansion of its supply of natural gas to Europe, e.g. through the new North Stream pipeline in the Baltic Sea and the South Stream pipeline under the Black Sea, is also a political opportunity. A long-term agreement with Kazakhstan and Turkmenistan ensures that natural gas from Central Asia will only be imported into Europe through Russia. The constant disagreements with Ukraine and Georgia and interruptions or reductions of gas supply into Europe are testament to the reaction speed of this natural gas supplier. Russia has also authorised Gazprom's security service to use military force and to protect Russia's interests and pipelines even outside of its borders. It is also interesting to watch Russia's attempts to interfere in the construction of a third, southern pipeline from Azerbaijan and Turkmenistan to Europe, supported by the EU and the U.S.A., through some German and Austrian groups. The Nabucco pipeline, financed by the European Investment Bank, the European Bank for Reconstruction and Development and the World Bank, would introduce a separate pipeline from Russia into Europe, competing with the Russian South Stream project. Energy policy is linked to both national security and trade politics. It is increasingly common to see former prime ministers and foreign ministers from Russia and Europe behind these companies. Denmark approved the northern pipeline once Danish fishermen were supplied with special equipment, France is negotiating warship contracts, Turkey attempted to acquire a 15% share in the natural gas passing through its soil through Nabucco and link this chip to its EU membership negotiations. Iran does not want to get involved in Nabucco because of its conflicts with the U.S.A., and countries around the Baltic Sea feel uneasy about the increasing presence of the Russian Navy in Arctic regions and the Baltic Sea. New Kremlin-approved management teams are leading companies that were in control of vital drilling areas. Run-of-the-mill energy politics?

### Europe's self-sufficiency

The creation of self-sufficient European energy production and a single market, the exploitation of all energy sources and the construction of reserves and transmission networks are necessary elements of the reasonably priced, renewable and sustainable energy policy of the future. The possibility of transmitting Nordic energy to continental Europe helps to stabilise energy prices. Increasing reciprocity with Russia makes it unnecessary for individual countries to blunder and also develops Russia's market economy, which may strengthen Europe's connection to China and other developing economies. The creation of energy partnerships and distribution networks in Arctic regions will tell us how much political will exists to work hand in hand for the benefit of Russia and the citizens of the enlarging Europe.

Arja Karhuvaara

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Committee

Finland





## Arctic – the world's new playground

By Krista Kiuru and Vera Lindman

The Arctic region plays a completely new role in international politics. The region is becoming increasingly important in the political, economic and environmental spheres. Climate change, natural resources and rising oil prices have recently made the Arctic region extremely attractive for various actors. Moreover, it is believed that the melting Arctic ice opens new shorter transport routes via the sea.

The question on how to define the term "Arctic" is in itself an intriguing topic. Usually the Arctic region refers to the geographical area consisting of eight Arctic states. They are Iceland, Canada, Norway, Sweden, Finland, Denmark (due to Greenland and the Faroe Islands), Russia and the United States (because of Alaska). But in fact, the Arctic region is much larger, as it comprises 8 percent of the Earth's surface. Furthermore, not only the official Arctic states but also other countries, such as China, Japan and South-Korea, as well as international companies, are keen to utilize the new possibilities of the Arctic in the future.

Especially the members of the Arctic Council share regional security policy interests in the coming years and it is likely that military activities and presence will continue in the area. Nevertheless, international experts today tend to claim that the Cold War era and time of confrontation is over in the Arctic and that now is the time for cooperation. Yet, the question is: how will all these actors be able to coordinate and develop the needed cooperation and which are the challenges created by the amount of various actors?

The Arctic states form the Arctic Council, which is the existing and recognised intergovernmental body promoting cooperation, coordination and interaction among its members. In order to develop the cooperation further, Finland has actively been promoting an Arctic Conference at the highest level. It would give a new direction to the Arctic cooperation and perhaps become a milestone in the development of the Arctic Council.

However, increased economic activity and shipping, even if organised in a cooperative atmosphere, could also create new forms of security challenges for the Arctic states. Are the states with an Arctic coastline prepared to deal with an environmental catastrophe like the one in the Gulf of Mexico or even with a smaller accident? The Arctic is an enormous area with an extremely vulnerable and unique nature. Damaging the nature could also endanger the indigenous people's traditional ways of living and livelihood.

In recent years Finland has realized the importance of outlining the goals and resources of its Arctic policy, as well as monitoring implementation. Even though Finland does not have an oceanic coastline, it has profiled itself as an

Arctic and Nordic state. Finland wants to be, and is undoubtedly, a significant Arctic actor with its own strategy. Finland's asset and potential is considered to be its knowhow in technology and shipping with regard to the Arctic, as well as in environmental protection. Moreover, Finland can also bring added value to Arctic research. The idea of establishing an EU Arctic Information Centre in the city of Rovaniemi as a part of the Arctic Centre of the University of Lapland is very welcome in Finland.

Finland is not the only one among the Arctic and other states to have already drawn up an Arctic strategy. It is in the interest of the international community to deal with Arctic questions by increasingly closer cooperation. Therefore, the status of the Arctic Council should be further strengthened in order to ensure that it remains the key platform of international Arctic cooperation. In addition, the work of the Arctic Council and Arctic matters should be promoted within the various levels of the European Union. The EU should also gain an observer status for the Arctic Council in the future.

The Arctic region is the world's new playground. Therefore, the questions of the Arctic should not remain solely an issue for politicians. Civil society can and should play a more active role in the coming years. Throughout its history STETE (the Finnish Committee for European Security) has had an important role, particularly in raising awareness of new issues related to international security. We will continue with our frequent awareness-raising on security-related topics of the world's new playground also in the future.

*The Finnish Committee for European Security (STETE)*

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Member of Parliament  
STETE's Chair*

*Vera Lindman  
Secretary General  
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*Finland*

# Foreign direct investments in Baltic States – lessons learned and prospects for the future

By James Zhan and Astrit Sulstarova

The Baltic States – Estonia, Latvia and Lithuania – have been through an experience of contrasting performance in their transition period. Impressive growth rates were recorded for more than a decade driven by domestic demand linked with rapid financial deepening. Starting in 2007 the boom turned out to be unsustainable. Mirroring these dynamics, foreign direct investment (FDI) flows to Baltic States leapt 7-fold between 2000 and 2007, followed by a sharp decline in 2008 and 2009. As economic recovery takes shape, it is the right time to raise the question how FDI evolved during this period and what are the FDI prospects for the future.

The Baltic FDI boom of the mid-2000s was driven by several factors. Investors from Northern Europe, in particular, were eager to leverage their financial positions and stock market gains in projects carried out in the Baltic States. The latter were attractive locations for those investors due to their geographical and cultural proximity, impressive economic growth, and the new business opportunities resulting from the transition to a market economy and EU accession. The dynamics of FDI flows was determined by one-off large privatization-related deals, and more recently by greenfield projects. During the boom period, all three components of FDI – equity capital, reinvested earnings and other capital (mainly intra-company loans) – played an important role in FDI directed to the Baltic States. Over time however the share of reinvested earnings was on the rise, from 20% in 2000 to more than half in 2007<sup>1</sup>, at the expense of new equity investment.

During the boom years, financial intermediation and banking attracted the lion's share of FDI. In 2005, in what remains the largest FDI deal ever for the three countries, Swedish Swedbank took over the Estonia's Hansabank, which had several affiliates in Latvia and Lithuania. Other industries in the services sector targeted by foreign investors included trade, transport and storage activities, benefitting from the subregion's geographical position as a transit hub, as well as telecommunications, in which the Baltic States undertook major efforts towards modernization. As a result, the bulk of FDI inflows during 2000–2007 targeted domestic market oriented services. Manufacturing was less preferred by investors; there

were, however, sizeable projects in downstream hydrocarbons, cement, paper, wood and alternative energy industries.

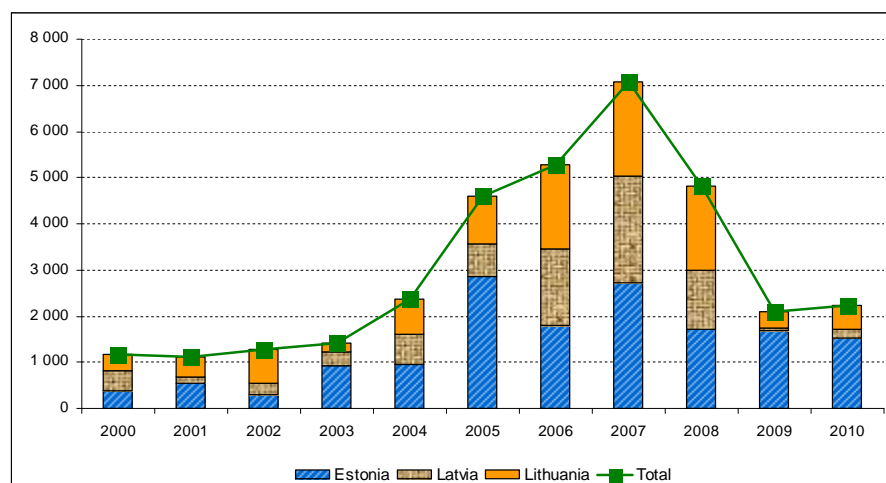
There were some notable differences between the three Baltic States in terms of FDI in the boom period. Estonia – the smallest of the three – was the leader in the transition countries in terms of inward FDI per capita. Lithuania – the largest of the three – attracted 35% of FDI stock in manufacturing. Latvia attracted a major part of FDI from neighboring Estonia, which became the largest investor in the country.

By the end of 2007 the global financial crisis pushed the Baltic countries into a severe recession. Unsurprisingly, FDI also declined in 2008 and 2009, by 32 and 56 per cent respectively, as both cross-border mergers and acquisitions (M&As) and greenfield investments fell. Reinvested earnings turned negative, and intra-company loans dried out, particularly in the financial sector. However, foreign banks in the Baltic States demonstrated a long-term commitment to the region by providing liquidity to their Baltic operations during the worst stage of the crisis in October 2008. Despite the fact that foreign investment continued to flow in 2008, albeit at a much reduced pace, FDI inward stock declined for the first time in these countries, reflecting a falling asset valuations. The industry composition of FDI also changed in 2008 and 2009: in Estonia the financial sector continued to account for the lion's share, but in Latvia and Lithuania there were large divestments in the services sector, while investments in manufacturing continued.

FDI flows to Baltic countries recovered slightly in 2010, to an estimated \$2.2 billion mainly due to gradual improvement of macroeconomic conditions, recovering corporate profits and stock market valuations. Recovery proved to be uneven: while greenfield investments rebounded, cross-border M&As remained subdued. From 2011, prospects for FDI in the three countries are expected to improve, as the key factors driving their FDI such as growing per capita income, relatively low labor costs in manufacturing, low investor risk as measured by credit risk premia are in place now. In addition, in Estonia, institutional strength and financial stability, linked to the country's entry into the euro zone on 1 January 2011, will give further impetus to FDI flows.

<sup>1</sup>2005 was an exception

**Figure 1. FDI flows to the Baltic States, 2000–2010 (Billions of dollars)**



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Source: UNCTAD. \*Preliminary estimates.

# Health care reform in the Russian Federation

By Maria Gaidar

Russia as many other countries is facing the need to reform its health care system. Demographic changes, advances in medical care technologies, and higher expectations of patients put an upward pressure on spending. Budgetary constraints drive the need to seek the highest return on this spending as well as look to for financial sustainability in a long run.

For Russia the agenda is even more urgent. Despite 20 years of transition, Russian health care system resembles the Soviet socialist model. There are more physicians, hospitals, and healthcare workers per capita than almost any other country in the world. At the same time, life expectancy is now just 68 years at birth, which is nearly 12 years shorter than the overall average for the European Union or the United States. Even though social factors such as high alcohol consumption, stress, smoking, traffic accidents, and violent crimes are significant contributors to mortality, an essential factor is a healthcare system that cannot adequately meet today's challenges and is not yet modernized.

For the past 20 years many efforts have been made to improve the situation but the Health care system remains overly underfunded, fragmented and inefficient.

Country	Doctors/ 10000hab.		Nurses/ 10000 hab.		Hospital beds/10000 hab.	
	2005	2010	2005	2010	2005	2010
Australia	24,7	25	91,2	109	40	39
Germany	33,7	35	100,5	80	89	83
Greece	45,3	54	31,0	35	49	48
Israel	36,7	36	62,0	61	61	58
Italy	44,6	37	61,9	69	41	39
USA	27,9	27	97,2	98	34	31
France	33,5	34	73,0	81	78	72
Russia	42,5	43	85,1	85	105	97
Japan	20,1	21	86,3	95	147	139
World av.	12,3	14	25,6	28	26	27

Source: WHO report.

Constant underfunding makes technological development difficult and, importantly, stimulates illegal side payments from the population to medical personnel.

Country	% in GDP		Share of government spending		Share of government spending in all spending		Government Spending per capita a year in US dollars	
	2000	2007	2000	2007	2000	2007	2000	2007
Australia	8,3	8,9	66,8	67,5	15,3	17,6	1728	3986
Germany	10,3	10,4	79,7	76,9	18,2	23,72	4209	
Greece	7,9	9,6	60,0	60,3	10,1	13,2	919	2679
Israel	7,7	8,0	62,8	55,9	10,2	10,1	1557	1893
Italy	8,1	8,7	72,5	76,5	12,7	13,9	1541	3136
USA	13,4	15,7	43,2	45,5	17,1	19,5	4703	7285
France	10,1	11	79,4	79,0	15,5	16,6	2256	4627
Russia	5,4	5,4	59,9	64,2	9,6	10,2	96	496
Japan	7,7	8,0	81,3	81,3	16,0	17,9	2827	2751
World av.	9,2	9,7	57,9	59,6	14,5	15,4	481	802

Source: WHO report.

In 1993 a mandatory health insurance fund was introduced. After 18 years the level of funding pooling remains low: budgetary allocations are not pooled within mandatory health insurance (MHI) leading to the fragmentation of financial flows and inconsistency in health care purchasing. There are great distortions in funding and delivery across Russian regions. The same compulsory medical insurance program varies from 2 603,1 rubles per capita a year in Ingushetia to 15 373, 3 in Moscow to as much as 33 132 in Chukotsky Region. It is hardly possible to guarantee the same range and quality of basic medical services, with spending per capita varying more than 10 times.

Despite constant effort to eliminate excess bed capacity and create incentives for primary health care the substantial

distortions in the structure of service delivery remain. Almost one third of the populations are hospitalized at least once a year with an average duration of stay of around 10 days. In some municipalities of Kirov Region people stayed 30 -40 days a year on average which means that a significant number of people stayed in a hospital about three months during one year.

Another example of unaccomplished reform is insurance: more than 300 private insurers and numerous public ones now coexist in the market. In many cases, they are passive intermediaries, making money by simply channeling funds from regional Mandatory Health Insurance funds to healthcare providers for a fixed fee. They are paid 2-3% from payments to providers financed by MHI Fund. They don't bear any risk and cannot get any additional revenue. That is why the insurance companies do not have incentives for cost-effective interventions.

The Government of Russian Federation started a new Health Care reform. At the end of 2010 a new "Law of Mandatory Health Insurance in Russian Federation" was adopted. Its main changes are related to finance mechanisms and introduce competition of insurance companies and providers.

From 2011 the payroll tax rate for mandatory contribution to Health Insurance Fund will increase from 3,1% to 5,1%. Presumably this will bring additional 230 billion rubles year (6,7 billion dollars) to the Federal MHI fund. During the first transitional years 2011-2012 this money will be distributed to regions as subsidy for reequipping of state and municipal providers. From 2013 the resources will be channeled from Federal Health Insurance Fund to regional Funds In order to level off the coverage of basic medical services across the state. Along with compulsory tax contributions regional authorities will have to make a legally mandated per-capita insurance contributions on behalf of non-workers that will bring additional 240 billion rubles to MHI.

From 2011 employers and insured persons are given the choice of insurance companies. They can also choose a health care provider that participates in the mandatory health insurance system. The Mandatory Health Insurance Fund cannot deny access to any provider no matter whether it is private or state owned. This measure aims to create incentives for providers and insurance companies to increase efficiency and quality of medical service and to attract private investment. At the same time it contradicts the need of global budgeting and does not encourage limiting unnecessary utilization of medical care.

According to the new law insurance companies still do not bear any financial risk for the insured. But now they can receive 30% remuneration if they find excessive medical services at the side of providers. It is difficult to predict how effective this could be in reducing excess treatment but still this measure does not create any stimulus for preventive care and early diagnosis.

This reform seems interim. Many problems remain unsolved and many measures are not consistent one with another. But it is still an important step forward for Russia. These measures could be a good financial platform for future changes. Russian health care system still needs to find a reasonable balance between coverage quality and cost, and introduce incentives to keep the balance. There is a strong need to create a system of check and balances and find a right place for insurance companies, doctors associations, and NGO's. This will be an important agenda in Health care for the next decade.

Maria Gaidar

Deputy Governor

The Kirov Region

Russia



# Mecklenburg-Vorpommern as logistics hub for Baltic Sea transport

By Volker Schlotmann

Mecklenburg-Vorpommern is situated right at the Baltic Sea - and in the middle of Europe, between the European centres of Berlin, Hamburg, the Øresund region, the Baltic states or St. Petersburg. European transport axes intersect in Mecklenburg-Vorpommern: In the East-West direction from the regions around the North Sea to the Baltic states and on to Russia, and also in the North-South direction from Scandinavia all the way to the Adriatic Sea. That is a locational advantage. Efficient ports, well developed transport routes and room for growth make sure that, already today, the federal state is able to benefit from international traffic flows. The ports are not just places of transshipment nowadays, they are also industrial and logistics sites. The aim is to be able to respond quickly to requests for space from investors in order to allow for further industrial location and jobs to be created. That is why the area available is being extended against the background of growth forecasts up to 2025.

Both the ports and the industrial sites are very well connected with the German motorway network. In some cases the motorways go right up to the quayside. By now the federal motorways A 19, A 20 and the A 24 connect the metropolis regions of Berlin and Hamburg with the Baltic ports. The motorway network will be extended further with the completion of the A 14 to Magdeburg which is expected by 2020.

## Via Mecklenburg-Vorpommern to Lithuania and Russia

Thanks to short sea routes we offer an efficient transport infrastructure to the Baltic states and Russia. In order to assure competitive connections to Lithuania and Russia via our Baltic Sea ports, among others, around 40 partners from Denmark, Sweden, Lithuania and Russia jointly work on improving the East-West transport corridor in the so-called Interreg project EWTC II (East-West Transport Corridor). The project has a term of three years.

Furthermore, Russian and German representatives of political bodies, authorities, companies and institutions have been working for several years on establishing an intermodal railway ferry link between the new port of Ust-Luga west of St. Petersburg, Baltijsk in Kaliningrad Oblast and Sassnitz on the German island of Rügen. The German-Russian ferry advisory council Ust-Luga – Baltijsk – Sassnitz was established in July 2008 in order to remove administrative obstacles such as customs issues and border clearance procedures. Today the shipping company Finnlines already operates vessels to Ventspils (Latvia) and St. Petersburg (Russia) via Sassnitz twice a week.

The largest port in Mecklenburg-Vorpommern is Rostock seaport. All told it has 150 companies with approx. 4800 jobs in port services and logistics. The new areas being developed will add an estimated 500 jobs, possibly more. All the ports of Rostock combined handled approx. 25 million tonnes of goods in 2010.

## Well-developed transport routes in all directions

Apart from the East-West connections the North-South axis through Mecklenburg-Vorpommern also plays an important role. Already today the so-called Baltic-Adriatic corridor offers modern, flexible infrastructure with few traffic jams. Intermodal transport in particular benefits from an efficient logistics chain. Apart from ferry and ro-ro connections from the ports of Rostock and Sassnitz to Gedser and Trelleborg, there are also cargo trains running, for instance, from

Rostock to Verona and Basel. The state government actively advocates integration of the hinterland connections especially of the two ports of Rostock and Sassnitz into the system of trans-European transport networks (TEN-T). The directives currently in force for the trans-European transport networks are due to be revised still this year (2011).

In doing so the focus will be on the best possible use of existing transport routes. Transport is to be made more efficient and selected transport axes and junctions are to be upgraded even more. Furthermore the EU transport policy is meant to make a contribution to the targets of climate policy agreed on a European level.

Interlinking the current priority projects will play a special role in determining a 'core network', i.e. a priority network of transport connections. The obvious thing to do would be to link the priority projects No. 1 (Berlin-Palermo rail connection) and No. 22 (Dresden-South-Eastern Europe rail connection) with priority project No. 12 (road and rail connection 'Northern Triangle' between Oslo, Stockholm and Helsinki) via the ports of Rostock, Sassnitz, Gedser and Trelleborg. The bridge function between Central Europe and Scandinavia may be performed by the priority project No. 21 ('Motorways of the Sea').

The granting of both 'Motorways of the Sea' projects, Rostock-Gedser and Sassnitz-Trelleborg, by the European Commission advocates the inclusion of the ports of Rostock and Sassnitz in the future core network.

Apart from the EWTC II project already mentioned the two projects 'SoNorA' and 'SCANDRIA' are about transport in the Baltic-Adriatic corridor, i.e. from Scandinavia via the ports of Rostock and Sassnitz to Munich and Verona (TEN 1) or via Dresden and Prague to South-Eastern Europe (TEN 22) and to the Adriatic ports. While 'SCANDRIA' focuses on the Baltic Sea region we cooperate with partners from Italy, Austria, Slovenia and the Czech Republic, among others, for 'SoNorA'. The 'SoNorA' partners pursue the aim of creating a North-South network as the basis for regional development in Central Europe.

In this, the development of transport axes via Mecklenburg-Vorpommern is an important precondition for creating logistics chains and thus for developing our federal state into an efficient European logistics hub and a good industrial location. This does not only mean increasing cargo handling volumes for the ports in Mecklenburg-Vorpommern, the entrance gate to the Baltic boom region, but also economic growth for the entire industry involved in logistics in the hinterland all the way to Berlin and Brandenburg.

Volker Schlotmann

Minister for Transport

Building and Regional  
Development of  
Mecklenburg-Vorpommern

Germany





## Baltic Sea organisations put budgetary pressure on EU decision-makers

By Knud Andersen

These days the budget discussions are high on the EU agenda. EU needs a budget reflecting the need for growth and new jobs. For this reason, the next financial perspective (2014-2020) must focus on international cooperation and give priority to the policy areas ensuring growth, development, innovation, research and transfer of knowledge. Being closest to the regional challenges and hence the solutions, the regions play an active role in enhancing the European competitiveness and create sustainable growth and new jobs.

The regional and local growth strategies are essential to ensure the interaction between public authorities, research institutions and business. Through the EU programmes the regional and local authorities support this cooperation and add on the knowledge and development that has already been created in the European regions and municipalities. Thus, the regional and local authorities work as engines for growth.

In order to create growth and new jobs in the EU all regional and local authorities have to be seen as driving forces along with the cohesion policy. Commission figures show that the cohesion policy helped to create 1.4 million new jobs and provided training for millions of European citizens between 2000 and 2006.

The regional organisation of BSSSC (Baltic Sea States Sub-regional Co-operation) wishes to contribute actively to the ongoing debate and is in support of maintaining structural funds to all regions after 2013. The BSSSC along with two other Baltic Sea Organisations urge the decision-makers to put weight on those parts of the EU budget that support Europe 2020. I have been appointed BSSSC coordinator and spokesperson on the topic.

The Baltic Sea Region is already a dynamic region characterized by high levels of trade and cooperation, but still it has a huge potential for further development and prosperity. The EU's structural funds play an important role in this. In this context five key messages are of special concern for the Baltic Sea Organisations.

First of all, EU regional policy must cover all EU regions. The regional programmes and funds are designed to bridge the difference in prosperity and development to the benefit of all. Only by supporting all areas, it is ensured that the potential of all regions and municipalities are used to enforce the overall European growth and thus to support Europe 2020. In an increasingly globalised world, growth in one region leads to the creation of new jobs in another region. Moreover, regional and local investments lead to growth and prosperity not only for the region or municipality but for all of Europe.

Secondly, the European Territorial Cooperation (Interreg Programmes) should be strengthened. Interreg is an integrated part of the Cohesion Policy. The Interreg programmes supporting cross-border, transnational and interregional co-operation have shown good value for money. To the benefit of the whole community, the Interreg programmes have contributed to diminishing border barriers and increasing exchange of experiences on best practices within many fields between partners from two or more countries.

Thirdly, the EU Baltic Sea Strategy is of great importance to the Baltic Sea Organisations. After 2013 the transnational programmes should be programmed specifically for the support of the macro-regional strategies, e.g. the Baltic Sea Strategy. The macro-regional strategies will thus constitute the strategic framework behind the use of the transnational

Interreg funds. At present, the financial support for the Strategy for the Baltic Sea Region is not satisfactory because various programmes, e.g. national programmes, have supported the strategy without any coordination. The European Parliament should maintain a budget post for the coordination of the implementation of the Baltic Sea Strategy, as was the case in the EU budget for 2010.

Fourthly, the Baltic Sea Organisations stress that rural development resources should to a higher degree serve to promote the business opportunities and economic development in rural areas. The EU rural development policy should be seen in close connection with the cohesion policy. Activities such as creating more jobs and making rural areas more attractive places to live in should be given higher priority.

Finally, the Eight Framework Programme for Research (FP8) must be added the extra funds needed to support the Europe 2020 goals. Particularly cooperation between industry, government and the knowledge institutions should be strengthened. A greater emphasis in the coming FP8 on innovation, commercialisation, technological development and development of key technologies is needed in order to substantiate the Baltic strongholds within these fields. Strengthening research, science and innovation communities will render the region as a whole more competitive and also benefit the development of the European Research Area in general.

The position paper presenting these five messages has already been distributed to a wide circle of policy-makers and administrators in Brussels, such as commissioners, CEMR's working group and the Baltic Europe Intergroup in the European Parliament.

The Baltic Sea Region is Europe's first macro region representing over one fifth of the EU's total population and one sixth of its economy. Inter-territorial cooperation has already fostered mutual understanding between neighbouring regions and promoted high-quality political and economic relations. This has made the region more competitive and attractive. This has to a large degree been possible due to the structural funds. However, more efforts are needed. A first step has been taken by the Baltic Sea Organisations by working together to ensure the resources for future growth and new jobs. We look forward to contributing further to the negotiations on the EU budget 2014-2020.

Knud Andersen

Member of the BSSSC Board

Member of the Board of  
Danish Regions

Denmark



*The Baltic Sea States Sub-regional Co-operation (BSSSC) is a political network for decentralised authorities in the Baltic Sea Region (BSR). It co-operates closely with other key institutions in the BSR and Europe.*

## Arctic challenges – a Finnish view

By Hannu Halinen

### The Arctic Strategy of Finland

In the Arctic the move towards a state change – the Arctic Tipping Points – has been recognized during the last few years by the circumpolar governments as well as researchers. What used to be considered periphery is becoming the center of global politics. This has led to national assessments and reassessments of the situation. In Finland we have approached the new Arctic challenges and opportunities by adopting the national Arctic Strategy. Our basic principle is that Arctic issues should be dealt with in a rules based-multilateral framework with an emphasis on comprehensive security and environmental sustainability. All Arctic and non-Arctic actors need now to remain committed to an approach based on constructive cooperation, not confrontation.

The Finnish Arctic Strategy from June 2010 draws together views on Arctic issues in one package and provides an assessment of the challenges and the potential of the region from a Finnish perspective. The Strategy defines our goals in the Arctic region as well as the means to reach them; it deals among other issues with the utilization of Finland's Arctic know-how and research, institutional issues, and regional cooperation; and it emphasizes the importance of environmental matters and questions related to the indigenous peoples.

The opening of the Arctic Sea offers new perspectives for exploitation of natural resources in energy, mining and fish-stocks. New sea routes attract both tourists and commercial transport. Finland has wide Arctic expertise and knowhow to offer in this context. A key issue for Finland – and I believe to all stakeholders in the Arctic – is to combine economic activities in the Arctic with environmental concerns, keeping sustainable development as the basic platform.

The utilization of the regions natural resources require both know-how, caution and responsibility as compatibility with the principles of sustainable development is necessary due to the fragile nature. We for our part believe that education, research and application of our Arctic expertise is the key to a responsible exploitation of the Arctic. Finland has plenty to offer in this regard as we have strong traditions in winter shipping and technology, shipbuilding, as well in offshore industries, such as oil and gas rigs and vessels needed for Arctic circumstances.

### The Arctic Council

The Arctic Council is the primary intergovernmental forum to deal with Arctic policies. Last summer the Foreign Minister of Finland, Mr. Stubb, presented some concrete proposals on the strengthening of the Arctic Council, such as the establishment of a permanent secretariat for the Council; better burden sharing with a joint budget; review of the Council's mandate and improvement of its' working methods; and the role of observers.

Enhanced interaction between Arctic and non-Arctic stakeholders and players is indispensable – an integrated approach requires engagement from all with legitimate interest in the Arctic. The eight Member Countries have concluded that the Council is the platform for Arctic considerations. This includes the bilateral as well as cooperation between five coastal states, on one hand, and indigenous peoples, observer countries, institutions and organizations on the other. The Arctic Council Foreign Ministers meet in Nuuk in Greenland in May 2011. In our view a firm decision on observers at that meeting is indispensable for the future of the Council.

Finland has also proposed a meeting at the top level to discuss the Arctic issues. This First Arctic Summit, under the auspices of the Arctic Council, would give new direction to the Arctic cooperation and become a milestone in the development of the Council itself. An Arctic Summit should not be seen solely as a supporting track in the process of strengthening of the Council. The high profile attention given by the Heads of States of the Arctic countries could substantially contribute to the

reaffirmation of the multilateral and rules-based approach we are witnessing in the Arctic today. Idea of an Arctic Summit is not new, it has been raised by researchers during the years. A serious consideration of the initiative gives in itself an added value and content to the emerging region with global reach. The Summit would have a major impact in reaching "High North with Low Tension".

### The European Union

The Arctic policy of the European Union is to some extent still a work in progress. During 2008 and 2009 we have seen the European Commission and the European Council publish Arctic Communications and Conclusions that have laid the foundation for Arctic thinking within the Union. Finland will continue to assist to shape the Union's Arctic policies for the years to come. A new Communication is currently under preparation in the Commission. This will be, we are confident, a step again to the right direction.

The European Parliament has consistently contributed to the formulation of the EU's arctic policy with resolutions, statements and conferences. The Parliament recently adopted a much awaited "Report on a sustainable EU policy for the High North". Finnish Members of the European Parliament took actively part in the preparations of the Report. The latest Report will undoubtedly be duly noted in discussions within the EU institutions, including the Commission while preparing its Communication.

To support EU's Arctic policy and increase its visibility Finland is proposing the establishment of an Arctic Information Center for the European Union. EU's Arctic Information Center would be essential for awareness raising on Arctic issues both within the Partner countries and outside the Union. There is an obvious need both among the public, as well as decision makers and the scientific community in gaining easy access to information relevant to the Union's Arctic policies. The Saami, as the only indigenous people in the EU, could have a specific role in the Center. Our candidate for hosting the EU Arctic Information Center is Rovaniemi. The Arctic Center at the University of Lapland in Rovaniemi would be the best location for the Center for a number of reasons, the most important being the strong and internationally acknowledged cross-disciplined scientific Arctic research conducted at the Center. The Arctic Center already serves as the hub of the existing network of Arctic Universities, known as UArctic.

Another dimension of EU's arctic policy is the concept of so called Arctic window of the Northern Dimension policy of the EU. Geographically, the region covered by the Northern Dimension closely coincides with the Barents Euro Arctic Council. In our view, as a first step, there is an added value in the synergy and positive overlapping between the Northern Dimension Partnerships and the Working Groups of the Barents Council. The ND Partnership on Environment has demonstrated the viability of the concept. The newest Partnership on Transport and Logistics is particularly relevant in dealing with the development of harbors and transport corridors leading to them from mainland. This could be the platform to extent the cooperation broader to the Arctic.

Hannu Halinen

Arctic Ambassador

Ministry for Foreign Affairs

Finland



# Modernisation of Russian economy in collaboration with Finnish partners

By Valery Shlyamin

The global financial-economic crisis has yet again revealed weak spots in domestic economy – oil and gas sector dependence, traditional raw-material export orientation, low rate of economy and external trade diversification, high labour intensity and power consumption of industry, insufficient receptivity to innovative proposals, lack of market development in broad sense of the term, low labour output and wage, domestic financial market underdevelopment.

The crisis has shown that Russia requires undelayable economy modernisation. At that taking into account relative limitation of state and corporate financial resources that could be invested in modernisation process it stands to reason that the state should target its efforts and resources at a rather narrow list of modernisation priorities with a view of achieving structural improvements by 2020 and directed at attainment of the Russian economy competitiveness in chosen fields.

President Dmitry A. Medvedev approved a list of priority fields for modernisation and technical development of Russia: medical technologies and pharmaceuticals, energy efficiency, nuclear technologies, computer technologies and software, space technologies and telecommunications. Implementation of the above priority tasks is carried out by federal and regional bodies in cooperation with companies, scientific community and higher education institutes. Within this process major importance is attached to the external economic factors such as foreign investments, technologies import, hiring of qualified foreign specialists, added-value goods export development, scientific, technological and production cooperation.

Finland is in full sense one of the Russia's strategic trade and technological partners in Europe. It's non-random that in the course of Finland's President Tarja Halonen visit to Moscow in November 2010 Russian leadership proposed to sign a Declaration on partnership for modernisation. The Declaration is expected to contain approved plans of both parties and an appendix of perspective projects implementation of which will enjoy state assistance.

I presume that proposed partnership will evenly contribute to economy modernisation goals achievement in Russia as well as in Finland. Our Finnish partners are experienced in technological projects commercialising with full chain path: "idea – invention – technological trials / market testing – certification – product marketing". We expect that Russian-Finnish modernisation partnership will contribute to creation of tools providing for the various projects implementation within the modernisation priorities designed on the basis of Russian specialists' technology.

Among the project ideas proposed for discussion I would like pick out a number of projects within the fields of telecommunications, computer technologies and software, energy efficiency, medical technologies and pharmaceuticals developed with participation of such well-known companies as "Nokia", "Nokia Siemens Networks", "Fortum", "Farmos" and others.

The Trade Representation of the Russian Federation in Finland is working on continuation and intensification of business cooperation between Russia and Finland also in other economy fields, expanding of production cooperation between our countries in various forms including subcontracting. The most promising sector of cooperation between Russia and Finland from the point of view of production cooperation expected outcome is shipbuilding.

Freight management on the Northern Sea Route, development of new oil and gas deposit fields will demand vigorous efforts on creation of fleet that would be capable of fulfilling the national Arctic strategy. Russian shipyards can provide no more than 30% of the new first class ships demand as calculated up to 2030. Finland is one of the world's shipbuilding leaders and old-time USSR and Russia partner. In this sector Russia has also gained a unique practical experience and created considerable scientific potential. As is well known in 2009 Russia and in 2010 Finland have adopted national Arctic strategies. At this point we consider it expedient to reveal the points of intersections between the two countries' strategies. In all probability this task should be solved by means of intergovernmental dialogue because the matter in question concerns spatial planning in the mega region. Russian and Finnish companies displayed eagerness for joint projecting and building of maritime ships (Arctic class tankers and gas carriers, ice-breakers), modern depot drilling

stations necessary for development of new hydrocarbon deposit fields in northern seas with use of Russian technologies as well as Finnish "know-how".

Shipbuilding cooperation is not limited to direct vessel construction. This sector implies interaction of the wide spectre of machine-building and instrument-making enterprises involved in design, production and maintenance of diverse equipment as well as metallurgical companies and chemical industry enterprises.

At present time a number of perspective Russian-Finnish projects are being successfully implemented within the framework of production cooperation. These are: construction of Arctic tankers in Russian shipyards under Finnish license; production of low-speed vessel engines with use of Finnish technologies on the Russian enterprise; joint design of multifunctional diesel-electric ice-breaker with capacity of 25 megawatt for operation in the Arctic region; joint construction of ice-breaker for oil-overflow counteraction in the Gulf of Finland; joint design and projecting of drilling stations; propulsion systems production; supply of Finnish azipod propulsion systems for ice-breakers built in Russia; supply of Russian screw propellers and spare vanes to Finnish shipbuilders. These projects are being implemented by Russian companies "Objedinenennaya sudostroitel'naya korporatsiya" (Joint shipbuilding corporation), "Sovcomflot", "Admiralteiskie verfi" (Admiralty shipyards), "Petrobalt", "Baltiyskiy zavod" (Baltic plant), "Rosmorport", Bryansk machine-building enterprise, "Zvyozdochka" (Star) with Finnish companies "STX Finland", "Aker Arctic Technology", "Wärtsilä", "ILS", "ABB Marine", "Steerprop", "Raahen Tevo", "SET Group". Companies "STX Finland" and "Objedinenennaya sudostroitel'naya korporatsiya" (Joint shipbuilding corporation) have started a joint venture "Arctech Helsinki Shipyard" for joint production of high-level technology Arctic class vessels. The Agreement on production of two multifunctional supply ice-breakers for "Exxon Neftegaz" company in Sakhalin has already been signed.

Collaboration in the field of production cooperation is also carried out in other branches of machine-building. The perfect example of it is the long-term cooperation between companies "Metso Paper" and ZAO "Petrozavodskmash": The Russian enterprise produces accessories and assemblies for paper-making machines. In May of 2010 Finnish company "Wärtsilä" and ZAO "Transmashholding" signed a contract on starting a joint venture in Russia for production of modern multifunctional economy-type and environmentally safe diesel engines "Wärtsilä-20". Partners started a holding company which will set up diesel-making enterprise in the city Penza for assemblage and testing of engines and production of major engine parts.

One cannot but mention possibilities provided by Finnish companies in Russian pulp and paper and wood industries. Modernisation of Bratsk and Kotlas pulp and paper plants is carried out with significant assistance of Finnish machine-building companies "Metso" and "Andritz". New saw-mills in the Russian Far-East and East Siberia are supplied by companies "Järtek" and "Heinola Saha Koneet". Projects on construction of new pulp and paper mills are under preparation. We expect active participation of Finnish business in these break-through projects and are ready to render needed assistance to them.

Valery Shlyamin

Doctor of Economics

Trade Representative of the Russian Federation in Finland

Russia



## Finnish presence in St. Petersburg

By Olli Perheentupa

Tsar Peter I founded his new Capital' in the middle of what Pushkin later called Finnish marsh and swamps. In 1809 the Grand Duchy of Finland was established within the Russian Empire. A new Minister State Secretary's office presented all affairs concerning the Grand Duchy directly to the Emperor. We had even a passport expedition for issuing documents to Finns who came to work in St. Petersburg. In 1880 there were 24400 Finns in the City, more than in Turku, the second largest town of the Grand Duchy.

Till 1809 'Finland' was economically and administratively an integral part of Sweden. The separation from Sweden took actually several decades when the economy of the Grand Duchy very slowly turned from the West to the East. The Imperial Capital imported goods, hands and heads. Most Finns worked in handicraft and factories, but there were also generals, admirals, academicians or masters in jewelry and chimneysweeps etc. Several Finnish entrepreneurs were successful, e.g. in grain trade, foundries and shipping. Actually we might say that Finns enjoyed much of what would be in modern terms called four freedoms: free movement of goods, services, capital and persons.

Now St. Petersburg is by population the fourth largest City of Europe. Together with the surrounding Leningrad region it forms an integrated economic area, with a population of more than 6 million people. This area is one of the most important growth centers of the country and the most important corridor for foreign trade. Finland has three main trade partners: Germany; Sweden and Russia, each with a 10 % share. In regional terms St. Petersburg is our most important export area.

The main sectors of our export are machinery, equipment, chemicals, food, but also services incl. tourism. Today, according to our rough estimation, there are 400 - 500 Finnish companies active in the City. Finnish companies have invested in Russia over 6 billion euros. Direct investments have been made by 100 companies. Finnish enterprises employ 50 000 persons. We do not have any regional statistics, but it is clear, that most investments are concentrated in St. Petersburg and Leningrad region. According to the Russian statistics Finland is St. Petersburg' s fifth trade partner and the third among investor countries.

Just to give a few examples. of larger investments: In retail trade Stockmann's flagship in Russia is the new Nevsky Center in the heart of the City. Kesko has 8 K-rauta hardware stores, S-group 5 Prisma supermarkets and three hotels. In food sector we have Fazer Bakeries, Kotipizza, Atria's meat processing Pit-Product, Valio (milk products) are well known. In construction sector we have YIT, SRV, Lemcon, NCC Finland, in production of construction materials there are also several companies real estate Sponda, in banking and finance sector Nordea and others. One should mention also Neste Oil (petrol station chain), Tikkurila (paints), Fortum (electricity), EKE (office premises) and Technopolis (office hotel for innovation companies).

Of course many big companies are not any more "pure" Finnish companies, but that is one of the aspects of internationalization. On the other new hand subcontracting chains are being created between big companies and SME.

Problems met by Finnish companies are obviously common to all foreign - and in many cases to Russian - companies. Lack of suitable lots of industrial land, especially in the City, lack of infrastructure - e.g. water and energy supply, waste water canalization - in the Region can cause delays and extra cost. The immense number of permits, licenses, inspections require often a lot of time and additional expertise. Behavior of tax and other authorities is not always predictable, but courts do not always fail to respect the law and the rights of foreign companies. Many companies face various forms of corruption or attempted corruption. Big companies can resist corruption better than SME, because they can wait and appeal to higher

authorities. During, say, past 15 years, the situation has in general become better - it's easier to import, to establish, to repatriate. Although business visas, work permits and registration are a permanent theme, but in these issues there has also been some progress, and we can expect more in future.

Finnish companies have many supporting organizations in St. Petersburg. The Consulate General first of all maintains contacts with all relevant Federal, City and Regional authorities. We discuss with them on general issues, e.g. work permits, registration, implementation of construction norms etc. But we also try to find tailored solutions, e.g. water supply to a specified investment object. We organize general, sectoral and regional meetings.

In the House of Finland we have now such organizations as Finpro, Finvera, Chamber of Commerce to provide e.g. market research, feasibility studies, legal and financing services first of all to SME. Helsinki, Tampere, Turku, Lahti, Kotka are represented, as well as Aalto University and Lappeenranta University of Technology, a couple of regional development organizations and private companies are also represented. Consequently the Consulate General does not have to everything itself. On the contrary, we all together form quite a network to support the Finnish presence in St. Petersburg. In our staff we have experts not only from the ministry of foreign affairs, but also from the ministries of interior, environment, labor and economic development, social welfare and health. The Basic institutions in the House of Finland are the (Cultural) Institute and the Finnish school, both supported by the ministry of culture and education.

If you ask about the results of our activities in St. Petersburg, I would pick up first of all the encouraging experience in environmental co-operation: Russians are willing to learn knowledge and obtain and develop modern technology, they have shown that they are capable to modernize basic infrastructure of a big city. In this field we have moved from bilateral projects to Northern Dimension Environmental Partnership. Energy efficiency might well be the next objective.

And what about the four freedoms today and tomorrow?

We issued last year in St. Petersburg 751 000 visas, about 90 % multiple. Last year the number of border crossings on our South-Eastern land border stations was almost 7 million, the share of Russian citizens was over 5 million. In February this year we opened a separate Visa Center for reception of the ever increasing amount of applications without the famous queues we have had 20 years in front of the Consulate. Now we shall improve the visa issuing process itself to be able manage with 1 000 000 - and more - applications. We can only hope that the Russian Consulates in Finland will work in the same direction. Russia has unilaterally given ferry passengers the status of cruise passenger, that is a 72 h visa free stay. The new high speed train Allegro takes you from Helsinki to St. Petersburg in three and a half hour. An analogous right of 72 h to the train passengers is already been discussed in Russia. One might ask, whether a general mutual 72 h visa free travelling could possible before the joint target of visa free regime will be reached.

This is of course an EU-Russia issue. And so is the question of free movement of goods, services and capital. Russia's membership in the WTO, new agreement and deep FTA between the EU and Russia would without doubt contribute in many ways to the strengthening of the Finnish presence in St. Petersburg.

*Olli Perheentupa*

*Consul General of Finland in St. Petersburg*



## Lithuania – the adjustment process towards the euro

By Ramune Zabuliene

After the major contraction in the first half of 2009, the Lithuanian economy started to stabilize in the middle of 2009 and is now back on a growth path. Economic recovery takes place mostly in the tradable sector, driven by strong and broad-based rebound in the manufacturing. Exports almost returned to their historic peak observed two years ago. Domestic demand is also about to start recovering – confidence indicators improved, retail sales stabilized, the housing market is showing signs of strengthening. The economic growth is forecasted to increase considerably in 2011-2012.

Economic recovery has been supported by the internal adjustment process that has been crucial for correcting external and internal imbalances and rebalancing the economy towards the tradable sector. The key element in the adjustment process has been the fixed exchange rate regime under the currency board arrangement. The fears of possible currency devaluation dissipated in the second half of 2009, when the ongoing “internal devaluation” proved the flexibility of the economy. Other most important policies in the adjustment process have been fiscal consolidation, wage and price restraint, and measures to maintain and strengthen financial stability.

The Government has undertaken strong and ambitious efforts to maintain stability and soundness of the public finance by implementing tight fiscal consolidation measures, totaling about 12% of GDP in 2009-2010. However, despite the substantial austerity measures already undertaken, further fiscal tightening in order to put public finances on a sustainable path and to limit debt accumulation is inevitable. Recently, the parliament passed a 2011 budget with a fiscal deficit target of 5.8 percent of GDP. Lithuania is committed to reduce fiscal deficit to below 3% of GDP in 2012 with a view to the euro adoption.

The economic downturn was followed by a sharp adjustment in labor costs and a decline in consumer price inflation. From the peak to the trough, gross wages fell by one-tenth with a somewhat stronger adjustment in the private sector. The average annual inflation rate, as measured by the HICP, stabilized at 1 percent. While developments in wages and prices helped to strengthen competitiveness of the economy, it is important to note that Lithuania was able to contain costs in the tradable sector during the boom time, since the highest wage and price inflation was in the non-tradable sector, mostly construction and public services. Unit labor costs in tradable sectors increased less than in trading partners, helping more than double the country's share of global exports over the decade. The process contributed to a relatively favorable initial position to rebalance towards the tradable sector.

Financial sector in Lithuania demonstrated strong resilience to the global financial crisis. Lithuania benefited from the deep financial integration with the Nordic-Baltic region, as strong presence of the Nordic banks contributed to systemic stability. The Bank of Lithuania has been paying close attention to preventive prudential measures. Recommendations to hold sufficient capital and liquidity buffers and apply conservative risk management encouraged banks to improve their liquidity positions and prudential ratios.

Overall, the reoccurrence of macroeconomic imbalances is much less likely in the years to come, having in mind the ongoing structural changes in the economy, transforming lending practices and adopted macro-prudential measures. Both lenders and borrowers learned a costly lesson during the recent years, and currently they show strong commitment to maintain prudent credit standards and make more grounded borrowing decisions.

The risks of domestic price and cost increase are expected to be contained. First, situation in the labor market is not likely to provide inflationary pressures from the supply side. Second, the ongoing household deleveraging process will also weigh on the rebound in private consumption. Third, the capacity utilization rate shrank during the economic crisis, thus the significant supply side pressures on inflation should not reappear in the coming years. Fourth, the banking sector is unlikely to resume lending to the pre-crisis levels. Finally, the necessity of fiscal consolidation and public debt growth stabilization will also discourage the acceleration in the consumer price growth.

Despite the significant impact of the global financial crisis on the economic developments in Lithuania, the broad monetary strategy remains unchanged – Lithuania intends to adopt the euro as soon as the economic convergence criteria are met. Lithuania has not determined the exact target date for euro introduction, but preparatory work has been ongoing. Much has been done already in 2006, when Lithuania was thoroughly preparing for the introduction of the euro. The plans have been modified to take into account the necessary improvements. The success of the euro introduction depends to a large extent on the attitude of the public towards the adoption of the euro. Therefore, the provision of the relevant timely information to the public is one of the primary tasks in the preparatory process.

*Ramune Zabuliene*

*Deputy Chairperson*

*Bank of Lithuania*

*Lithuania*

## It pays to invest in the welfare of children and families

By Maria Kaisa Aula

The first meeting of the prime ministers of the Nordic countries, the Baltic countries and Great Britain took place in London in January. Convened by David Cameron, the British premier, the meeting could rather be described as a brainstorming session, where experts from various countries shared their best practices and policies in technological innovations, green economy, family, work and equal opportunities, and entrepreneurship.

Familiarising himself with the 'Nordic model' was one of Prime Minister David Cameron's motives in convening the meeting. One of the main topics for discussion in London covered family, work and equal opportunities. Accordingly, speeches given by the premiers focused on issues such as parental leave, parents' joint child-care responsibilities, paid and unpaid work at home, day care services for children, and support for the continuity of relationships.

The Norwegian, Swedish and Icelandic premiers outlined the parental leave arrangements in these countries. In Finland, the parental leave system is undergoing a major revision. Cameron's government plans to enhance the role of fathers in child-care through the introduction of an earmarked period for them in parental leave. In the 2000s, this tendency has also been apparent in the Nordic countries.

What causes the premiers to address family issues that are traditionally viewed as 'soft'? Why should there be a national policy focusing on the welfare of children and families? There are several good reasons for this.

First of all, the indicators of a nation's success are changing. GDP, or economic growth, is no longer a sufficient indicator of a nation's strength and welfare. Both in Finland and in the United Kingdom, governments are looking for more extensive and versatile indicators of welfare. Their aim is to combine the growth of GDP with the welfare of the people.

The people's welfare consists of both objective and subjective factors, such as their views and experiences. A happy nation is likely to be economically strong and better capable of surviving crises. The sources of both economic and non-materialistic, psychological well-being are combined in family and work.

Secondly, people are interested in the success of the Nordic model. The recent past has witnessed a period of strong and continuous economic growth in Finland, Sweden, Norway and Denmark. These countries are both innovative and flexible in their approach. People's mutual trust and their faith in public institutions in these countries are relatively strong.

A significant factor in economic growth in the Nordic countries has been the active participation of women in the labour market, both as workers and, increasingly, as entrepreneurs and managers. There is also a long tradition of equal opportunities. This can be seen in their parliamentary institutions, where the proportion of women is the largest in the whole of Europe. Likewise, the number of women on corporate boards is increasing, albeit slowly.

In all Nordic countries, public services aimed at families are designed to support both the employment of mothers and fathers and the welfare of the children. The most important of these is day care. Recent years have seen the development of new, flexible solutions that emphasise families' freedom of choice. These make it possible for mothers and fathers to stay at home with the children during the first few years of their lives. The general atmosphere in workplaces has also changed, and nowadays people's attitudes to parental responsibilities and the combining of work and family are more tolerant. The best companies and workplaces even try to outcompete each other in their family-orientation.

In terms of the welfare of children, the Nordic countries have traditionally been at the top of international surveys, both OECD and Unicef. These surveys measure the objective and subjective welfare of children, their material well-being, health, academic

performance, family relations, and risk behaviour. The Nordic countries also have the highest birth rates in Europe, with more children per family than any other European country.

It is often said that the Nordic countries have managed to combine a strong economy with good public services, gender equality, and children's well-being. Indeed, it can be argued that the Nordic economies are strong because of the equal opportunities for both boys and girls and men and women, as well as because of their investment in the welfare of their children. Healthy and happy girls and boys are also the best guarantee for long-term economic competitiveness and expertise. But expertise is not based on good learning outcomes in theoretical subjects and mathematics alone. Naturally these are also necessary, but another important factor in the creation of expertise is the appreciation of the opinions and active participation of children and young people. This is where the Nordic countries all excel.

The objectives of family policy are also increasingly on the agenda because modern child research emphasises the importance of the early years as the foundation for human welfare. Good interaction and a close relationship between the child and those looking after him or her during these early years will support the child's health, functional ability and learning skills. It pays to support parenting skills and the continuity of relationships. The OECD also recommended investment in children's early years in its recently published review 'Doing Better for Children'.

Finding the right balance between work and family will support both the parents and the welfare of the children. On the other hand, many parents in their daily lives are faced with the competitiveness of modern working life, working increasingly at nights and at weekends, and the difficulty of coping with their workload. It seems that businesses are aiming for a 24/7 society where all services are available night and day. Mobile technology and the Internet allow us to work anywhere and at all times. In many respects, these developments are not in the best interest of children and do not support their well-being. We cannot bring up the new generation through distance work.

Economic and industrial policies always have an impact on children and families. Unfortunately, in most cases these impacts are not studied or assessed beforehand, prior to the decisions being made. An ideal economic and industrial policy combines the interests of working fathers and mothers on one hand and employers and the labour market on the other with those of the children. A short-sighted economic and industrial policy may result in quick pickings in the short term, but in the long run it will lead to the ill-being of children, marginalised youth, and broken families. It will not support sustainable economic growth.

Following this meeting of the Nordic, Baltic and British premiers, the hope is for future continuation of the discussions that took place, leading to increasing focus on the well-being of children and families in the policies of these countries. It pays to invest in the welfare of children and families.

*Maria Kaisa Aula*

*The Ombudsman for Children in Finland*

*The Office of the Ombudsman for Children in Finland*



## Aalto University – think again

By Tuula Teeri

*This article will review the foundation of Aalto University and discuss the new university's strategy, exploring the contribution Aalto seeks to make in the Baltic region - as well as beyond. It posits that universities in the Baltic region should embrace change, sharing the knowledge gained through developing new initiatives to strengthen the sector overall.*

Aalto University is a spearhead initiative in Finland's Innovation Strategy and was established through a full merger between three of Finland's leading universities in their fields; the Helsinki University of Technology, the Helsinki School of Economics and the University of Art and Design Helsinki. The merger was championed by the Rectors of the three universities as well as partners from industry. At the same time as the university was established, the government of Finland created the Aalto Foundation to fund us and redefined the University Law establishing Aalto as an independent legal entity. The University has been active from the 1st January 2010. I have the privilege of being Aalto's first President.

Both ideas and commerce have played significant roles in the development of the Baltic region; we have had to stay smart to stay ahead, making intelligent use of our talented populations and natural resources. Aalto University was founded in this spirit, with the goal of ensuring that Finland continues to strive for excellence in research, whilst at the same time working to ensure that research findings have impact on society through educational programmes and innovation activities. Perhaps uniquely, the creation of Aalto provides a brilliant opportunity to redefine the nature of a modern European university. The distinctive capabilities bought to Aalto by the three founding universities coupled with the independence given to direct our own future, enable us to rethink our understanding of how knowledge is produced, indeed, to "think again" about what it means to be a university. Whilst it is challenging to bring together artists, scientists, economists, designers and technologists, the long-term benefits of developing, as well as deepening, the ways in which we think will provide the fertile ground upon which the seeds of fresh, original and high-impact growth can be nurtured. I encourage other universities in the Baltic region to "think again" a share below some of our initiatives.

### Promoting top quality research

Aalto University has as its vision the ambition to be amongst the leading institutions in the world in its chosen research and education fields by 2020. We have identified excellence in research and artistic endeavours as amongst our core values, believing that subsequent activities in education and innovation can only be sustained when built on a foundation of quality. The current status of activities within the existing universities and Finland's longstanding commitment to research, combined with generous funding for the Aalto Foundation, make this a vision which can be realised. Over the coming years, we will nurture our own research talents, setting robust criteria for promotion through establishing a Tenure Track Programme and relating rewards to achievements. We will only make international calibre recruitments and aim to diversify the talent pool we have access to. We will focus our resources on the fields where we know we can have a global impact, seeking to develop rather than expand.

### Surpassing traditional boundaries

Whilst proud of our heritage, Aalto University is not willing to rest on existing merits. This merger provides unique possibilities to build links between different disciplines and to breakdown traditional boundaries between education, research and innovation. Disciplinary excellence will remain our first priority, however, we already see exciting opportunities to work together for example in projects that consider the functioning of the human brain from both physiological and social perspectives. We

are particularly proud of the Aalto Design Factory that brings together young engineers with artists and students from our School of Economics to address real life industrial design challenges together with partners from industry.

We work constantly to re-imaging our relationships with society. Sometimes this work focuses on the social; students from our different Schools are actively considering how rural communities, that often find their younger populations depleted by the promise of "big city life", can sustain themselves and continue to thrive. This work is having impact in China as well as Finland. At other times our focus is economic. Students from Aalto University have established their own society supporting start-up companies and almost 60 companies have been founded already! The Aalto Centre for Entrepreneurship (ACE) is developing education and research programmes in the innovation field, as well as providing support for researchers commercialising their ideas. It is in the innovation field that we see particular opportunities to link together activities in the Baltic region so that we can deepen concepts and build critical mass.

### Pioneering education

Our most profound impact on society will be through the graduates we produce. Aalto aims to educate responsible, broad-minded experts with a comprehensive understanding of complex subjects to act as society's visionaries and agents of change. Our programmes will always be based on a deep understanding of the core principles of each discipline; however we will seek to reconsider how the students can best learn these principles. Our leading Faculty will teach so that students become inspired. We are re-thinking the traditional lecture format to explore how problem-based learning and individualized learning plans can enable our students to take responsibility for their own continuous development. Gradually, we are introducing inter-disciplinary courses and programmes. Our new Masters Programme in International Design Business Management is proving to be particularly popular.

### Embracing renewal

With the granting of our independent status, it has also been possible to reconsider how a modern university is lead and managed. In particular I have enjoyed interactions with our now wholly external Aalto Foundation Board, seeing this as a robust and engaging forum within which to discuss the long-term future of Aalto in a global perspective. We have reflected on our administrative systems, redeploying these as services that provide our researchers and students with the high quality support they both want and need.

As President, I have profound respect for the manner in which the Aalto community, despite being just one year old, has embraced the idea of this new university and made it a reality through their actions. Aalto is very much alive! Through its evolution, I feel certain that Aalto will make a powerful and exciting contribution to society in Finland, the Baltic region and countries beyond. Each of us is adapting to being part of a high-pace, global knowledge economy. By experimenting, by "thinking again", and sharing the experiences gained, we can develop faster and together, furthering the Baltic's impact on the global economy.

Tuula Teeri

President

Aalto University

Finland





## The University of Turku has its roots far behind and a look into the future

By Tapio Reponen

The new University act, valid from Jan 1st, 2010 gives Universities in Finland more autonomy, but at the same time financial responsibilities increase. Separated from the state, the Finnish universities became either public universities (corporations under public law) or foundation universities. To increase the global competitiveness, there was a merger between University of Turku and Turku School of Economics that led into a new public university. This action was in line with the Finnish higher education strategy to build globally recognized universities.

University of Turku (UTU) is one of the leading Finnish Universities in science and education, with a high position in many international rankings. UTU is a multi-faculty university having six faculties, business school and several special units. With its 20 000 students it is one of the biggest Universities in Finland. The annual graduation rate is around 1500 master's degrees and 150 doctor's degrees.

According to the strategy University of Turku will be developed as a multidisciplinary and international community, focused on basic research and teaching based on research. The University of Turku also takes a positive view of the incorporation of business activities and cooperation enterprises, provided that the activities are economically viable and the solutions made support carrying out the University's basic missions. According to the *Action plan for societal interaction*, the University of Turku develops its innovation activities with a special platform ("Turku Innovation Platform") as part of activating the interdisciplinary knowledge clusters. In addition to the commercial exploitation of research, the University of Turku offers and markets know-how connected with the development of companies' business activities. Cooperation partners can be found at the University for research and for developing new innovations. Enterprises also have the possibility to utilise the testing, measuring and analysis equipment at the University's research laboratories. At the University of Turku, services are produced especially in the special units outside the faculties and in the units of the Turku School of Economics.

The operation is founded on advanced, strong and profiling areas of research, which are complemented by selected development targets and special national assignments. The synergy is strengthened by the cooperation between subjects, merging related subjects and actively searching for new combinations of research and education on discipline interfaces. The new University will also become a strong centre of business competence where specialised business know-how is applied to different substance areas.

UTU has a strategy to focus on the following research areas to keep it status in the world class also in the future:

- Molecular biosciences
- Cardiovascular and metabolic research
- Ecological interactions and ecological genetics research
- Learning and education research
- Future studies
- Research on institutional design and social mechanism

To meet its objectives in the future the Universities need multiple sources of funding. The Ministry of Education and Culture provides the core funding. The most important financiers of the University's research activities were 2009 the Academy of Finland (20.0 million euros) and Tekes (3.7 million euros + funding portions of companies 0.2 million

euros). The share of other jointly funded research activities was 5.5 million euros, of which the EU's share was 4.1 million euros.

Besides of these UTU is now running a fund raising campaign with special terms until the end of June, 2011. Special terms include tax reduction to donations from 850 to 250 000 euro, and additional funding from the state budget. For each euro the University collects, the state pays 2.5 euro. The objectives is to reach both a high number of donors and a significant amount of capital. As the first Finnish-language university, the University of Turku has from the beginning, since 1920, upheld its founding message *from free people to free science and learning* as its starting point. The University was founded with donations of 22 040 citizens from all over the country. To maintain this same spirit the objective was to reach within a few years the same number of donors.

The campaign has been done with enthusiastic marketing, but with very limited resources. Multiple ways of communication has been used to reach both organizations and private persons. These actions have included social media, print media, presentations and by word of mouth. The members of the small fund raising organization have been moving around and contacting people throughout the campaign. This has also been an attempt to change national culture more favorable to donations.

After the merger Turku School of economics is now a part of UTU. In the fund raising campaign this has had a significant influence. Business world has regarded this as a strong combination of research and business knowledge. Many donors have indicated that they want to direct their support to strengthen business research and education, but within this new environment. Income from the capital gained by donations will have a role in implementing University's strategy.

UTU has always operated with exterior partners but this going to be increasingly strengthened. Take one example. At the *Laboratory of Industrial Physics* the research services for industry are significant. The Laboratory has long traditions in collaboration with industry starting from metallurgy studies. Although the laboratory is small, it is now one of the leading laboratories in Finland in this research field due to its specialization, and it is continuously developing new methods and instrumentations to keep its leading role. The main part of the external funding comes from the big international companies, but most of the partners are local small size Hi-Tech companies emphasizing local business impacts of the laboratory. The department has had important impacts to generate several new Hi-Tech companies. The collaboration with companies and good employment of the students are important to the department. Ph.D. studies have been changed to better meet industry demands and currently also the M.Sc. studies are to be reformed.

Tapio Reponen

Vice-rector

University of Turku

Finland





# The European Research Area needs to go global

By Marja Makarow

More than 50 years ago European governments embarked on their first international research collaboration by establishing the European Organisation for nuclear Research, CERN, as a research institute based on voluntary membership of national governments. CERN is still the most significant cross border common pot investment in fundamental research outside of the European Commission's Framework Programme, addressing questions such as the birth of the universe. Innovation, development and engineering are part of CERN's research agenda, and indeed a number of countries have been able to fetch back their membership fees, and even more, in the form of commercial deals with industry providing CERN with high tech products.

After the establishment of CERN a number of similar intergovernmental research institutes were created, referred to as "EIROFORUM" organisations, including for example the European Molecular Biology Laboratory EMBL, The European Southern Observatory ESO and the European Space Agency ESA. The total investment into these organisations is annually about 10% of the entire research investment in Europe. These institutes have returned value in the form of excellent research, training of young scientists, technological development, mobility of researchers, industry-academia collaborations, and cohesion by providing access to infrastructure to researchers from countries lacking large-scale facilities.

Some 35-40 years later, two international efforts, again on voluntary basis, were initiated in Europe, COST (European Cooperation in Science and Technology) for networking of researchers, and ESF (European Science Foundation) for coordination of cross-border collaboration in research, funding of research and science policy. Today the members of COST are 36 governments and the funds are provided by the European Commission. The 78 funding members of ESF are national research councils, research performing organisation, academies and learned societies that cover 30 countries.

In the mean time the European Commission established its Framework programmes, the ongoing 7th programme managing about 5 % of the total investment in research in Europe. The EC achieved a milestone when it in recent years adopted the notion of excellence in research in its ERC programme (European Research Council), which funds principal investigators according solely to the quality of their track record and research proposal. The content and form of the next Framework programme as of 2014 is in the making, but it is evident that it will concentrate on the Grand Challenges menacing mankind, such as impacts of climate change and the aging population, threats on health and lack of sustainable clean energy sources. Science can help to solve these problems, but only if researchers embark on global collaborations, and that national policy makers and funding organisations allocate resources for cross-border programmes. Indeed, the European Commission is already promoting an instrument to tackle the Grand Challenges, designated Joint Programming. The research consortia of Joint Programming Initiatives would be paid directly by the national organisations, while coordination costs would be financed from Commission's Framework programme.

It is not only research and funds that need to cross borders within Europe and beyond, there is a need for world-wide access to state-of-the-art infrastructure and for transversal activities like agreeing on procedures and criteria of assessment of applications, and on standards for research integrity and ethics. And the mid-set should change. The existing and emerging scientific powers on other continents should be seen as instrumental partners rather than hostile competitors. The risk of national silos is the lack of new ideas restricting the increase of quality of research and development of new technologies. It is useful to realise that mediocre research is very expensive as it is redundant and does not create original new knowledge.

For research to contribute to tackling the Grand Challenges, and indeed to the economical and cultural development of our societies, we need strong national institutions that are engaged in European and global efforts with adequate budget shares for international collaboration. We need a new pact between researchers, funders, society and decision-makers. This pact should acknowledge the importance of freedom of thought, have the courage to take risks, share responsibilities, build mutual trust and partnerships, and adopt evidence-tested political decision-making.

The Commissioner for Research and Innovation, Ms Geoghan-Quinn highlights the importance of innovations in solving Grand Challenges. The advisory body to the Commission, the European Research Area Board composed of 22 independent experts, published in October 2009 its vision on the characteristics of a successful European Research Area. The key drivers for change were identified to be globalisation and virtualisation of research, and the Grand Challenges. In its second report in October 2010, the ERAB put forward concrete recommendations to accelerate the translation of fundamental research findings into innovations. In this context, also the ERAB identified internationalisation beyond Europe, in a reciprocal way, to be instrumental to manage global challenges by research. The new challenges call for adding relevance to the criteria of excellence in science in the form of return to society, with the understanding that frontier research is key for innovation, and that the forms in which research yields impact, and the time-lines, are different for different scientific disciplines.

ESF was established 36 years ago to coordinate Europe-wide collaboration between its member organisations. Half of the ESF organisations are covered also by the EUROHORCs, an association of the Heads of the European Research Councils of the EU and its Associated States. The EUROHORCs and ESF have worked together over the past years on strategic issues and published a joint vision on the ERA, the "EUROHORCs and ESF Vision on a Globally Competitive European Research Area and their Road Map for Actions". The signatories of this document have committed themselves to engage in activities which foster collaboration in Europe and beyond. The organisations of ESF and the EUROHORCs manage together about 30 billion euros annually, three times more than the Commission's Framework Programme. This is why they are key for realising not only Europe-wide but also global collaborations. The ESF has embarked on discussions with EUROHORCs to create a qualified merger of both organisations, to aggregate the national strengths in order to provide a unified voice for European science. National visions and strategies need alignment, together with the supranational one. The urgency is tremendous to get Europe working together.

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## Russia and reform

By Joseph Nye

When Barack Obama became president of the United States in 2009, one of his first foreign policy priorities was to “reset” relations with Russia. This came after a campaign in which his rival, Senator John McCain spoke of “expelling” Russia from the G8 because of its poor record on human rights. Obama believed that a healthy relationship with a healthy Russia was essential to global security. Now with the recent ratification of the START Treaty by the Senate and the Duma, it looks like Obama’s policy has succeeded. But just under the surface, problems lurk as evidenced by the recent Khodorkovsy trial, rising ethnic tensions, and the desultory performance in Davos as President Dmitri Medvedev presented his plans for the modernization of Russia.

Americans have often misjudged Russia’s future. In the 1950s, Americans feared that the Soviet Union would surpass the United States as the world’s leading power. The Soviet Union had the world’s largest territory, third largest population, and second largest economy, and it produced more oil and gas than Saudi Arabia. It possessed nearly one-half the world’s nuclear weapons, had more men under arms than the United States, and had the highest number of people employed in research and development. It exploded a hydrogen bomb only one year after the United States did in 1952, and it was the first to launch a satellite into space in 1957. In terms of soft power, following World War II communist ideology was attractive in Europe because of its resistance to fascism and in the Third World because of its identification with the popular movement toward decolonization. Soviet propaganda actively fostered a myth of the inevitability of the triumph of communism.

When Nikita Khrushchev visited the United States, he boasted that the Soviet Union would overtake the United States by 1970 or by 1980 at the latest. In 1976, Leonid Brezhnev told the French president that communism would dominate the world by 1995. Such predictions were bolstered by reported annual economic growth rates ranging between 5 and 6 percent and an increase in the Soviet share of world product from 11 to 12.3 percent between 1950 and 1970. Yet what in fact was happening was that the Soviet Union was failing to cope with the “third industrial revolution.” Its central planning system was optimized for heavy industry, but turned out to be all thumbs and no fingers when it came to the new information revolution. After that, however, the Soviet growth rate and share of world product began a long decline. In 1986, Mikhail Gorbachev described the Soviet economy as “very disordered. We lag in all indices.” A year later, Foreign Minister Eduard Shevardnadze told his officials, “You and I represent a great country that in the last 15 years has been more and more losing its position as one of the leading industrially developed nations.” Reform proved impossible. As he tried to arrest the decline with perestroika and glasnost, Gorbachev inadvertently accelerated the breakup of the Soviet Union.

The end of the Soviet Union left a Russia significantly shrunken in territory (76 percent of the USSR), population (50 percent of the USSR), economy (45 percent of the USSR), and military personnel (33 percent of the USSR). Moreover, the soft power of communist ideology had virtually disappeared. Nonetheless, Russia had nearly 5,000 deployed nuclear weapons, and more than 1 million persons under arms, though its total military expenditure was only 4 percent of the world total (10 percent of the U.S. share), and its global power projection capabilities had greatly diminished.

In economic resources, Russia’s \$2.3 trillion gross domestic product was 14 percent that of the United States, and its per capita income (in purchasing power parity) of \$16,000 was roughly 33 percent that of the United States. Its economy was heavily dependent on export of oil and gas, with high-tech exports representing only 7 percent of its manufactured exports (compared to 28 percent for the United States). In terms of soft power, despite the attractiveness of traditional Russian culture,

Russia has little global presence. In the words of Russian analyst, Sergei Karaganov, Russia has to use “hard power, including military force, because it lives in a much more dangerous world and has no one to hide behind from it, and because it has little soft power—that is, social, cultural, political and economic attractiveness.”

Russia is no longer hampered by communist ideology and a cumbersome central planning system, and the likelihood of ethnic fragmentation, though still a threat, is less than in the past. Whereas ethnic Russians were only 50 percent of the former Soviet Union, they are now 81 percent of the Russian Federation. The political institutions for an effective market economy are largely missing, and corruption is rampant. Russia’s robber baron capitalism lacks the kind of effective regulation that creates trust in market relationships. The public health system is in disarray, mortality rates have increased, and birthrates are declining. The average Russian male dies at fifty-nine, an extraordinarily low number for an advanced economy. Midrange estimates by UN demographers suggest that Russia’s population may decline from 145 million today to 121 million by midcentury.

Many Russian futures are possible. At one extreme are those who project decline and see Russia as a “one-crop economy” with corrupt institutions and insurmountable demographic and health problems. Others argue that with reform and modernization, Russia will be able to surmount these problems and that the leadership is headed in this direction. President Medvedev has issued a sweeping call “for Russia to modernize its economy, wean itself from a humiliating dependence on natural resources and do away with Soviet-style attitudes that he said were hindering its effort to remain a world power.” But as Katynka Barisch of the Centre for European Reform argues, Russian leaders’ concept of modernization is too state led, and problematic because public institutions function so badly. “An innovative economy needs open markets, venture capital, free thinking entrepreneurs, fast bankruptcy courts and solid protection of intellectual property.” Instead there is “wide-spread monopolies, ubiquitous corruption, stifling state-interferences, weak and contradictory laws.” Dysfunctional government and pervasive corruption make modernization difficult. A Russian economist says flatly that “there is no consensus in favor of modernization.”

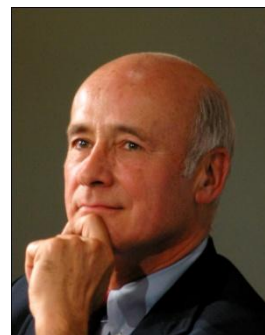
Whatever the outcome, because of its residual nuclear strength, its great human capital, its skills in cyber-technology, its location in both Europe and Asia, Russia will have the resources to cause major problems or to make major contributions to a globalized world. In that sense, Obama was right. We all have an interest in Russian reform.

Joseph Nye

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## Russia at another cross-road

By Fyodor Lukyanov

Year 2011 marks the 20th anniversary of the collapse of the Soviet Union, and there will certainly be plenty of analyses about what that meant and where Russia stands two decades later. But one of the most important results became apparent in 2010: Russia made a psychological (although not conscious yet) break with its past and its former status as an empire. While Russia has left its imperial ambitions behind, the main reference point for defining itself is no longer rooted in the Soviet collapse but somewhere in the uncertain future. The main task facing the country is to do everything it can so this future will be stable and prosperous.

Despite all obvious differences between three presidents of Russian Federation – Boris Yeltsin, Vladimir Putin and Dmitri Medvedev – until recently their agenda was similar in terms of objectives. All of them had basically two main goals – to restore Russia as major international player and as principal actor on the post-Soviet space. Means available were very much different from one period to another, Russia-1995 had little in common with Russia-2005, but the framework sustained. Russia's foreign policy attempted to convince the West that the country's weakness throughout the 1990s was a historical accident and that the ascendancy of the West in relation to Russia was a mere coincidence. Until recently, the Soviet collapse served as the main prism through which the country's identity was defined, and the foreign policy of the first three presidents focused on the West. This agenda has been exhausted by late 2008. Georgian war marked Russian readiness and ability to defend "red line" against expansion of Euro-Atlantic structures eastwards. But it also showed limits of real capacities. The latter was boldly confirmed by world financial crisis which stressed vulnerability of Russian economy.

So, the system of priorities, which shaped Russian politics after 1991, has been largely implemented. But now Russia is facing another, much more difficult task – filling its restored status with new content. Its real capabilities for that are limited, and new requirements are now set for foreign policy.

**First**, major global actors have de facto finally recognized that Russia has priority interests in the former Soviet Union. Neither US, nor EU are keen to intervene. The question now is whether Russia is able to effectively capitalize its newly returned status. Very cautious behavior in Kyrgyzstan last year demonstrated new sense of reality in Russian foreign policy. True, the decision was strongly driven by pragmatism since the risks of intervention far outweighed the chance for success in resolving the situation in Bishkek. But it was also another example that the Kremlin is not willing to take advantage of instability in its backyard to restore – even in part – its lost empire.

**Second**, Russia's policy has turned towards the East, towards Asia – from the point of view of international relations and in the context of territorial development of Siberia and Russia's Far East. Although past Russian policy toward Asia was meant to show the West that Moscow had an alternative partner, now that policy is independent of other considerations. The problem is that in its relations with Asia, Russia must essentially start from scratch. Even when Russia was at its weakest in the 1990s, it still held considerable political significance for Europe. But for most Asian countries, Russia practically never existed as a regional strategic factor, and this remained true even when it became more powerful in the global arena in the 2000s.

And **third**, Russia has been rethinking its relations with Europe – they have ceased to be strategic and are largely

becoming socio-economic. This is because Russia has proclaimed a policy of domestic modernization, which historically has a source in European countries, while Europe is rapidly and apparently irreversibly losing its status of a global political actor. Although Russia continues to see Europe as a source of modernization, Moscow no longer views it as the sole source, looking at Asia as well. The reduction in tensions between Russia and both NATO and the EU is linked to their gradual declines. The stakes in European politics have fallen sharply. Two years ago, it seemed as if the question of keeping the Black Sea Fleet at Sevastopol was almost worth going to war over. But when leaders reached an agreement last spring to keep the fleet in place for many more years, the world hardly noticed.

The global frameworks, within which these three processes, important to Russia, are taking place, are set by actions of the two most influential powers in the world – the United States and China. The growth of China's economic and political influence on the international scene is gradually becoming a dominant of Russia's foreign policy. Russia will have to position itself vis-à-vis its great neighbor. Different options are available from becoming part of "political West" to position of junior partner to Beijing. All are under discussion. The desire to use opportunities offered by the growth of Asia in general and China in particular is mixed with concern that Russia may turn into a second-rate power in Asia, which would entail a decline of its global status.

The shift of the U.S. strategic interest towards South Asia and the Asia-Pacific region requires a new agenda for Russian-U.S. relations. It must be basically different from the present one which was largely inherited from the Cold War times and which, therefore, does not meet the 21st-century reality at all. The New START treaty will probably be the last in the series of Cold War-style disarmament treaties. Most likely, Russia's nuclear strategy in the future will no longer be based on maintaining nuclear parity with the United States. Moscow is beginning to understand that it needs a nuclear arsenal of sufficient size to deter threats from other countries, first of all China. But inertia is very strong both in the U.S. and Russia. Course of Asian affairs can still change previous attitude.

Everything happening now is a result of fundamental shifts in the world order, which were set off by the end of the Cold War's ideological standoff. However, their end – just as the expected configuration of the future international system – is nowhere in sight yet. During last two decades the reference point for all Russian activities was in the past, collapse of 1991 and how to overcome consequences of that. The new reference point is ahead of us – what place will Russia occupy in the 21st century. The answer is open and not at all predetermined.

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*Russia in Global Affairs*

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# Russia, Belarus and Kazakhstan on way to closer economic co-operation

By Seija Lainela

A customs union was formed last year by Russia, Belarus and Kazakhstan. Although various plans for economic cooperation among former Soviet republics have existed on paper since the early 1990s, in the end, it all happened very quickly. After years of slow motion, the idea of a customs union was actualised in 2007, and the timetable for its realisation was announced by the Russian Prime Minister, Vladimir Putin in the summer of 2009. Concrete preparations by the three countries' authorities gained momentum after that, with less than a year left till the 2010 deadline.

An explanation for the rapid progress lies in the fact that in many respects the organisation does not yet function like a genuine customs union. The construction of the actual union is still underway and implementation of several decisions is due to take place only gradually.

The path to the customs union has been short but rough. It has been troubled by serious disagreements between Russia and Belarus. Disagreements have occurred regularly over the past few years with the issues at stake mainly concerning Russian deliveries of energy to and via Belarus. Although sooner or later an agreement has usually been found, there is no guarantee that such problems wouldn't recur.

The reasons behind the countries' search for regional cooperation stem from their wish to find broader outlets for their products, which do not always meet the requirements of other, more developed markets. For Russia, there are certainly also political reasons – gaining more influence in its neighbouring countries and strengthening the process of rapprochement within the CIS as a whole.

## Customs union

The customs union was launched in January 2010, but in a restricted form with unified import regulation and licensing only. In July 2010, when the union started functioning at a broader scale, its competence was extended to common import duties and a common customs code to regulate customs procedures. Unification of import duties was a tough task as each of the countries had their special interests to guard. Russia wanted to protect for example its automobile and aviation industries with high import duties while Belarus did not want to restrict imports of second-hand passenger cars. Kazakhstan supported as little regulation as possible on goods imports by private citizens. An even more difficult problem was the export duty that Russia levied on part of its crude oil exports to Belarus and which Belarus wanted to have abolished. The issue was finally settled in July 2010 a few days after the official inception of the customs union.

As Russia is by far the biggest economy of the group, it has the strongest say in the formation of cooperation principles and practices. On the whole, of the three countries, Russia has pursued the most protectionist foreign trade policies. This meant increases in the level of protection for the other members. For instance, common import duties of the union are to some 90% based on Russian duties. The unification increased duties for 18% of Belarus imports and 45% of Kazakhstan's imports, while Russia saw only 4% of its import duties increased. For nationally sensitive product categories, unification of tariffs will take place gradually, over a transition period of a few years.

Yet another point of contention in the negotiations was how the common import duty proceeds would be divided among member countries. It was agreed that Russia will get 88%, Belarus 4.7% and Kazakhstan 7.3% of the income.

In principle, a customs union should have open internal borders for the transportation of goods. According to the agreement on the Russian-Belarus-Kazakhstan customs union, customs controls were lifted from the Russian-Belarus border at the start of 2010 and they will be abolished from the Russian-Kazakhstan border on 1 July 2011. However, in practice border

controls still exist in some form at the Russian-Belarus border, and it is not certain that they will be abolished from the Russia-Kazakhstan border in July 2011. Due to the gradual unification of tariffs, border checks will be carried out at the internal borders until all transition periods for tariffs have ended. Another reason is that in particular the outer borders of Kazakhstan are not secure enough to handle customs controls according to the union's requirements. The southern Kazakh borders have become a significant route for drug trafficking to Russia.

On average, customs, border and other foreign trade procedures are more developed in Kazakhstan and Belarus than in Russia. The moment importers and exporters in the customs union can freely decide in which member country they present their goods for customs clearance, the Russian customs will face tough competition from the other two member states. So far a transitory rule is in force requiring companies to clear goods in the country whose residents they are. For instance, Russian importers cannot clear goods at a Kazakhstan border point even if they import goods through Kazakhstan.

The competitive situation should put pressure on Russia to improve its standards. Indeed, the Russian government has admitted the situation is worrisome and wants to improve the operation of border authorities in order not to lose income from customs procedures to other member countries.

## Common economic space

The three-country customs union is soon to turn into a common economic space (CES). By the end of December 2010, after a hectic autumn, Russia, Belarus and Kazakhstan had signed all the basic documents governing the principles of the CES. Concrete procedures for carrying out common policies are to be prepared in the course of 2011. This would allow for the launch of the CES at the start of 2012.

The documents cover a wide variety of areas such as competition policy, macroeconomic policies, financial markets, and currency regulation. At first the authorities had very ambitious plans concerning the scope of the common economic space. It was planned, among other things, that common limits be set e.g. for member countries' budget deficits, inflation rates, and public debt. During the talks these limits were, however, abolished. In the end, the agreements became far less binding. It was obvious that differences in the three countries' economic structures, sizes of their economies and perhaps also the degree to which they were ready to give up their sovereignty made the unification of economic policies too difficult a task.

In the same way as the customs union that currently operates in a restricted form, the common economic space may at the beginning exist more in principle than in practice. The common currency area, which according to the Russian President Dmitri Medvedev is the final goal of the integration, lies very far in the future.

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# Russia and World Trade Organization (WTO) – end of journey or endless one?\*

By Sergei F. Sutyurin

Both options suggested by the title of this small article could be sensible argued. Indeed, on the one hand, top ranking Russian officials including Prime Minister Vladimir Putin and President Dmitry Medvedev express their hopes for the successful completion of the WTO accession in 2011. This optimism was shared by the organization Director-General Pascal Lamy who told a news conference on the sidelines of the latest World Economic Forum: "I believe Russian accession to the WTO before the end of this year is doable". On the other hand, similar type of forecasts has already been made (at least in Russia) for more than a half of decade. Under the circumstances pessimists might really expect that current prognosis would share a sad destiny of the previous ones. Recently declared extension of the end of talks till June, instead of April indicated just a week earlier, supports skepticism.

According to an official cite of the WTO the process of Russian accession was launched in June 1993 when the country applied for GATT membership. After establishing of World Trade Organization in 1995 initial application was transformed into application to the WTO. This means that among all currently acceding countries RF has the second longest accession story after Algeria (application was submitted in June 1987).

So far forty one new members joined the club since it started to operate. Thinking about certain general trend of the WTO enlargement one might claim that each next participant (taking under consideration its size, structure, level as well as dynamics of economic development) tended to pay higher entrance fee in terms of concessions and duration of negotiating process. Under the circumstances Russia – at least after Chinese accession – really had not that many chances to finalize the deal fast and easy.

From purely technical point of view only bilateral talks with 62 members of the Working Party on Russian accession<sup>1</sup> were doomed to be very lengthy. Similarly, just due to the scope of issues on agenda multilaterals also were extremely time-consuming. In some cases negotiating parties aspired to secure the best possible outcome for themselves regardless of their *vis-à-vis* interests, concerns and arguments<sup>2</sup> substantially contributing to extension of the talks. At last but not least, trying to understand why during certain periods negotiations either almost stopped or produced no results one might recall famous "*Cui prodest?*" Indeed, because of various economic, political, ideological reasons different groups of both domestic and international stakeholders benefited from the delays in Russia's accession. Hence, they could influence the process accordingly.

Taking under consideration several evident previous failures to fulfill initially announced schedules, is it of any sense to declare once again yet another date for completion of the talks? In spite of an obvious risk, time targeting has its own and pretty powerful logic. Generally speaking schedules are needed to mobilize available resources, to focus them on achieving clearly defined ends.

In a specific case under discussion announced dates tend to introduce additional internal discipline for the negotiators. In addition to that, time targeting demonstrates to the other party seriousness of our intentions. Even if it simultaneously

might diminish our bargaining power, nevertheless it looks fair to claim that without any schedules at all negotiations could last almost forever. By the way, Russian accession is far from being the only example of relatively poor time management. Already more than six year delay in completion of Doha Development Agenda<sup>3</sup> provides critics of the WTO with a very convincing argument. Under the circumstances it is not that clear who has to take the bulk of responsibility for protracted talks with Russia.

Meanwhile, from an author of the present article point of view nowadays chances to bring the negotiations to the successful end are higher than before. On the one hand, there are fewer reasons to expect any serious developments similar to June 2009 Russia's Prime Minister Vladimir Putin declaration. He said that RF together with Belarus and Kazakhstan halted their separate talks on accession to the World Trade Organization. Instead they would apply to join the WTO as a single customs union. At least in a short run this dramatic shift in Russian position generated additional tension between negotiating parties and required extra time to bring them back to fruitful discussion. On the other hand, global economy this year most probably will not experience new wave of economic turmoil similar to 2007-2009 crisis. The latter, as is well known, initiated substantial growth of protectionist pressure, making whatever trade liberalization initiatives more difficult to implement.

At the same time, whether completion of negotiations under review will happen in 2011 or later, adjustment to Russia's new status in comparison with accession *per se* will by all means present much more diverse set of challenges – both threats and opportunities – to the substantially greater number of stakeholders in the country as well as internationally.

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\* The paper was written within a framework of the project "The WTO Chair in St.Petersburg State University"

<sup>1</sup> Such an impressive membership will for sure stay as an absolute record of the WTO accession.

<sup>2</sup> This type of tough negotiating strategy is sometimes referred as "Generation me" philosophy.

<sup>3</sup> According to Doha Declaration a new package of agreements on wide range of international trade related issues had to be agreed by 1 January 2005.

## Baltic Sea electricity market needs a functioning grid infrastructure – EstLink 2 will be one of the main electricity highways in the region

By Jukka Ruusunen

### Setting the scene

In the previous issue of Baltic Rim Economies (6/2010) Einari Kisel wrote an excellent story about the long dream of a common Nordic-Baltic electricity market coming true. Nordic-Baltic electricity market integration is actually part of a much bigger process of creating a European electricity market. And indeed in parallel with the market integration process around the Baltic Sea region, the Nordic market is integrated with the Central West European market, i.e. Belgium, France, Germany, Luxembourg, and the Netherlands. This North West European market is the biggest electricity market in the world with a total consumption of around 1500 TWh! Estonia is already today part of this market and hopefully Latvia and Lithuania will join during 2011 - an even bigger Baltic dream is coming true soon.

The driver for the electricity market integration is our common European Union energy policy with ambitious climate goals together with the goals of ensuring energy security and guaranteeing competitive electricity prices to European companies and citizens. It is very obvious that these goals cannot be met by the historic national approaches but we need deeper cooperation between the Member States.

If electricity could be stored and shipped from one country to another we would definitely have a European electricity market today! But as this is not the case today, the only way to integrate markets is to have enough transmission capacity so that electricity can flow within and between countries in the most efficient way. Instead of national planning we have to plan the grids from a regional perspective taking the regional benefits as the goal to be maximized.

### The first Baltic Sea regional grid plan

The transmission system operators around the Baltic Sea started to make the first common regional grid plan in 2007 and the final plan was launched in 2009. Before that there had been discussions of various individual projects but this was the first time when experts from the companies sat down around the same table to develop a common view about the required grid reinforcements in the region. The grid has to be planned using a system level approach since the benefits of one connection are typically tightly linked to the existence of other connections.

The plan included three new major cross-border connections: Estonia and Finland (EstLink 2), Sweden and Lithuania (NordBalt), and Lithuania and Poland (LitPol). But this was just a plan and things tend to become much more complicated when we start to turn a plan into reality. But this time we had some luck...

### Baltic Energy Market Integration Plan (BEMIP) speeds up the process

In June 2009 the Prime Ministers of eight Baltic Sea Member States and the President of the European Commission signed a Memorandum of Understanding on the BEMIP. This started a real regional process with a strong commitment from various stakeholders including the Member States, the regulators, the transmission system operators and Nord Pool Spot as the regional power exchange. The active role of the European Commission as a facilitator should not be underestimated. The process has really been a success story and can act as a model of electricity market integration for the whole EU.

When we talk about a non-storable commodity like electricity, the market integration plan in fact becomes quite complex. There has to be an agreement on the development of the grid infrastructure that will make possible the integration - electricity can be traded only if there is enough transmission capacity. But this is not enough since the market design, i.e. the market rules, also have to be defined and agreed on a very detailed level. It is due to this complexity and the long lead times in building grid infrastructure that make electricity market integration such a long process compared with the integration of other commodity markets. This is actually why we do not have a European wide electricity market yet.

On the other hand, when the market design has been agreed and there is enough transmission capacity available for the market, the market functions very efficiently. We have already seen this in the Nordic market. The day-ahead hourly market prices defined in the

daily auctions provide a good basis for the efficient use of power plants and transmission capacity for the next day. This is complemented by the intra-day market where electricity for each hour is traded continuously until one hour prior to delivery. "The invisible hand" of the market has really shown its superiority in optimizing the resources of the power system - almost in real time.

### EstLink 2 will be one of the main electricity highways in the Baltic Sea market

BEMIP action plan defined the way forward in terms of common market rules and new interconnections. Very soon Estonia was taken on board to the Nordic - or North West European - electricity market. And we expect the whole 25 TWh Baltic electricity market to be integrated into the 1500 TWh North West European electricity market during 2011.

When a transparent market mechanism was introduced to the trade between Estonia and Finland, the lack of capacity in the current 350 MW Estlink connection became very transparent. In fact, this border has been the most congested one when comparing with other borders in the Nordic market showing that more transmission capacity is definitely needed.

EstLink 2 HVDC connection has been under discussion for several years, but now both studies and practice have confirmed that this connection is really an important part of the Baltic Sea grid infrastructure in the future. We have also introduced the market mechanism that will ensure that this connection will be used in the most efficient way. From the funding point of view the decision of the Commission of the European Union to give 100 million euros as investment subsidy as part of the European Economy Recovery Package was also very important. The total budget of the project is approx. 320 million euros, which will be divided between Fingrid and Elering.

The connection will have a transmission capacity of 650 megawatts, which increases the total transmission capacity between the countries to 1,000 megawatts. The total length of the link is approx. 170 km, some 14 km of which is overhead line in Finland, about 145 km submarine cable laid on the bottom of the Gulf of Finland, and about 12 km underground cable in Estonia.

The timetable of the project is very ambitious. The cable will be laid at the bottom of the sea in the summer of 2013, and the testing of the connection will commence in the autumn of 2013 so that the new link can be made available to the electricity market at the beginning of 2014. I am confident that we can keep this timetable with good co-operation between Fingrid and Elering and all the other players that are participating in the project. The common goal of this excellent team is to ensure that the companies and citizens in the region have reliable electricity deliveries with competitive prices and that the grid infrastructure makes possible the increase of low carbon energy sources in the Baltic Sea region.

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# Lithuanian Energy after the decommissioning of the Ignalina nuclear power plant

By Aloyzas Koryzna

**2010 was a very important and productive year for the Lithuanian energy sector. During this period, all necessary works for successful and prompt achievement of the key aim of Lithuania and other Baltic States, i.e. creation of a successful, reliable, effective, competitive and environmentally-friendly market, which would be integrated into the energy system of the continental Europe and not dependent on one supplier, were accomplished.**

When decommissioning the Ignalina Nuclear Power Plant, Lithuania, as well as France, was on the top of the list of the countries, the electricity demand of which was satisfied by nuclear power. The Ignalina Nuclear Power Plant produced over 70 percent of the energy consumed by the country.

After Lithuania finally decommissioned the turbines of the second unit of the nuclear power plant (the first unit was decommissioned 6 years ago) on 1 January in fulfilling the obligations it assumed upon its joining the European Union, about 80 percent of the energy it consumes is imported from Latvia, Belarus, and Russia. All these countries are still dependent on the UPS/IPS synchronous zone created in the Soviet period.

In other words, Lithuania as well as Latvia and Estonia are still energetically isolated from the European Union, which means that the Russian energy monopolies, which are the only energy suppliers to the Baltic States, regulate the prices and under necessity use their monopoly as a geopolitical weapon.

Therefore, Lithuania is facing two strategically essential problems: shortage of energy generation and energy security. In 2010, Lithuania developed the preconditions for energy independence.

First, pursuant to the EU Third Energy Package, Lithuania performed the reorganisation of enterprises in the energy sector, thus separating, clarifying and forming four blocks: energy production, transmission, distribution and the block of maintenance of the sector enterprises.

Second, the country has actually launched the implementation of energy security strategic projects, i.e. continued with the preparatory works for the construction of Visaginas Power Plant, construction of the power link with Sweden "NordBalt" and with Poland "LitPol Link", preparations for the connection to the continental Europe in order to ensure synchronous works of electricity transmission networks, created a successfully functioning electricity exchange "BaltPool" and, in cooperation with the Baltic States and the electricity exchange of the Nordic States "NordPool", developed a common electricity market of the Baltic States.

Third, the Ministry of the Energy of Lithuania drafted the National Energy Independence Strategy.

In 2010, legal acts for the reorganisation of the energy market regulator, construction of the new power plant and continuation of the energy reform were drafted and submitted to the Parliament. In addition, Lithuania will have to draft and adopt legal acts necessary for demonopolisation of the gas sector in accordance with requirements of the EU Third Energy Package.

## Production

At the end of 2010, all the main energy sector reorganisations were finally accomplished and the sector structure consisting of 4 blocks was developed. When

reorganising energy sector enterprises, it was expected that the separation and clarification of activities of certain enterprises will improve the overall efficiency of the system, increase the sector transparency and protect the consumers. The production block based on AB LIETUVOS ENERGIJA has been created for the concentration of production capacities.

The production block unites the enterprises LIETUVOS ELEKTRINĖ, Kruonis Pump Storage Plant and Kaunas Hydro Power Plant. The lion's share in the production belongs to the Lithuanian Thermal Power Plant situated in Elektrėnai; however, so far, it cannot compete with imported energy because of its dependence on the natural gas prices and outdated technologies.

One of the main tasks of LIETUVOS ENERGIJA is to find ways (for example, use of renewable resources, effective heat production and realisation, etc), which would reduce the energy production cost.

Therefore, the works in the national energy production sector are further implemented starting with the announcement of a tender for the construction of the fifth unit of Kruonis PSP. The new unit will fundamentally serve for the development of national alternative resources, since it is designed for energy generation from renewable resources for capacity reservation and system balancing.

The construction works of the ninth unit of the combined cycle gas turbine at LIETUVOS ELEKTRINĖ are further performed. The new combined cycle gas turbine and generator have been brought to Elektrėnai. The ninth unit will enable LIETUVOS ELEKTRINĖ to generate energy at 30 percent lower costs than using the older units.

However, these changes will not solve the main problem, i.e. the shortage of capacities. Therefore, Lithuania and its regional partners from Poland, Latvia and Estonia are further searching for a strategic investor into the project on the new power plant in Visaginas and its further construction.

So far, the major part of preparatory works of the construction site have been implemented and positively assessed by IAEA specialists.

## Transmission

Pursuant to the EU Third Energy Package, after the separation of transmission networks by AB LIETUVOS ENERGIJA, a new company LITGRID TURTAS was formed. This company manages the transmission infrastructure and functions as an operator of the energy transmission system. This company is also responsible for a very important task, i.e. the implementation of projects of electricity links with Sweden and Poland. The company must ensure the conditions for Lithuania's connection to the energy network of the continental Europe for synchronous work. In addition, LITGRID and the electricity exchange "BaltPool" have a common task – liberalisation of the energy market.

The capacity of "NordBalt" link with Sweden is 700 MW, the length of the link is 450 km. The launch of the link operation is scheduled for December 2015. The project is being implemented successfully. In December 2010, an agreement on the cable construction and equipment and construction of converter stations with AAB, the winner of the tender announced as per Sweden's public procurement law, was signed.

The first part of the "LitPol Link" project on the link with Poland (500 MW) is planned to be accomplished by 2015. The preparatory works on the coordination of the line and

environmental impact assessment surveys were performed. The total cost of the project of 1000 MW line is EUR 237 million.

On 31 December, the new 330 kV switchyard started its operation. The switchyard connected high-voltage air lines Klaipėda-Sovietsk and Jurbarkas-Sovietsk. The switchyard connected Lithuanian electricity transmission lines in an interrupted circle, which will ensure electricity supply to the western regions of Lithuania and have an important function after the launch of the operation of the electricity link "NordBalt".

#### **Distribution and maintenance**

At the beginning of 2011, the company LESTO commenced its activities. The company will unite electricity distribution and supply companies AB RYTŲ SKYRSTOMIEJI TINKLAI and AB VST. Centralisation and automatising of the management of Lithuanian distribution networks will enable LESTO to operate more efficiently and have a greater focus on clients' demands. It is expected that the first year of the reorganisation will bring in LTL 25 million, which will be invested into service improvement, modernisation of electricity networks of garden communities, electrification of remote households, etc.

The maintenance block of energy sector was successfully created last year, i.e. 2 identical network maintenance enterprises, a production maintenance enterprise, an asset management enterprise accumulating non-technological immovable property and transport were incorporated. A

commercial IT company, which will sell the services of data transmission and data centres to the market was established. This company together with the new Technology and Innovation Centre will create and install a smart network and accounting technologies.

The implementation of these and other unmentioned works, i.e. the reorganisation of the national gas infrastructure, will enable Lithuania to protect the interests of its consumers as well as of the consumers of other Baltic states by gaining freedom from energy monopolies, refusing the necessity to buy energy and resources for the generation of energy, i.e. gas, from one source. The integration of the Baltic States into the EU market would allow solving the problems of energy security as well as provide conditions for a civilised and consumer-oriented competition.

*Aloyzas Koryzna*

*Director General*

*LIETUVOS ENERGIJA*

*Lithuania*



## A new nuclear race

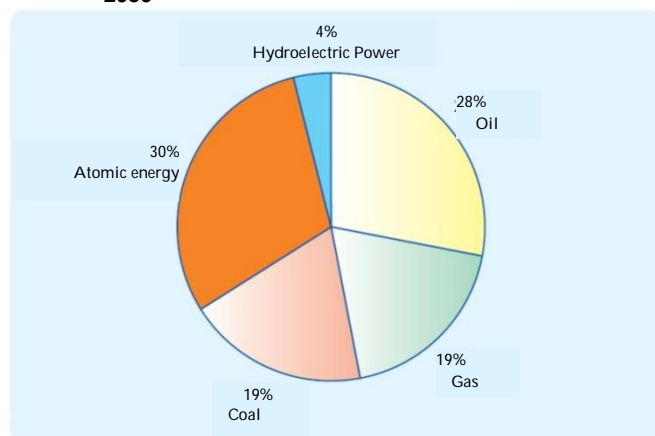
By Sergei Pereslegin and Artiom Zheltov

The current state of global nuclear power is meta-stable. At international conferences, countries keep a close eye on each other. Only a small push would drastically change the situation towards rapid development of next-gen nuclear power technologies. Russia with its long history of technological breakthroughs is eager to take its part.

The expected new nuclear technological system would be based on so-called fast nuclear reactors and encompass a closed nuclear fuel cycle. This technology would be capable of solving the problem of generating capacities shortage and giving hope of eliminating the main burden of nuclear power, the nuclear waste stockpiles. In this case, fast expansion of nuclear power would be practically inevitable. New nuclear power technologies permit construction of scalable, reliable and clean capacities of virtually any size. In future, nuclear power would be capable to reduce the role of coal, oil and gas generation. Of course, it would be not a single-step event but quite a long process, but its consequences would be quick and roughly comparable with replacement of wire phones with wireless cell phone technologies.

The economic background for the expecting technological revolution is dozens of percentage points in the world power generation pie. In the "Nuclear world" scenario, structure of primary energy resources consumption, in terms of fuel equivalent, would drastically differ from that of today:

**Fig. 1. Forecast of Primary Resource Consumption for 2050**



The future energy market size could be roughly estimated on the basis of electricity consumption forecast for 2050 at about 45,000 TW\*h and an electricity price of 0.05 (2006) dollars per kilowatt hour. Taking into account accompanying markets, we have a rough annual figure of about a thousand billion dollars.

World first nuclear technological platform with closed fuel cycle and minimum SNF burden would inevitably become a *de facto* standard, and in certain conditions, it would to become a *de jure* standard. It means that this platform is likely to occupy up to two thirds of world power market; all other competitors, supported by state protectionism, would "hold" together the rest.

Therefore, as soon as a country or corporation starts development of such fast nuclear system and the entire new technological platform, all the other players would be forced to do the same. The point is that creation of the new technological platform would immediately make traditional nuclear reactors obsolete and commercially unattractive.

That is what the current moment in global technological development is about.

Because of the Chernobyl accident, the diversification of generating capacities in nuclear energy was delayed for twenty years. Moreover, it has practically coincided with the next,

upcoming stage - displacement of traditional thermal energy with nuclear power and mass construction of economically efficient, safe and clean large and middle-power reactors. Hence the actors in this global technological strategic game today are facing a difficult choice: to concentrate resources on more or less commercially viable Generation 3 reactors, or to embark on a technological venture and concentrate all effort on development of a new, far more competitive generation of units. Moreover, current economic calculations underestimate profitability of closed-cycle fast reactors for various technical reasons.

In fact, we are facing a typical "prisoners dilemma". If none of the actors on reactor market starts work on "fast reactors" and closed fuel cycle, the current situation will be prolonged. If one of the actors develops a new technological platform and others do not, then the market would be completely redistributed in favor of innovator. If everyone succeeds in development of the new generation units, nuclear power would receive a number of bonuses at the expense of coal, gas, and to some extent of oil. However nuclear market would experience serious competitive struggle where the winner receives superprofits, and others get return of investments and remain in the game.

It seems that when global nuclear industry actors grasp the "prisoners dilemma", all nuclear countries and corporations will start working feverishly on the design of reactors and new generation power system.

This would be recorded in history as the "second nuclear race".

Russia is capable to win the "second nuclear race" by consistently implementing hardly probable but possible "Nuclear Breakthrough" scenario for its nuclear industry. The core of this scenario is to establish a new technological platform as a system integrator for the entire energy system. The scenario includes intensive construction of all reactor types including sodium breeder reactors, closed-fuel cycle reactors integrated into an NPP, lead-cooled reactors, gas-cooled reactors with hydrogen cogeneration, and liquid-salt burner reactors. The problem of spent nuclear fuel would soon be generally solved. The long-term goal here is to make Russian Federation leader of the global nuclear energy market. The scenario requires clear political will at the state and corporate levels, as well as of the Academy of Sciences and the scientific and expert communities. Certainly, there are no reasons to postulate that this scenario would surely be implemented in Russia, but we are keen to do so.

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This article is based on "Global Energy and Next-Generation Nuclear Technologies: Foresight of the Global Energy System 2010–2075" report by Future-Design Group for the Research Institute of Atomic Reactors of Rosatom State Nuclear Energy Corporation; St. Petersburg, 2009.

## Whither Gazprom – can Gazprom survive in a shale gas world?

By Alan Riley

The Great Recession was bound to damage Gazprom's gas sales to Europe. The scale of that damage has been however been compounded by global gas liquidity caused by the shale gas revolution. At first sight the enormous global shale gas resource base would appear to threaten Gazprom's future. However, there is a compelling argument that far from threatening Gazprom the shale gas revolution could give the company a new lease of life.

Gazprom's traditional business model operated on a number of key assumptions. First that it need long term supply contracts with large energy incumbents in EU Member States who could ensure high gas prices across their national territory by effectively foreclosing the market. Second, the revenues from those high gas prices could be then deployed to cover the cost of expensive transit, exploration and production operations in Siberia. Underpinning those two assumptions was a third assumption that gas was a scarce premium resource and that Russia increasingly had most of it.

Even before the shale gas revolution that business model had come under some pressure due to the activities of the European Union. EU liberalisation legislation had made the traditional energy incumbent customers of Gazprom, such as ENI, GDF and E.ON far less masters of their own domestic markets. Third party access and other EU energy rules had begun to reduce the scope to foreclose national markets. Reinforcing energy liberalisation, the European Commission's DG Competition brought a series of antitrust prosecution's against major energy incumbents. It was these prosecutions that broke the back of the traditional model of dominant vertically integrated domestic monopoly energy companies. This liberalisation had already new competitors into the market place; greater transparency and some liquid natural gas (LNG) to enter the market.

The shale gas revolution threatens all the assumptions that underline Gazprom's business model. The world no longer needs mega-projects to generate gas production from the high north or the seas of the Arctic. Gas can now be brought into production near where it is needed. Gas is no longer a scarce premium fuel current IEA figures suggest that the resource base in North America is over 230 trillion cubic metres; over 100 tcm in China and even in Europe over 30tcm. These figures are almost certainly an under-estimate of the total resource base due to the fact that these figures were compiled when looking for conventional resources. The US experience is that when geologists start examining the resource base the size of the base expands. This US experience is confirmed by the first assessments of Indian and Argentinean shale plays which suggest that there is a very significant unrecognized resource base in both those countries.

Worst still for Gazprom is at about the time the shale gas revolution took off in the United States global LNG production began to be ramped up. With capital committed LNG production will rise from 240bcm in 2008 to 410bcm in 2013.

It is the interaction between shale gas production and the ramping up of LNG production which is generating Gazprom's current problems. Although no gas production from European shale plays has yet been developed and significant production is probably unlikely till 2015 at least Gazprom is already feeling the effects of the shale gas revolution.

One of the principal reasons for the increase in global production was the prospect of supplying the US market. Unfortunately for LNG producers just as they committed capital to increased LNG production found that shale gas production had taken off. As a result US demand for LNG has collapsed. A significant proportion of LNG demand has now, using market access provided by EU liberalisation rules, been diverted into European markets. This LNG diversion has cut the spot market price to below that of the Russian border price for gas.

Gazprom has already had to respond by providing discounts to its European customers to ensure that they do not lose too much market share to the LNG sellers. This 'shale gas' effect is happening all before a single molecule of shale gas is produced in Europe. As more states generate their own gas from shale there is a real danger that LNG will become largely restricted to the European and Japanese markets.

In addition, there is a strong likelihood that the prospect of surging gas production in the United States will encourage shale gas producers to seek overseas markets. It will take a few years for liquefaction plants to be developed but Gazprom does face the prospect of 'shale as LNG' arriving in Europe in significant quantities by 2020 (the first actual shipments of US shale as LNG arrived in Great Britain in December 2010).

Shale gas does threaten Gazprom's current business model but it does not necessarily threaten Gazprom. Gazprom itself has enormous amounts of unconventional gas around its existing conventional gas reserves and near its existing infrastructure. The argument within Gazprom is between those who say that for \$30 billion as much unconventional gas can be generated as spending \$150 billion developing the conventional gas fields of Yamal or Shtokman.

Such external realities and internal debates are likely to force Gazprom to fundamentally reassess its business model. Gazprom could provide cheap and plentiful gas to its domestic market and into the EU and go head to head in competition for the European market with LNG producers. In such a market EU energy liberalisation is welcome as it allows Gazprom maximum market penetration.

Gazprom should also be cheered by the increasing European hesitancy over shale gas. Following the hype surrounding the European launch of the anti-shale gas film *Gasland*, moratoriums on drilling have been imposed in France and some of the German states while environmental protests have escalated across the EU. This is likely to significantly delay any European shale gas development leaving the gas market to Gazprom and the LNG producers.

While European delay presents an opportunity for Gazprom seizing that opportunity will require a fundamental shift away from mega investment projects to smaller scale shale gas drilling projects. It will also require Gazprom to reassess its pipeline strategy. In a world of gas to gas competition the cheapest gas wins. This reality suggests that Gazprom requires access to the cheapest major capacity pipelines: which means the Ukrainian pipeline network and not Nordstream (although that now may be a sunk cost) or Southstream (cancellable).

One final thought for Gazprom. Plentiful gas will lead to a final termination of the link between oil and gas prices. Gas will be cheap and plentiful. Gazprom will have a lot of cheap gas on its hands if it develops its own shale gas resources. Would not Gazprom generate much bigger revenues if it built a gas to liquids plant and converted the gas to oil? In other words will the shale revolution ultimately turn Gazprom into an oil company?

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## Tallinn 2011 invites the world to hear its sea and its people

By Jaanus Mutli

In 2011 the capital of Estonia Tallinn is also the European Capital of Culture, proudly wearing the title that was first introduced 25 years ago in the cradle of European culture – Athens.

European Capital of Culture is the only Europe-wide culture brand. It is a strong brand yet it doesn't come with a certain format like the Olympic Games, but rather leaves every city the option to fill it according to its own ideas, needs and possibilities.

To Tallinn and Estonia the title means first of all our own big party that enables positive changes in the city environment and the cultural life – it's not merely a festival but rather a chance to channel the positive energy properly and long term.

At the same time it is a unique chance to present us to Europe through our culture – every serious media channel in Europe will at least once during this year ask, what is going on in Tallinn? And they will all want to find out more. This grants a long term attention on many levels – both from media and from the people all over Europe. Estonia and Tallinn don't currently have another event of that scale and we can even say that it is the most important cultural event in Estonian history.

It was not difficult to create the programme for the Capital of Culture year. Through an open bid we aimed to include and involve all creatives of the city who wanted to participate in what is happening here. Everyone could be part of creating the face of the Capital of Culture.

The creative council received over 900 ideas, out of which 251 have been developed as the core programme resulting in about 7000 single events throughout the year. We wanted to find out what topics and issues are important in the city, in order not to create empty slogans or an artificial campaign but rather support genuine real ideas and events. An ongoing theme that linked many proposals and ideas like a red thread was the relationship or non-relationship of Tallinn to the sea. The proximity to the sea has been both a blessing and doom for Tallinn; the sea has brought us wealth, European culture and foreign invaders.

However during the soviet occupation everyday life was cut off from the sea as the seashore in city centre was a restricted zone, both military and industrial. The area was not accessible and has been neglected in the recent past. So instead of bustling seaside promenades with cafés, restaurants, cultural attractions and amazing sunsets we have had to live with wastelands in supreme locations. And this has been in the minds and hearts of so many people in this old maritime town. The year as European Capital of Culture offers a chance to recapture the seashore for the people of Tallinn. The sea has not been part of Tallinners' lives in 70 years; we want to bring this connection back to people's minds through our stories - awareness of how much more beautiful the city could be with this connection. That's where the main core of the Capital of Culture year programme came from – stories of the seashore.

The sea offers the programme a poetic inspiration and countless beautiful backdrops for so many events. At the same time, as this practical need to reconnect to the sea has been recognised, many actual projects involving the seashore redevelopment have started because of the Capital of Culture. The Seaplane hangars will open as the most state-of-the-art maritime museum in Northern Europe in July 2011 to be linked to the harbour and the city centre by a promenade – the Culture Kilometre.

The concept of stories enables us to place the events in other areas as well, not just physically at the seashore. The programme we present during 2011 offers a good balance between traditional events that have shaped the cultural identity of Tallinn and Estonia for many years and completely new ideas that will spread their wings with the help of Capital of Culture.

Certainly the Song and Dance Festival in the beginning of June would be a great opportunity to take a peek into Estonians' souls for people who have not experienced Estonian culture before. To see and hear 30 000 children singing together on stage and 100 000 people listening and singing along would offer a chance to get a taste of the „singing revolution“ that enabled Estonia to regain its independence 20 years ago. This nearly 150 year old tradition is one of the most important pillars of the Estonian identity and therefore an essential event during the year 2011. The Song Festival Grounds will also be the venue of an international rock and pop concert „Song of Freedom“ on 20 August, celebrating the 20th anniversary of regaining the independence.

NO99 Straw Theatre is the biggest event especially created for the Culture Capital year. It is an installation, a public space and a venue for cultural events. Straw Theatre will be built on the Skoone bastion, next to the famous Old Town of Tallinn. It will be open from May to September 2011 and after that, it will disappear. NO99 Straw Theatre, based on the idea of Ene-Liis Semper, an internationally renowned video- and stage artist and director, is a functional installation surrounded by a consumption-free public space. Everybody is welcome to do their morning workout there, play with their children on the playground, read intellectually enthralling magazines, eat healthy food or just listen to the birds singing and gaze at the sea. From May to September NO99 Straw Theatre will host numerous famous contemporary artists with plays, space- and sound installations. Among others the creations of Sebastian Nübling, Gob Squad, Christoph Schlingensiefel, Kristian Smeds, Nature Theatre of Oklahoma, Siren can be seen. The curator of the programme is award-winning Theatre NO99 and its creative directors Tiit Ojasoo and Ene-Liis Semper, who themselves will bring productions and projects to stage.

Another major highlight of the programme is a unique ceremony on Tallinn Bay – 60 Second of Solitude in Year Zero. A full-length, open-air cinema session will feature one-minute films made by directors from all over the world especially for the event. It is also the premiere of a film anthology – as part of the ceremony, the sole copy of the film will be burnt during the screening, right before viewers' eyes. Each frame of the film will be lost forever. Just like every second in a minute, or a moment in your life. It is homage to larger-than-life cinema's fragile fabric, unsullied prophecy, and those you watch, see and remember.

A major visual arts event will start right at the beginning of the year. 'For Love, Not Money' – 15th Tallinn Print Triennial will be held at the Kumu Art Museum. The 'For Love, Not Money' exhibition will look at contemporary graphics in the broader context of the creation of and trends in modern art. The project will be attempting to reflect current trends in modern art, set against the backdrop of the global financial crisis, and to examine problems associated with the creation, exhibiting and reception of art in this context.

Contributing to the exhibition will be 51 invited artists and 63 additional artists who won places as part of a fiercely

contested international competition. Part of the main exhibition will showcase the work of the grand prix winner from the last triennial, Colombian artist Óscar Muñoz. The triennial also traditionally shines the spotlight on art from the Baltic States, maintaining the fundamental identity of the event through the participation of artists from Estonia, Latvia and Lithuania. The exhibition will focus on the latest trends in modern art, including video, performance, photography and print media.

The summer's grand exhibition 'Gate(way)s' presents new, experimental, media-based forms of art by Europe's younger generation. The projects are a study of how digital networks and technology influence our everyday lives, activities and perception. At the centre of this are works that deal, in various ways, with gateways to information and knowledge in today's digital, networked culture, and offer up alternatives to the mainstream consumerist approach.

For the first time two European Capitals of Culture – Tallinn and Turku – are so close to each other both geographically and culturally. There are many projects that involve and bring together creatives from both cities. Like Sasha Pepelyaev's Dancing Tower. Produced to mark Turku's Aurinkobaletti's 30th anniversary, the Dancing Tower will rise into the firmament of Tallinn and Turku. The ten-metre tower represents the core of humanity: a soul bursting with energy, creativity and dreams. Dancing Tower fuses dance with physical theatre and music, presenting captivating tricks, trained monsters, ventriloquists, fire and water. The international project features artists from Finland, Russia, Estonia and the United States. The moving force behind the performance is visionary Sasha Pepelyaev.

Another theatre project involving both Turku and Tallinn is Kristian Smeds' Karamazov Workshop. There is no doubt that Kristian Smeds is currently Finland's most outstanding and daring theatre director. His unexpected and highly personal takes on classics are famous, sometimes even notorious, and make theatre festival circuits from Moscow to Brussels. They require a new type of flexible actor – just the

kind trained by Von Krahle Theatre in collaboration with the University of Tartu's Viljandi Culture Academy. So that the task is worthy of the performers, Dostoevsky enters the picture with his most complex and weighty work. The big questions of the novel turn into powerful pictures on stage through music, dance and DIY art: God, love and death; the state of humanity; good vs. evil; and guilt and fear. Smeds leads an expedition into the depths of the Russian soul and does this in both Tallinn and Turku.

European Capital of Culture has offered a format for much more international cooperation. Tallinn will expect Cityrama from the United States, SIGNA from Denmark, Punkt Festival from Norway, artists, musicians, actors from Germany, France, UK, Austria, Russia, Spain, USA, China, Georgia, Latvia and many other countries bringing their ideas to Tallinn and hopefully taking inspiration back home.

We have seen great enthusiasm among foreign embassies in Tallinn to join in the programme with ideas and by supporting artists from their countries to come to Tallinn in that special year. The title of European Capital of Culture truly is a door-opener to people's hearts and minds and an excellent tool for international cooperation and European integration at its best.

*Jaanus Mutli*

*Member of the board*

*Foundation Tallinn 2011*

*Estonia*





# Through great commitment a new tourist destination in the Baltic Sea is created!

By Anne-Marget Niemi

Tourism is one of the main themes in the Baltic Sea Strategy published by the European Commission in June 2009. Each main theme of the strategy contains flagship projects, the responsibility of which often rests at the national level. The implementation of the tourism theme is coordinated by the Mecklenburg-Vorpommern region in Germany. In Finland the responsibility rests with the Regional Council of Southwest Finland and Turku Touring (the region's marketing and sales organisation for tourism). Operating in close cooperation with the Centre of Expertise for Tourism and Experience Management, our focus is on a strategy that concentrates on the development of environmentally friendly coastal and rural tourism.

The Baltic Sea Strategy is the first sub-area strategy in the European Union. This is an honour and a challenge as the good results are likely to be copied in the future, which is why our work is being followed with such interest.

The Baltic Sea region has a good chance to become a globally attractive and competitive tourism destination. We are lacking a common vision about our future as a tourist destination and despite sharing a common history we have not yet identified a unifying concept to be marketed. This is important as the Baltic nations are relatively undiscovered by international tourists.

Turku Touring is a member of the Cruise Baltic-co-operation and through this collective we have, together with 10 countries and 26 cities, worked tirelessly as a team. We use the slogan "Ten countries on a string" where every city is a pearl, and together we build the world's greatest cruise experience, a glorious necklace to adorn the Baltic Sea. Our strengths lie in the history and culture of our old cities, many of them medieval towns and former centres for the Hanseatic League. One unifying agent could be the material Amber, used in a range of products in the various Baltic regions. Another commonality is the close proximity to nature that most of the cities have. We in Turku offer "Nordic Walking on the island of Ruissalo" - a neighbouring island and national park belonging to the city. However it is also a strength that the cities are not too similar and differ enough from each other. This enhances the attractiveness to the cruise passenger as they can enjoy a unique experience in every port. The cultural collective offers an enticing contrast to the Mediterranean or Caribbean regions.

At "Seatrade - Miami" (an exhibition for seatriade professionals) we are together promoting cruise opportunities in the Baltic Sea. Our central focus will be on the next two years as Turku and Tallinn are the European Capitals of Culture 2011, whilst in 2012 Helsinki enjoys its status as the World Design Capital. This is a fine example of cooperation at its most effective, with Baltic competitors co-operating professionally to achieve a greater share of the global market for Europe and the Baltic Region.

The Baltic region boasts a seascape that is truly unique. The most beautiful experience has to be island-hopping between Sweden and Finland. Together with the Swedes we are co-operating in marketing and product development. Our goal is to get the brand "Scandinavian Islands" (meaning the islands between Turku and Stockholm) onto the map and into the minds of people worldwide as one of the fascinating parts of the Baltic Sea region.

It is natural that the funded projects are targeting non-European markets, but I think it should be remembered that visiting our neighbours is also very important. We in the Baltic do not know our neighbours very well. There are many more possibilities in the region other than the cruise industry and the focus areas of our flagship-project. The key-word here when developing tourism is 'accessibility'. Sailing in the Baltic, biking in the Baltic, hiking in the Baltic, fishing in the Baltic - there are so many possibilities. Our colleagues in Poland have developed the "Amber route" and there is the possibility to enlarge this to other countries where they utilise amber. Of course this is not all we

have cooking in the Baltic! The Baltic cuisine varies a lot, but seafood dishes, berries, mushrooms, reindeer, lamb are all typical foods for Scandinavian countries. This exciting and varied mix of cuisine should be highlighted as a strength too when marketing the region as a tourist destination.

When talking about the near-markets, the events have an important role. When the city is easy to reach you can visit there many times a year: for concerts, exhibitions, festivals etc. With our closest neighbours there is no need to worry about image-marketing as you already know each other well. For non-Europeans, Russia is still an extremely exotic destination. All the cruise ships have St. Petersburg as a final destination and we try to gain what we can from this. St. Petersburg's cruise port is very modern with the possibility to take grey and black water from the vessels. Port facilities are one of the most important development areas for the whole Baltic Sea region.

We in Turku, are also promoting the new train-connection from Turku to St. Petersburg via Helsinki. Travelling between European Capitals of Culture is also easy: 1-2 times a week we have a flight connection operated by Air Baltic. The flight takes approximately 40 minutes, but cities can also be reached by land and sea, in which case travelling would take half a day. New, joint cultural ventures, born from co-operation between Estonians and Finns, will also be available. We are producing common products under themes such as, "Modern Life in Historical Towns", "Design and Architecture in Turku and Tallinn", "Facing the Sea" and "Food culture: Feed your soul."

I am very proud that my city of Turku has been honoured with the status as European Capital of Culture, with so much to offer for the tourist. Together with the many pre-existing art and artistic experiences that form the essence of Turku, the Cultural year will deliver a variety of intimate, unique, and above all, free encounters with art, culture and the people of Turku. Unfortunately, art and culture has often only been accessible to the privileged few. The "Turku 2011" programme has taken great effort to offer memorable and uplifting experiences for everyone - especially those on a tight budget!

Turku prides itself on the fact it is one of the few places to offer a Circus Art degree programme. This form of cultural creativity contributes to many of the cultural activities. Through circus performances, the "Fire! Fire!"- exhibition and many other events during the year, Turku 2011 offers a variety of ways in which visitors and locals can get physical with culture, with a real emphasis on the interactive possibilities of art.

All of us in the Baltic Sea have huge possibilities to turn the region into a number one tourist-destination, right on our doorstep. However, I would like to leave you with the reminder that, despite these opportunities and our ambition to see the region thrive internationally, we must remember the vulnerability of the natural world on which our progress depends. We must always endeavour to create sustainable means by which we can enjoy the sea, the landscape, the marine life and the wildlife, for many years to come.

Anne-Marget Niemi

Director of Tourism

Turku Touring – Southwest  
Finland tourist and convention  
bureau

Finland



# Creation of a healthy and wealthy Baltic Sea Region (BSR)

By Wolfgang Blank, Leonas Grinius and Peter Frank

## Health Challenges for the EU and BSR

The Health challenges for the EU member states, as described in the EU white paper "Together for health – A strategic approach for EU 2008 – 2013", are the following:

- As the EU population ages, changing disease patterns are challenging sustainability of EU health systems.
- Pandemic incidents and bioterrorism pose potential major threats to health of EU citizens.
- Rapid development of new technologies revolutionizes prediction, prevention and treatment of illnesses.

The white paper stresses the need to incorporate health concerns into all EU policies and to reduce health inequities in order to achieve tangible results for the EU member states and stakeholders. For the Baltic Sea Region (BSR), it is both a challenge and an opportunity to demonstrate how these intentions can be put into practise at the macro-regional level serving as a heaver for BSR and for the Northern Dimension Policies or even entire EU policies.

To our opinion, these challenges can only be met with Innovation in Health and Life Sciences, which are key factors to ensure prosperity and wealth in the wake of globalization and enhanced trans-continental competition. A broad range of policies, actors and stakeholders need to be involved, the relevant interests and responsibilities being:

- Providing public and private financing of social and health care systems.
- Funding of innovations from public and private sources.
- Increasing efficiency of governmental support for innovation in Health and Life sciences, which currently is dispersed among a variety of ministries responsible for health, environment, agriculture, regional development, education, research and finance, just to mention some.
- Increasing cooperation within the research triangle - science, education and economy – a process with many gaps, challenges and un-exploited opportunities.

These monumental challenges are not restricted to a single country and they are highly complex and closely interconnected cutting across sectors and disciplines. Therefore, it is necessary to strengthen trans-national, as well as cross-sectoral, approaches for removing disparities, gaps and barriers within the EU thereby facilitating the access to the market of innovative Health products and services.

## Health Economy as an opportunity for the BSR

BSR plays an important role in modern Europe, as it comprises nine European Union member states plus Norway and Russia. The BSR has the following key features:

- Covers **1.745 Mio. Sq. Km.**, e. g. about **40%** of the **whole EU**.
- Hosts about **85 Mio.** Inhabitants - more than **20%** of the **EU's population**.
- Accumulated **GDP** amounts to **400 Bio. €**, making the BSR one of the EU's major **economic macro-regions**<sup>1</sup>.

<sup>1</sup> For this paper the term macro-region means regions comprised of adjacent territories from several different countries that share a number of common challenges.

The region shares with the rest of EU common challenges like rising costs of health care, ageing population, environmental threats due to climate changes, and the need for alternative sources of energy. We would like to point out that health contributes to wealth and a healthy population is necessary for economic productivity. Therefore, investments in health foster long-term growth and sustainability of economies.

Furthermore, health care strongly and directly benefit from research and technological development in life sciences, and it also triggers technological innovations thus fostering "business driven technology".

Unfortunately, distribution of innovative SMEs and Health industries varies remarkably between metropolitan and remote regions of the BSR. More, SMEs have particular difficulties to participate in research and development of innovative technologies. All this leads to weak transnational and trans-sectoral coordination of the whole innovation chain, resulting in:

- Impeding generation of innovative ideas by research in Life sciences.
- Obstructing development of innovative ideas by SMEs.
- Slowing transfer of innovative products and services.

Also, a fragmented system of research and innovation demonstrates weak internal links and low level of cooperation between actors. Under-investment in the knowledge foundation, unsatisfactory framework conditions ranging from poor access to finance, high costs of IPR and slow standardisation, as well as ineffective use of public procurement, are additional challenges, as described in the "Innovation Union"<sup>2</sup> document.

Health Economy provides an opportunity to make BSR a global front-runner. To achieve this ambitious goal, it is necessary to identify the key stakeholders and to remove barriers for exploiting the full potential.

## ScanBalt Health Region as a tool for Health Economy

The European Union adopted the "EU Strategy for the Baltic Sea Region"<sup>3</sup> in 2009. The EU BSR strategy encompasses an integrated approach to enable BSR to enjoy a sustainable environment and optimal economic and social development.

The ScanBalt Health Region flagship is an acknowledged project within the BSR strategy's action plan. The ultimate goals of the Flagship are to promote a globally competitive BSR Health Economy by solving the grand societal challenges of Health within the BSR, and to play a leading role promoting global health.

The flagship is lead by BioCon Valley® GmbH (Greifswald, Germany), and the Lithuanian Biotechnology Association (Vilnius, Lithuania) based on mandates from German and Lithuanian Governments, respectively. These

<sup>2</sup> Communication from the Commission to the European Parliament, the Council, The European economic and Social Committee and the Committee of the Regions, Europe 2020 flagship initiative Innovation Union, SEC (2010) 1161.

<sup>3</sup> The strategy is described in three documents: a Communication from the European Commission to the Council and the European Parliament, an associated Action Plan which complements the Communication, presented to the Council and European Parliament at the same time and a Working Document of the European Commission's Services which presents the background, approach and content of the strategy.

entities, together with the Västra Götaland Region of Sweden, ScanBalt fmba (Copenhagen, Denmark) and ScanBalt Academy (Oslo, Norway), have formed a task force with the support of many partners and associated partners in the BSR.

To promote coherence of regional policies, strategies and actions, the ScanBalt Health Region flagship has already launched the first cross-sectoral reference project entitled "Baltic Sea Health Region - Business acceleration support and training bridging innovative SMEs and health care organisations to strengthen BSR Health Economy" (acronym "BSHR HealthPort"). The BSHR HealthPort is co-funded by the Baltic Sea Region programme 2007-2013 and encompasses 9 partners together with 15 associated partners. Specifically, the BSHR HealthPort is focused on the following challenges of the Health Economy:

- Insufficient exploitation of ideas from health care researchers and practitioners.
- Procurement practises that limits access of SMEs to the BSR health care market.
- Insufficient innovation competencies of health care providers and SMEs and cultural differences across the Baltic Sea Region.

A key delivery at the end of the project is a Health Economy Innovation agenda for ScanBalt Health Region.

#### **10th ScanBalt Forum: Balanced regional development based on smart growth and specialization between clusters**

Ten years ago (in 2001), the first round table discussion took place, which subsequently led to formation of the ScanBalt BioRegion.

The 10th anniversary of the foundation of ScanBalt BioRegion will be celebrated September 21 – 24 this year in the German State of Mecklenburg/Vorpommern on the Pomeranian Island of Usedom organised by BioCon Valley. The Forum will focus on promotion of a balanced regional development based on smart growth and specialization between clusters.

*Wolfgang Blank*

*BioCon Valley and Chairman of ScanBalt*

*Leonas Grinius*

*Lithuanian Biotechnology Association*

*Peter Frank*

*ScanBalt*

# New trends in business in Moscow–St. Petersburg

By Pirjo Karhu and Manfred Janoschka

## New leadership and corporate culture in Russia

Russia has suffered a huge cultural change during last 20 years while moving from Soviet society to a market economy. The new trends in leadership and corporate culture are today hot topics in business.

### From Soviet style...

As a Soviet heritage there was no proper corporate culture existing at the early 90's in Russia; the culture was more or less authoritarian and masculine: I tell you what to do. The management was based on a strong hierarchy, a huge bureaucracy, commanding and punishing people. As a result of that, the decision making was centralized and slow. The initiative and independency of employees were not accepted. The long term target setting or business orientation were missing. In that kind of environment the employees became passive, avoiding mistakes and shirking responsibility. The general manager was expected to be strong, dictatorial, self-confident and autocratic.

### ...to modern corporate culture

The new roles of managers are the opposite to the old ones. Cross cultural communication and understanding of the Russian way of thinking and acting is a continuous learning process. It's worth doing, because it encourages confidence inside the company. Today young Russian professionals are eager to work in companies, which allow them the independent thinking, the use of own talents and the advancement in career. It's also important that employees can internalize the company values as their own ones. Setting the common goals together increases the commitment and responsibility of people working for company. It also creates a wonderful atmosphere and a team spirit. This all reflects to the client service: the clients can sense that people who love their work, love also clients and want to make them happy with a surprisingly good service. This distinguishes 'the best from the rest'. A client can really feel him/herself as a king or a queen. The top manager's new role is extremely important. A good leadership consists of the efficiently organized work methods and resources, the comfortable work environment, the high-quality IT-solutions and tools and the quality system with the correct, functioning processes. As an umbrella there is a fair, incentive and inspiring leadership.

According to the survey made among American companies it's stated that the success companies do not go after the maximum profit; yet, they do make twice better profit than their competitors. The top companies focus on developing own business operations excellent, to be a forerunner on the market. They are not following how their competitors are running their business. And the top companies do the things differently than the others. When creating a new corporate culture in Russia there are some tips to be followed: Set clear targets and track results. Be present and reachable. Communicate actively, openly and honestly. Be yourself, don't hide your feelings. Create a friendly atmosphere. Keep your promises. Have a party now and then - and relax.

The new corporate culture consists of a well prepared road map: clear mission, vision, values, strategic targets and an incentive leadership. Everybody wants to be a part of a success story. The success depends mostly on a good client care: to keep clients always happy. When employees are highly motivated, there is no concern for the business results. A good leadership can be summarized by saying: We are in business for profit and fun. The more fun - the more profit. In Russia with love.

### Need for modernization

Russia mainly got over the crisis. In 2010 the economy grew already by about 3,8 % after the hard decline of GDP by 8% in 2009. IMF forecasts for 2011 an increase by 4,5%. The Russian Government assumes further increasing GDP rates and rise of production up to 10 % in the next years. The Russian government wants to promote a profound diversification of the economy, an expansion of the values production chain and the development of innovations. Russia should become the world market leader in the production of different goods. Foreign investors should be won over through such great projects the Russian Silicon Valley "Skolkovo", the Olympic Games in 2014 and the Football World Cup in 2018. Eight foreign big companies – such

as for example Cisco, Microsoft, Boeing, Siemens, Nokia, Intel etc – already became partner in "Skolkovo".

### Modernization offensive

Following branches should first bring forward the modernization of the country: measures for the improvement of the infrastructure, production of the technologies in the fields of medicine, energy and information, development of the telecommunication and space systems as well as the increase of the energy efficiency. The total investments are over a trillion US dollars for the next 30 years.

Measures for the improvement of the infrastructure concentrate on road construction, railways, local traffic (underground) and airports. Till 2015 over 6000 kilometers of roads should be built, tens of thousands kilometers should be improved. Besides 3000 kilometers of new railways are planned including improvement (St. Petersburg – Moscow –Nishnij Novgorod) and extension of the railways for the high-speed trains as well as a considerable extension of airports (among others also in St. Petersburg).

Medical branch is an extremely important Russia's building site. Hospitals as well as work of the medical institutions and structures and their management require profound renewal. There is no production of the modern medical equipment in Russia, important medicines must be imported. The government promotes the development of this branch. Russia possesses the biggest energy reserves (oil, natural gas, coal). At the same time it has the best possibilities to reduce the energy losses. Till 2020 Russia wants to reduce the primary energy consumption by 40% (in comparison with the level of 2007).

IT and telecommunication is a branch of economy, in which Russia wants to reach a world level. This branch is financed with the funds from the federal budget and the local budgets. These funds total over 70 billion\$. Other programs in the field of nanotechnology, aviation and space travel are also the points for the future industry.

### Business activity in Russia

In case of an investment in Russia there is a following question: How should I make a business start-up, a business roll-out in the regions; in what kind of legal form and with what partner? Also, all the foreign employees need in Russia a work permit and visa. For "foreign specialists" this procedure has become easier since June 2010.

### Conclusions

New leadership and corporate culture enable to develop continuously organization and services and work as a one dream team for the best of the clients. That is a base for a good business. Furthermore, the need for modernization in Russia and the modernization offensive which is introduced by the president and the government should attract in the first line the European companies and give them possibilities for their business in Russia. These are great chances for an investment in Russia.

Pirjo Karhu

Chairman of the Board

Konsu ACCOUNTOR GROUP

Finland-Russia-Ukraine

Manfred Janoschka

CEO/Managing Partner

Konsu ACCOUNTOR GROUP





## Port development in the Baltic Sea Area

By Markku Mylly

The **Hanseatic League** (also known as the **Hanse** or **Hansa**) was an economic alliance of trading cities and their guilds that dominated trade along the coast of Northern Europe in the later Middle Ages. It stretched from the Baltic to the North Sea and inland during the Late Middle Ages and early modern period (c.13th–17th centuries). The Hanseatic cities had their own legal system and furnished their own protection and mutual aid, and thus established a sort of political autonomy and in some cases created political entities of their own.

### Foundation and formation

Lübeck became a base for merchants from Saxony and Westphalia to spread east and north. Well before the term *Hanse* appeared in a document (1267), merchants in a given city began to form guilds or *Hansa* with the intention of trading with towns overseas, especially in the less-developed eastern Baltic area, a source of timber, wax, amber, resins, furs, even rye and wheat brought down on barges from the hinterland to port markets. The towns furnished their own protection armies and each guild had to furnish a number of members into service, when needed. The trade ships often had to be used to carry soldiers and their arms. The Hanseatic cities came to each other's aid.

### Expansion

Lübeck's location on the Baltic provided access for trade with Scandinavia and Kiev Rus, putting it in direct competition with the Scandinavians who had previously controlled most of the Baltic trade routes. A treaty with the Visby Hansa put an end to competition: through this treaty the Lübeck merchants also gained access to the inland Russian port of Novgorod, where they built a trading post or *Kontor*. Other such alliances formed throughout the Holy Roman Empire. Yet the League never became a closely-managed formal organisation. Assemblies of the Hanseatic towns met irregularly in Lübeck for a *Hansetag* ('Hanseatic Day'), from 1356 onwards, but many towns chose not to send representatives and decisions were not binding on individual cities. Over time, the network of alliances grew to include a flexible roster of 70 to 170 cities.

### End of the Hansa

At the start of the 16th century the League found itself in a weaker position than it had known for many years. The rising Swedish Empire had taken control of much of the Baltic. Denmark had regained control over its own trade, the Kontor in Novgorod had closed, and the Kontor in Bruges had become effectively defunct. The individual cities which made up the League had also started to put self-interest before their common Hansa interests. Finally the political authority of the German princes had started to grow—and so constrain the independence of action which the merchants and Hanseatic towns had enjoyed.

By the late 16th century the League had imploded and could no longer deal with its own internal struggles, the social and political changes that accompanied the Protestant Reformation, the rise of Dutch and English merchants, and the incursion of the Ottoman Empire upon its trade routes and upon the Holy Roman Empire itself. Only nine members attended the last formal meeting in 1669 and only three (Lübeck, Hamburg and Bremen) remained as members until its final demise in 1862.

Despite its collapse, several cities still maintain the link to the Hanseatic League today. The Dutch cities of Deventer, Kampen, Zutphen, and the ten German cities Bremen, Demmin, Greifswald, Hamburg, Lübeck, Lüneburg, Rostock, Stade, Stralsund and Wismar still call themselves *Hanse* cities. Lübeck, Hamburg, and Bremen continue to style themselves officially as "Free (and) Hanseatic Cities." (Rostock's football team is named F.C. Hansa Rostock in memory of the city's trading past.) For Lübeck in particular, this anachronistic tie to a glorious past remained especially important in the 20th century. In 1937 the Nazi Party removed this privilege through the Greater Hamburg Act after the *Senat* of Lübeck did not permit Adolf Hitler to speak in Lübeck during his election campaign. He held the speech in Bad Schwartau, a small village on the outskirts of Lübeck. Subsequently, he referred to Lübeck as "the small city close to Bad Schwartau." After the EU enlargement to the East in May 2004 there are some experts who wrote about the resurrection of the Baltic Hansa

### Baltic Sea ports today

The year 2009 has been difficult for the entire shipping industry and the majority of the Baltic ports saw their cargo volumes fall. Finland and Germany recorded biggest losses, but Sweden, Lithuania and Poland followed with considerable falls in their ports' cargo throughputs for the first three quarters of 2009. However, it seems that the end of the year has borne witness to some kind of recovery, at least in Lithuania and Poland. In addition, Estonia was able to boost its already positive growth during the last quarters. Preliminary data suggests that Estonia was the only state in the Baltic Sea region to increase its cargo volumes in 2009. According to the preliminary statistics, only three of the ten major ports in the Baltic Sea managed to increase their total cargo volumes during 2009, namely Primorsk, Tallinn and Riga. In the case of Primorsk, this positive development is explained by the increase in Russian oil transports, which is probably also behind the successful year experienced in the other two ports. Among the top 10 ports, two German ones – Lübeck and Rostock – saw the greatest decline. This reflects state level statistics, where 2009 appeared to have been most difficult for ports situated in the western or northern part of the Baltic Sea, with only Denmark being an exception.

A brief study of the quarterly statistics gives some grounds for optimism, despite the apparent over-all gloominess. We can see that in six of the nine Baltic Sea states, Q3 saw the best development when compared to the preceding quarter, and in one state (Lithuania) growth during Q3 was as high as during the preceding one (both being positive). Either this implies that some sort of turning point was reached in the development of cargo volumes after the first half of 2009, or Q3 merely represents a momentary peak on an otherwise downhill path. The first half of 2010 will be a crucial pointer to how things develop.

### Baltic Port Barometer 2009: slow recovery expected

The Baltic Port Barometer is a survey designed to provide short-term trend information on Baltic Sea port development, by assessing business and traffic prospects across the BSR. It gathers the views of Baltic Sea ports on their future development, covering topics from economic and cargo development to planned investments and bottlenecks. In the Baltic Port Barometer 2009, a special theme was included on the ongoing recession. The Baltic Port Barometer 2009 had a

wide geo-graphical coverage: 51 port authorities from nine BSR countries participated in the survey. The key results of the Barometer are related to the outlook on economic and cargo developments as well as expectations on the duration of the recession and the timetable for recovery in the BSR. Ports' views on expected economic development in the BSR in 2010 varied from slightly negative to slightly positive, but those forecasting regional growth outweighed those expecting negative result. Big and middle-sized ports regarded future development in a slightly more positive light than the small ones. Moreover, the majority (63%) of the respondents expected growth in their cargo handling volumes in 2010, and same as with views of the overall economic development, big and middle-sized ports' expectations were somewhat more positive about the cargo volumes.

Nearly half of the ports expected some growth in their liquid bulk volumes and only 7% saw them falling. Expectations were slightly more polarised with respect to dry bulk transport. Strong growth was foreseen by 8%, some growth by 33% and some fall by 15% of the ports. Half of the respondents expected growth in other dry cargo volumes (including all non-bulk cargo). The forecast for container volumes was the most positive one; two thirds of the respondents expected increasing volumes, and one fourth no change. The majority (77%) of ports with passenger traffic expected it to grow slightly in their ports in 2010. 71% of the respondents believed that the worst period for their cargo turnover was Q1, Q2 or Q3 of 2009, and only one tenth predicted the worst to come in 2010. Two percent believed it would occur later than 2010. The majority of respondents believed that the peak cargo volumes of 2007/2008 would be achieved again by 2011 or 2012. One fifth expected the recovery to take longer. Some of the respondents forecast that volumes would reach the levels of 2007/2008 by 2010 or even 2009. The months following the publication of the Baltic Port Barometer in September 2009 saw the fall in transport volumes halted; nevertheless, confidence in the market remains fragile. For example, Die Welt reported that the logistics industry in Germany touched bottom in the fourth quarter of 2009.

In January 2010 Jan Fritz Hansen, deputy director of the Danish Shipowners' Association, announced that he saw signs of the industry exiting the crisis, but forecasts the winding up of a number of companies in 2010 (Berlingske Tidende, 19.1.2010). As early as November 2009, the German Seaports' Association (ZDS) declared that it expected cargo volumes in German seaports to grow by 3% in 2010 (Hamburger Abendblatt, 18.11.2009), while the German logistics industry expected growth of 1% in 2010 (Die Welt, 22.10.2010). The Finnish Shipping Company barometer, published in November 2009, indicated that an economic upturn is expected during the first half of 2010 (SPC Finland).

### The way forward

The BSR maritime transport has recently witnessed a series of changing trends. A brief summary of the main recent and forthcoming phases across the BSR is given below. High, but uneven total growth in volumes until early 2008, against generally strong economic development in the region; The global recession affecting the BSR from mid-2008 resulted in

GDP levels close to the 2007 level, with a final effect on total cargo handled in BSR ports of -0.4% in 2008;

A deep economic recession during 2009 with increasingly positive signs of recovery towards the end of the year; maritime transport volumes falling in many BSR countries in quarters 1 to 3, but generally stabilising volume development towards the end of 2009. Varying growth paths in different BSR countries: growth rates in total cargo handled in the ports ranging from +6% in Estonia to around -19% in Finland; Expectations for a moderate economic recovery in BSR raised in forecasts for 2010; some 2/3 of BSR ports expect an increase in volumes from 2009 to 2010, with the logistics sector estimating modest growth for 2010. The bottom was probably reached during 2009; In 2011, economic growth is expected to accelerate, but within certain limits (+1.6% in the euro area). Most BSR ports predict a full recovery (to peak cargo levels of 2007/2008) by 2011-2012. In its European Economic Outlook from September 2009, the International Monetary Fund (IMF) predicts a slow and fragile recovery this year, with some risk potential inherent in reliance solely on rising exports. The IMF sees Europe facing a weaker outlook for medium-term growth due to a drop in investment, the threat of unemployment and various financial and real estate sector characteristics. For the year 2010, the IMF's GDP growth estimates are still somewhat guarded: 0.5% for the whole European Union, 0.3-1.2% for Finland, Germany, Denmark and Sweden, negative for the Baltic States, 1.5% for Russia and, as the highest score, 2.2% for Poland. In its most recent forecast, the IMF set expected growth in world output higher than anticipated, but with variations in different parts of the world. In the euro zone, the forecast implies 1.0% rise in 2010 and 1.6% in 2011. For Central and Eastern Europe, the estimates are 2.0 and 3.7%. Despite the more positive outlook, IMF estimates that real output in the advanced economies will remain below its pre-crisis level until late 2011. BSR maritime transports will probably also see a slow and fragile recovery. Overall development is ultimately dependent on certain major factors: the development of the Russian economy and oil exports, unemployment and consumption, general investment activity in the area and the performance of export-oriented industries.

Based on preliminary data on maritime transport volume development in 2008 to 2009, the total volumes handled in the BSR ports in 2009 should amount to around 750 million tons. This would mean a fall of 10% compared to the totals for 2008. While estimates going beyond 2010 are risky, I would give the following tentative forecast: the total volume handled in the BSR ports will see 2% growth in 2010, 2% growth in 2011 and 3% growth in 2012. This means that the peak levels of 2007/2008 in the Baltic Sea will not be reached until 2013.

*Markku Mylly*

*Managing Director*

*Finnish Port Association*

*Finland*



## Impact of the recession on Baltic maritime transport

By Karl-Heinz Breitzmann

After several years of growth Baltic maritime transport considerably declined in the recession. Will it go back to post-crisis tendencies and growth rates? And are there structural changes, which evolved in the recession, already, or which can be expected?

### Structure and dynamic of Baltic maritime transport

The Mare Balticum is a very transport-intense sea, its share in world sea-borne trade is in the range of 7 to 8 per cent. The reason for this extraordinary percentage can be found in the high internationalization of Baltic economies as well as the pronounced logistics-intensity of leading industrial clusters in the Baltic Sea region and its hinterland.

In 2008 the hitherto largest sea transport volume was reached, it amounted to about 620 million tons. For 94 per cent of these cargo flows, going through ports with an annual cargo handling of at least 1 million tons, we know the composition of transports according to groups of goods as well as their regional structures.

Liquid cargoes by far is the largest group. Nearly 60 per cent of the tanker transport is Russian export going through the Russian ports, but also in transit through ports of Latvia, Estonia and Lithuania. Dry bulk follows with about 25 per cent of all transports. Here coal, iron ore and grain as well as fertilizers and respective raw materials and building materials like cement, stone and gravel can be mentioned. Higher value investment goods and consumer articles on the Baltic are handled by two technologies. In Baltic external trade container feeder services are dominating, but in Baltic internal transport this function is realized by ferries and ro-ro ships. The last cargo group is dominated by forestry products and iron and steel, additionally it includes several other general and heavy cargoes.

From the year 2000 onwards Russia had become the main driver of transport growth. On the one hand Russia extended port capacities and constructed new ports what allowed to increase cargo handling from 38 to 174 million tons between 2000 and 2008. As furthermore big parts of cargo handling in Estonia, Latvia and Lithuania is transit mainly for Russia, we come to the conclusion, that in 2008 about one third of all cargoes handled in Baltic Sea ports is foreign trade from Russia, in 2000 that share was 20 per cent only.

### Baltic maritime transport in the recession and structural changes

Baltic maritime transport and cargo handling of ports was severely hit by the financial and economic crisis in world economy and in economy and trade of Baltic Sea countries. For more than a decade, the Baltic Sea Area was among the European regions with the highest economic growth. But then in the recession it was going the other way round. Especially the Baltic republics saw GDP decreases of 14 to 18 per cent in 2009 and the rate in Russia was minus 8 per cent. Finland had the same downfall, whereas Germany, Denmark and Sweden came to about 5,0 per cent each. Only Poland was better off, reaching even a small increase in 2009.

The shrink in transport started in the second half of 2008, already. Then in the second quarter of 2009 the deepest point had been reached. All cargo types were affected, but the strength of the slump was quite different: Liquid bulk minus 7 per cent only, dry bulk minus 18 per cent, ferry and ro-ro cargoes minus 24 per cent, container goods minus 22

per cent and break bulk even minus 31 per cent (cargo handling in Baltic ports without Russia).

With a slight increase in the third and fourth quarter of 2009 the whole figures for 2009 compared to 2008 were a little bit better than in the second quarter. The total cargo amount was down to 92 per cent with liquids and dry bulk above this average and container, ro-ro goods and break bulk lower than the average (see table 1).

The shipping companies, ports and logistics providers had to adapt to these developments on the demand side. Reducing the costs was the overriding task. Ships were brought into lay-up, the frequency of lines went down, slow steaming was used and investments had to be postponed.

In 2010 economy, foreign trade and international transport in the Baltic Sea region recovered faster than generally believed. But nevertheless, several experts think that the high growth rates from the years 2000 – 2007/8 (see table 2) will not be reached again in the coming years. Much will depend on Russia, its economic recovery and the ability to master the modernization needed.

However it is not only the question on future growth, what is on the maritime sector's mind, rather several structural changes and environmental challenges have to be recognized and handled. In the container sector, for instance, in the recession several new developments occurred. It had been long discussed, if the actual hub-and-spoke system could be replaced partially by direct calls of larger overseas vessels in Baltic ports. Now a large deep-sea shipping company (Maersk) started to include a Baltic port (Gdansk) into its Far East transport system using container vessels of 8000 TEU. Will other carriers follow and which ports can grow into the function of Baltic hubs? Hamburg as the most important hub-port for Baltic feeder services lost substantial shares to Rotterdam, the port competition will even become stronger, when in 2012 the German deep-water port Wilhelmshaven will open its container terminal. There is an increasing number of containers on board of feeder ships, which as a part of short-sea shipments going from Western Europe to Russia and other Baltic countries, adding to the competition between different modes of transport.

### Future challenges

Baltic maritime transport is facing several future challenges, for instance the adjustment of logistical and transport chains under the condition of substantially higher fuel costs for shipping, the improvement of transport connections into the ports' hinterland and the strengthening of multimodal/rail transport especially in the new market economies or the enlargement of port capacities and the development of cooperation among ports. One of the most important aspects is developing by the increasing requirements in the environmental and climate fields. So the new EU Baltic Strategy in the first thematic pillar of its Action Plan, dealing with the region as an environmentally sustainable place, formulates the aim to develop the BSR to a model region for clean shipping. That includes a broad bundle of challenges for shipping and ports. According to HELCOM the main negative effects of main negative effects of shipping include air emissions, illegal and accidental discharges of oil, hazardous substances and other waste and the introduction of alien organism via ships' ballast water and hulls.

In the framework of the International Maritime Organization (IMO) and the MARPOL International Convention for the Prevention of Pollution from Ships our

Baltic Sea got the status as a Emission Control Area (ECA). According to Annex VI of MARPOL 73/78 the sulphur content of marine fuel oil in designated SOx Emission Control Areas (SECA) has to be limited to 1,0 % by 2010 and 0,1% by 2015, whereas global shipping has to go down from hitherto 4,5 per cent to 3,5 per cent as from 2012 and to 0,5 per cent 2010 (or 2025). That has raised strong concern among shipping lines. The argue, that they have to switch to marine gas oil with much higher fuel and operating costs. In comprehensive studies prepared in Sweden, Denmark, Belgium and Germany it was demonstrated, that this 0,1% limit will burden not only maritime transport, but also the export and import industries. And more than that: Increasing costs for maritime transport will weaken its competitive position compared with road transport and that will result in a modal back shift from sea to road with higher negative effects for climate and environment.

In order to come to sound and sustainable solutions, it is necessary to study the respective problems in their complexity, before far-reaching decisions are taken.

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**Table 1. Structure of Baltic maritime transport 2008 and 2009**

Type of Cargo	Year	Total		Baltic external transport		Baltic internal transport	
		mill. tons	Share (%)	mill. tons	Share (%)	mill. tons	Share (%)
Liquids	2008	251	43,0	184	73,3	67	26,7
	2009	251	46,6	189	75,3	62	24,7
Dry bulk	2008	144	24,7	105	72,9	39	27,1
	2009	129	24,0	97	75,2	32	24,8
Ro-Ro	2008	71	12,2	13	18,3	58	81,7
	2009	59	11,0	11	18,6	48	81,4
Container	2008	59	10,1	54	91,5	5	8,5
	2009	48	8,9	43	89,6	5	10,4
Break bulk/ other general cargo	2008	59	10,1	44	74,6	15	25,4
	2009	51	9,5	40	78,4	11	21,6
All Cargoes	2008	584	100,0	400	68,5	184	31,5
	2009	538	100,0	380	70,6	158	29,4

Source: own estimations based on EUROSTAT and Russian port statistics

**Table 2. Dynamic of cargo handling in Baltic Sea ports according to type of cargo**

Type of cargo	Period	CAGR <sup>*)</sup> (%)
Liquids	2004 - 2007	7,0
Dry bulk	2004 - 2007	1,7
Ferry and ro-ro	2000 - 2007	7,4
Break bulk/other general cargo	2004 - 2007	-3,1
Container	2000 - 2007	13,8
Total	2000 - 2007	4,7

\*) compound annual growth rate

Source: Own calculations using figures from EUROSTAT, Russian ports, Shippax



## Russia's innovation policy and modernization agenda

By Natalia Ivanova

Despite impressive growth in Russia's GDP and industrial production, achieved in 2000s before the crisis, the quality of growth reveals the existence of certain problems in the competitiveness of the country. Since late 2008, the deep financial and economic crisis has underlined the importance of many challenges: relatively low level of GDP per capita and even lower level of labour productivity, technological decline in much of the manufacturing, agriculture and service industries; slow modernization due to relatively low industrial investment and innovation activity (both foreign and domestic). Modernization agenda, formulated by president D. Medvedev in September 2009, has been focused on these problems. Actually, innovation and modernization become the two facets of the same fundamental process through which the economy of the country should be renewed.

High-level commitment to innovation has created the conditions for renovating and building new infrastructures in support of S&T and innovation along strategic lines. Creation of the Presidential Commission for Modernization and Technological Development, and of the Government Commission on High Technology and Innovation provides an opportunity to consolidate a nation-wide consensus on the strategic tasks of innovation policy. The key technology priority of Modernization: energy efficiency, nuclear and space technology, medicine and pharmaceuticals, information technologies – has been defined and got new Government's attention and resources. The Skolkovo innovation city is under design as a hub for big high-tech companies. This initiative should become an experimental space for testing and demonstrating arrangements that could be extended to the wider economy and contribute to Russia's modernization.

Basically Government innovation policy objectives and targets has been formulated in several official conceptual and program documents issued in 2002-2006. The necessity to stimulate innovations has been also stressed in several Federal goal oriented and industrial strategies. The most important are "The Energy Strategy of Russia up to 2020", "Federal Space program", "Development of Civil Aviation Technology", and "The Strategies for Development of the Russian Chemical and Petrochemical Industry up to 2015". Although the government has declared a need to create favourable climate for innovation, the actual innovation policy measures implemented are mainly aimed at specific support actions and are largely based on direct financial support of R&D and innovation activity. When a comparison is made of this policy documents, the same list of innovation policy instruments tends to be seen with the predominance of public procurement projects. In effect, a major procurement item is R&D itself, which is largely purchased through the direct R&D financing of branch institutes. At the same time, the use of public procurement to drive innovation in other types of firms, whether public or private, remains under-developed. Firms are not the central objects of these projects and programs as they should be, which distorts the balance of contributions from the public sector to Russian innovation performance. Recently the new version of National Innovation Strategy has been elaborated by the federal Ministry of Economic Development. It is available on the Ministry's web-site and for public discussion and comments.

A major challenge for the Russian innovation policy is to redefine the responsibilities of the various actors within the system in the light of a more dynamic and open market economy and develop new ways of interaction among them. The greatest challenge here is to induce a stronger participation by the Russian business sector in the whole innovation process, including that of conducting and supporting research. In Russia business enterprise expenditure for R&D accounts for nearly two thirds of total Gross Expenditure for R&D. However, the R&D expenditure of the business enterprise sector is to a large extent funded by government, not – as is the practice in high-performing economies – by the business sector itself.

There is also a structural problem in Russia's economy – the predominance of low-tech industries. The significant growth of the Russian economy in 2000's was mainly achieved by raising the rate of production of the oil, gas and mining industries, including their export, and in many respects owing to favourable foreign market conditions for primary goods.

We also observe the most active investment processes in low tech industries: mining and primary metals production, infrastructure sector and services. All technologically advanced industries such as machines and equipment including carmakers, aerospace and defence, invest several time less than mining or transport and communication. And these heavily invested industries are primary exporters while import of machine and equipment is the major article of Russia's import.

Russian companies, being relatively young as private enterprises, are more engaged in the financial restructuring of their business, mainly with the idea of market capitalization growth, and tend to rely on foreign multinationals as a source of new technology and equipment. In terms of their innovation mode they are rather "technology adopters" and innovate primarily by adopting innovations developed by other firms or organizations.

Reorienting the current system towards production-oriented firms as the central players depends on firms' developing the interests and capabilities to innovate and carry out R&D. More favorable framework conditions for innovation, combined with an appropriate mix of financial incentives and other policy measures, will play an important part in this regard. A healthy business environment may be considered a precondition for boosting innovation activities.

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# The National Innovation Strategy's impact on university of applied sciences learning environments

By Marja-Liisa Tenhunen and Irja Leppisaari

The national strategy of a strengthened knowledge base sets numerous challenges for higher education in Finland for the next several years. The National Innovation Strategy (2008) aims to create an internationally top quality learning development environment that widely encourages innovation, endeavoring to be an international pioneer in the development of *both educational content methodologies and technical tools*. Strengthening the knowledge base and developing a learning environment that widely encourages innovation and intrepidly combines multiple skills are emphasized as core measures. In terms of the strategy this means including entrepreneurship, innovation and internationality in the core of education, with the addition of incentives, opportunities for anticipatory education and continuous on-the-job learning. In our article, we raise linkages between National Innovation Strategy (2008) policy and developing a university of applied sciences learning environment. We briefly mirror development of university of applied sciences education against core strategic choices (borderless world, demand- and user-centrism, innovative individuals and communities, and systemics), which facilitate construction of an innovative learning environment.

Universities of applied sciences are significant players in regional business and public sector operational structural changes and internationalization. They develop technology, leadership, marketing, services and other knowledge areas directly impacting business and the public sectors. They also meet regional needs and endeavor in their areas of strength to be leaders in the delivery of teaching that meets practice, and in applied research and development. (TIN2010)

## A working life oriented innovative learning environment

The core task of universities of applied sciences is to educate practitioners able to renew skills and apply knowledge in practice. Educational quality is continuously improved through increased working life linkages and tighter integration of working life oriented RDI to teaching. Future workplace skills are anticipated in both educational content and implementation methods. Reciprocal interaction between fields of study needs to be strengthened, as does collaboration in acquiring skills required in workplaces of the future. Availability of cross-disciplinary education also means developing collaboration between teachers and working life and restructuring teaching. Innovative educational implementations are in fact multidisciplinary and traditional boundary crossing integrations.

The MOE's Promoting Higher Education Based Entrepreneurship Report (2009) calls for a university of applied sciences learning environment that encourages entrepreneurship. Teaching that makes entrepreneurial activity more familiar, RDI ventures with companies, and promotion of an entrepreneurial climate and business skills in all fields of study is central in developing education. Working life representatives should be more strongly linked to the design and delivery of education in ways that are innovative and utilize educational technology and social media to promote sustainable development, e.g. e-mentoring methodologies.

Applied research has a central role in the realization of the National Innovation Strategy, relying especially on an identification of the needs of enterprises and their clients. The potential of universities of applied sciences in RDI and regional development are highlighted in the search for new operational models. In addition to business, design and organizational innovations, the significance of service innovations is emphasized alongside technological innovations. All in all, the profile of universities of applied sciences as regional innovators, intermediary organizations in practical implementation of innovations, and partners and players in enterprises and communities, needs to be strengthened.

## A multicultural learning environment in a borderless world

The *borderless world* concept of the Innovation Strategy, which stresses speeding up development of internationalization in education and RDI (TIN 2010), is integral to constructing learning environments at universities of applied sciences today. Students at these institutions are able to complete part of their program in student exchanges abroad and increasingly through virtual mobile study in collective global virtual learning environments. Likewise

foreign teachers and students greatly enrich the physical and virtual learning environments of these institutions. Innovative, technology utilizing skill development operational models can be developed through collaboration between universities of applied sciences and working life RDI. They help to create borderless learning environments in which various skills are combined boldly and experts at various stages of development interactively enrich each other's performance.

Applying e-learning methods increases opportunities to develop and exchange skills with working life specialists or foreign partners in ways that reduce our carbon footprint and promote equal participation. There is a shift from closed classrooms and learning environments to learning situations in which the learning environment increasingly encompasses the entire world. In user-centric learning environments a mentor or peer group suitable to the development of one's needs may be physically close – or on the other side of the globe. The active participation of universities of applied sciences in international educational and applied research ventures deepens internationality and brings new abilities and knowledge to the region.

## Conclusions

The challenge for universities of applied sciences is to support the construction of a top class learning development environment in Finland and transform threats to globalization, sustainable development and new technologies – the most significant drivers of change as identified in the Innovation Strategy – into opportunities. In order to achieve this objective, working life oriented teaching and RDI must be linked into a tight, viable entity, so that future working life skill needs are increasingly better met. Our challenge in education development is the construction of meeting places between learners, teachers, working life partners and various cultural representatives – which creates a foundation for skill-centric competitive advantage. Universities of applied sciences can be pioneers in creating modern internationally networked learning environments that combine multiple areas of performance.

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## “Modernization from above” in historical perspective

By Leonid Polishchuk

“Modernization” is once again a buzzword in Russian policy quarters, and, consistently with the national tradition, the government is the protagonist and sole champion of the campaign. Such continuity makes lessons of history – both remote and more recent – highly relevant in today’s modernization debates.

The economic historian Alexander Gerschenkron in his famous essay *“Economic Backwardness in Historical Perspective”* identified common features of the most famous past waves of Russian modernization – from Peter the Great to Josef Stalin. All of these waves were initiated by powers that be in response to external threat and prospect of Russia’s losing its competitiveness vis-à-vis international rivals and potential adversaries, all relied on heavy borrowing of foreign know-how, and all required extraordinary mobilization of domestic resources at the cost of massive loss of life. Such modernization lapses did the job in the short run, propelling Russia to global leadership, but lost steam soon thereafter, failing to hold Russia from slipping back into backwardness.

A new coil of the Russian modernization spiral that the Russian government is about to unfold differs from the above pattern on one important count – it does not call for an extraordinary resource mobilization and draconian expropriation of income, property, and human life. This is not just impossible in today’s Russia, but luckily not even necessary, since modernization can be funded from resource revenues which are largely under government control. Are there other reasons to expect that this time there will be an exception from the “the Gerschenkron Rule”?

It is expected that the modernization will be powered by large-scale investment projects which the government will support not only financially, but also by offering preferential treatment. Such projects will be placed in “institutional enclaves” with special legal and regulatory regimes, tax and custom rules, etc. This strategy puts general institutional reform and infrastructure development outside of Skolkovo-like “institutional greenhouses” on the backburner as tasks of lesser priority. Anatoly Chubais, one of the key actors and advocates of the modernization-2011, while occasionally lamenting failures of Russian courts to impartially and consistently uphold the rule of law, flatly rejected the idea that modernization should be started from revamping of the *Basmanyi* justice system.

And yet sustainable growth in the post-industrial era is hardly possible without open-access institutions providing non-exclusive protection of property and contracts, without infrastructure ensuring access to markets, and in the absence of other material, legal and political foundations of market economies. So why not *start* Russian modernization from laying down such foundations? The answer might well be a political one.

Taking Gerschenkron a step further, the American economists Daron Acemoglu and James Robinson in their recent article *“Economic Backwardness in Political Perspective”* point out that broad-based market modernization is fraught with political instability. Political risks do not stop such modernization in countries where ruling elites are either fully confident in their grip on power or, on the contrary, fiercely compete with each other and hence cannot give political rivals trump cards by delaying overdue reforms. In three empires of the XIX century – Russian, Austro-Hungarian, and Ottoman – ruling classes did not face serious political competition within their ranks, and yet were

justly concerned about their political survival. Modernization of these states was consequently blocked, which eventually sealed their fates.

But is “modernization from above” insulated from its own, perhaps no less serious, political risks? Success of China’s special economic zones is often invoked in support of the “Skolkovo” model. What such argument misses is that, first, these enclaves played albeit significant, but by no means pivotal role in the Chinese “economic miracle”, and second, that capital and innovations were en masse spilling over the boundaries of special economic zones to the rest of the country, where regional and municipal governments vigorously competed with each other for economic resources by offering business-friendly investment climates.

In Russia state support to selected high-tech projects is not synchronized with general improvement of conditions for innovations and doing business economy-wide. This mismatch is bound to leave behind vast human, intellectual and material resources that just happened to be outside the boundaries of the pre-ordained would-be modern sector of the Russian economy. Such discrimination will likely breed social tension – what can better illustrate “enclave modernization” than a German-built super-express train running on an obsolete railroad track past depressed towns and villages, disrupting conventional passenger and freight services and followed with grave glances of those left on the sidewalks...

Mr. Chubais’s conviction that institutional reforms in Russia are of lesser urgency than large-scale innovation projects, and that hence such reforms can be put off until after these priority projects are completed or at least firmly underway, produces a clear sense of déjà vu. Almost twenty years ago Mr. Chubais who was back then in charge of privatizing (not yet technologically modernizing) Russia, with equal confidence maintained that the first order of business was to transfer economic assets from public ownership into private hands. Missing institutional foundations for private property rights were not considered as an obstacle to large-scale privatization – such foundations, it was argued, would come about naturally at a later time. Dismal state of property rights in today’s Russia, two decades since the above scenario was unveiled, refutes the “institutions-could-be-fixed-at-a-later-time” mantra, both in its previous and present versions.

Successful modernization in Russia cannot be sequential, when resources are first concentrated on a relatively few priority projects, and only later, perhaps in a few years, the rest of the national economy will get its chance. Institutional reforms establishing an open economic order, and economic infrastructure development should be given the highest priority. Such reforms make economic growth broad-based and do not upset social and political stability in the country – if anything, they might prove to be the only means to preserve this such stability for foreseeable future.

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## Russia's search for modernization

By Markku Kangaspuro

Modernization has already been on Russia's agenda for 300 years roughly speaking. Modernization in its various manifestations has been carried out using all possible methods from violence to huge investments in education and space technology. Typically Russia has focused on economic development while neglecting modernization of the political system.

Today, again, the real question is how modernization be undertaken and on what basis? The whole leadership of the country is speaking about the country's weaknesses while specific challenges of modernization are listed in numerous speeches. President Medvedev has devoted his political efforts and along this also his reputation in promoting modernization. He has focused on problems Russia needs to face: from corruption, the unsatisfactory state of democracy, primitive economic structure, oil and gas dependency and the lack of self-confidence in ideas and visions for the future of the state itself.

However, identifying problems is the easiest part of the task. The real question is how to overcome these problems and from where the reforms should start? Until now the focus has been on the economy translated into the discourse of international economic competitiveness. President Medvedev has determined that the basis of Russian modernization is technological overhaul of the entire sphere of production, which is based on both domestic innovations in special sectors of the economy along with foreign investments and the transfer of technology. Subsequently, he has identified several key sectors in which modernization with the help of investment and technical transfer are to occur: medical technology, the development of aerospace and telecommunications, and the improvement of energy efficiency.

In fact this programme doesn't include anything unexpected or new in terms of policy. Medvedev has said to several audiences that Russia can't trust its future solely to the continued exploitation of country's raw materials base and energy export due to the fact that Russia's capacity to increase or even maintain export at current level is not possible in the long run. Therefore, Russia's future has to be built on the basis of a diversified economy. Until now everything is clear and doesn't cause any major disagreement among enlightened audience.

The second and more complicated question under consideration is, "what is the relation between economic modernization and the existing political system." Again, in principal and at a general level there is nothing unclear. Medvedev has declared that his modernization policy is based on universal democratic values, market economy and respect of human rights. He has defined the overall state of democracy in Russia as developing gradually, but with the system itself possessing some deficiencies, and its evolution is uncompleted. Kremlin ideologist Vladislav Surkov has spoken several times in different tones on the unique features of Russian democracy, all of which are connected one way or other to the idea of the manipulation of democracy. Thus, what does that speech on democratic values mean in this context?

First of all democracy seems to be subordinated to the main ambition of attaining international competitiveness of the Russian economy. In other words that means keeping up the stability of society by all means. This then leads us to the discussion of historical experience of Russia's regime and historical development of Russian democracy, which refer always to the presupposed uniqueness of Russia and demand of strong centralized vertical power as a outgrowth of Russia's experience. In regards to this question, President Medvedev has consistently followed his predecessor's line in emphasizing the uniqueness of Russian democracy and society.

To what does this uniqueness refer? At first arguments about Russia's geography predetermining the necessity for a strong central power to keep scattered and differentiated

nations/ethnicities together and Russia strong come into the picture. The second argument is usually based on historical experience which illustrates that without strong central power Russia has always been weak, exploited and subjugated by its neighbors. The third argument, emphasizing the role of strong state, has been state's strategic role concerning long-standing investments in innovations and science.

The difficulty determining the relevance of different discussions is how to define the role of state – private relation. On the one hand the ruling elite is convinced that a strong state is inseparable and an indispensable precondition for the prosperity of Russia. However, the elite it is convinced of the advantages of privatization for economic growth and development. The conflict comes from two different demands. In order to attract foreign investments and high technology from abroad Russia has privatised and attempted to convince investors of the consistency of policy based on private ownership and a limited economic role for the state. However, the lack of private capital for new investments and Russia's desperate need to initiate the country's own scientific-innovative sector in particular demand a strong state role in determining future economic policy. As a consequence the discussion on the role of state in modernization policy circular in nature. From ideological standpoints the Russian elite is inclined to emphasize as small a role for the state as possible, but from a pragmatic point of view they still see the state as an essential actor. It is not out of the question that economic interests of political elite can have also a role in the discussion, but it is difficult to estimate how much it influences opinions.

The final questions concern the type of state and democracy Russia needs and, what does Surkov's sovereign democracy and does it fit within the universal concept of democracy mean? In general Russia's leadership has sworn allegiance to a democratic system of government. However last September's speech in Jaroslav, Medvedev and his closest staff proved in many ways that parliamentary democracy does not fit Russia and that it would be even disastrous to continually refer to Russia's historical experience of the need to maintain strong vertical state power. Medvedev stated that parliamentarism would mean a weak and vulnerable Russia, everything opposite to what Russia needs to become competitive economy on world markets. In this context the concept sovereign democracy was not used and historical development of democracy substituted for it.

My conclusion is that the modernization discourse in Russia is mainly focused on the economy and its international competitiveness. That's probably one reason why the Kremlin is more worried about corruption than any deficit of democracy. Democracy is understood in a quite abstract and formal way. It is perceived as a commitment on the part of Russia's leadership to general principles and democratic institutions outlined in the constitution. Public opinion doesn't see the direct link between Russia's need to modernize the economy and develop democracy. On the contrary, Russia's population seems to support the idea of a strong state as a correlary to all notions of wider democracy even in the sense of developing parliamentarism. As Medvedev said, parliamentarism would mean a weaker Russia.

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# Baltic Region will be the Silicon Valley of Europe

By Karri Hautanen

It is a well-known fact that entrepreneurship and the economic growth are linked together very closely; Robert M. Solow, who won the Nobel Prize in 1987 has said that 85% of the economic growth comes from innovations (new products and services, growth companies). The equation is not that simple though – creating business is one thing but creating successful, growth-oriented businesses, is another. The Baltic region has traditionally been poor in creating the latter. There are many reasons for why this is; this article will explain the reasons and outline simple solutions how to increase the success potential of the great companies we have in the region. The article will focus on Finland but most of the findings are also applicable to other countries.

## Situation and the real problems

Finland has been recognized as being one of the most innovative, competitive entrepreneurial and skilful countries in the world by various studies. Despite being a small, distant and relatively cold country Finland has been able to foster great multinational companies like Nokia, UPM and Kone. Finland has also given birth to great innovations that have truly changed the way people live and do business. These include Linux, MySQL and IRC. The foundations for mobile telecommunications as we know it today were laid in Finland. Many great startups have been born here and found their way into an international success. Here are a few of those:

1. Habbo by Sulake – One of the most successful social networks in the world.
2. Rovio – Angry Birds is currently the number one mobile game in the world.
3. Solid Information Technologies – A database company acquired by IBM in 2008
4. F-Secure – An anti-virus company listed in the Finnish stock exchange

The list goes on... The list is relatively good for a country of five million people. So what is this fuss about Finland not being successful in creating great companies? The fact is that we have plenty of more great companies which never became successes and even more future successes in the pipeline – we need to find ways to ensure that those companies will make it – BIG.

There are some fundamental problems that make it hard for companies to succeed.

**Problem 1 – The number of growth companies in the region is low** – In the recent years especially the growth entrepreneurship has been in the spotlight for obvious reasons; according to an international study, only 3-5% (In Finland 1-5%) of all companies are so called growth companies. However, the growth companies create 60-80% of new jobs. Also, according to international studies, the Finnish growth companies are the 2nd worst among 24 industrialized countries when it comes to growth and internationalization.

There are many reasons for the low number of growth entrepreneurs. The economic growth in the Baltic region has come traditionally from traditional companies in traditional industries. The entrepreneurial ecosystem has really emerged here in the past 10-15 years. Even today most of the university graduates prefer working in a large international company rather than becoming an entrepreneur. However, this is the way it should be. The skills required in

an international business can be acquired by working with somebody else. The real question is how to turn these people into entrepreneurs after 5-10 years?

**Problem 2 – The supporting Venture Capital industry is thin** – Venture Capital and other private investors are crucial to growth companies. They enable companies to grow faster than their peers thus helping the domestic economy. According to a study made by the British Venture Capital Association “77% of companies believe that without private equity the business would not have existed at all or would have developed less rapidly.”

Finland has a handful of good investors from angels to venture capital companies. The number of active, domestic Venture capital companies is about 15 – but the real problem is in the cross border investments. The number (both in quantity and Euro) of international investments into Finland has been decreasing during the recent years. This is really worrying since in many cases the local investors simply cannot invest enough to support the rapid growth which could be achieved with adequate funding. This is especially true in the late stage funding rounds, where the capital requirements are high.

*“An economy that does not have a strong venture capital sector is one that displays symptoms of deeper economic problems”* – J.P. Cotis, Chief Economist, OECD.

**Problem 3 – The visibility to companies in the region is poor** – It really does not matter if we only have one or two great, noisy companies with real success potential who go out there and score funding from international investors. The region needs to be able to show all the great companies, people and innovations it has to get the investors exited. As an example, Israel has done a great job in promoting its industries and companies to the world but most of all the companies cross-promote each other. If Finland and the whole Baltic region want to develop itself into a real startup hub, which attracts investors and investments globally, we need to put our heads together and start promoting. What good does it do to anybody if we have great companies that nobody is aware of?

Despite the problems, the region has great potential. We have what it takes to become the next Silicon Valley – we simply need to stop creating endless number of reports and plans and start doing the real work. We need to work together, raise our sleeves and start sweating. Real question is how can this be achieved?

## Solution

The Baltic Regions needs to shape itself into a “Silicon Valley” of Europe. We have what it takes; Companies, innovations and people. Currently, however, the region does not work together to ensure the visibility and access of our companies to the best investors. Companies work by themselves trying to make it in the big world.

I personally urge decision makers to build and support tighter, seamless and transparent collaboration in the region through some simple actions. Especially I recall actions that lead to results that can be measured.

**Collaboration between and across the region** – We need to realize that not all cities and countries are equal. Some are more interesting to investors than others – Sweden for example is interesting because of its success in web-based services; Denmark is well known for its life sciences

sector; Finland is world class in mobile telecommunications industry. However, there are still many great life sciences companies in Finland and mobile telecommunications companies in Denmark. We need to be able to collaborate and share information between the regions but most of all direct the region's message to the investors.

How can this work – Israel, again, have done great work in this. Many of Israeli companies have their headquarters in the US but R&D in Israel. The same thinking should be applied to the Baltic Region.

**Create transparency and increase noise** – Let's face it – many great but small companies don't simply have enough resources to raise their head above the surface and be heard. By joining forces the region can have a larger mass of better companies for the investors to screen. The region simply needs to build a common digital / physical platform for the companies to promote themselves. We need what Tech Crunch is for Silicon Valley or what Israel Venture Capital Online is for Israel. Through active online and offline marketing the international investors will have better access to the deal-flow and will eventually invest in and locate in the region.

**Actions, not plans** – All great successes are a direct result from excellent planning. However, enough is enough – The region needs to start the work and utilize the same methods in their work as the startups do – develop the region using the lean startup method; I have applied some of the thinking behind the Lean Startup in the following examples:

1. Continuous customer interaction – Customers (companies, investors) know best what they want / need. The region needs to be able to listen. Today we as a region sell what we have (companies), not what the customers need.
2. Revenue goals from day one – We need to be able to measure the success of all activities taken to increase the number of growth companies. It's not about how many events have been organized and how many companies have been trained – it's about the number of successful growth companies.

3. Low burn by design – There are already great activities in the region to support and endorse the growth entrepreneurship (Nordic Venture Forum, Arctic Startup, MoneyTalks events etc.). There is not much need to build something completely new – what we need is to find ways on how to ensure the best way of these programs & services to collaborate. This way, the low burn rate is by design.

At the end of the day it's all about passion. We need to have passionate entrepreneurs, employees, investors and even passionate government entities to create the Silicon Valley of Europe into the Baltic Region. It requires hard work but isn't that why we're being paid for and far more importantly – what we LOVE to do?

Let's create the future, together.

*Karri Hautanen*

*Head of Services*

*Technopolis*

*Founder*

*The Finnish Mobile Association*

*Finland*

## R&D and innovation – a window of opportunity for enhanced cooperation with Russia?

By Manfred Spiesberger

Research and Development (R&D), and innovation have experienced remarkable changes over recent years in Russia. They have been identified by Russian policy makers as one of the key drivers of the much propagated modernisation of the country's economy beyond primary goods production. In line with economic expansion and GDP increases of around 7% up to the year 2008, funding of R&D has also significantly improved. This trend encountered a setback in the crisis years 2009-2010, but should be back on a growth track with current economic recovery. Gross Domestic Expenditure on R&D (GERD) as a share of GDP stays in Russia slightly above 1% (in 2009 it reached 1.18%). The allocation of R&D funds has become more competitive, especially through a range of Federal Targeted Programmes and funding tools implemented by the Ministry of Education and Science. New funding bodies for innovation were introduced with the Russian Venture Company and Rusnano, the latter one caring specifically for nanotechnologies. In this context, opening-up tendencies towards international cooperation in R&D and innovation, especially with the EU, have been developing.

### Opening up through various Russian programmes,

Russia has started in recent years not only to attract emigrated Russian scientists to work with research groups back in their former home country, but is now reaching out actively to foreign scientists. In June 2010 the Russian Ministry of Education and Science launched the programme "Attracting leading scientists to Russian universities", which aims at stimulating research activities at universities and at internationalising them. This scheme comes with solid funding of approximately € 3.5 million per project. Scholars selected for funding will have to spend at least four months per year at a respective Russian university. As a result of the programme 40 scientists will receive support, whereby a majority is foreign residents and only 5 are permanent Russian residents. Among the foreign residents an important share are emigrated Russian scientists, but several non-Russians (especially Germans) were selected too. Review commissions included besides Russian also foreign experts, which is a new, but still rare feature of evaluations in the frame of Russian funding programmes.

In the field of innovation, President Medvedev's pet project Skolkovo shall be established with international partners. In the Skolkovo innovation zone specific privileges for research and business cooperation shall apply and development of high tech businesses be facilitated. But the success of the project and whether it can have an overall impact on the country's innovation system has still to be seen.

### Developments at the EU level

Russia's cooperation with the EU in R&D is ongoing on a broad scale both multilaterally and bilaterally with its member states. This is shown by indicators such as co-publication data or the number of joint bilateral R&D funding programmes.

At the EU level, the EU's Framework Programme for RTD and the EURATOM Framework Programme (FPs) are the main cooperation forums for R&D. Russia has consistently had the strongest participation in the FPs, of all countries not being EU member states or countries associated to the Framework Programmes. Through joint calls for RTD projects

of the EU and Russia within the Framework Programmes ("coordinated calls") in various scientific fields (e.g. aeronautics, nanotechnology, energy, fission, etc.), cooperation has been intensified and Russia has funded its participating teams from own national resources. This has strengthened ownership of this activity and perceptions of cooperation on a par, a fact especially important for Russia.

A next step in rapprochement with the EU would be an association of Russia to the Framework Programmes. Russia expressed its interest in becoming associated to the FPs in 2008, which was inspired by the fact that EU countries are Russia's main cooperation partners as well as by a policy to internationalise and increase competition within the Russian R&D and innovation system. But association to the FPs is discussed controversially within Russia and the EU, and consequently negotiations have advanced until now only slowly.

Meanwhile new cooperation tools are in the process of being established through ERA.Net RUS, a European Research Area (ERA)-Net project funded by the EU. ERA.Net RUS aims at coordinating bilateral funding programmes; it has resulted in a call for R&D and innovation projects announced for February 2011. This call is jointly funded and managed by funding bodies from EU Member States, countries associated to the FPs and Russia.

Another joint EU-Russian initiative concerns a "modernisation partnership", which was agreed in spring 2010 between European Commission President Barroso and Russian President Medvedev. The partnership's priority is on facilitating trade and investment, and on intensifying economic relations. The EU focuses here on alignment of technical regulations and standards, on enforcement of Intellectual Property Rights (IPR), on the functioning of the judiciary and the fight against corruption. But the partnership includes as priority area as well innovation, research and development, and space.

### At the bilateral level, cooperation with Germany stands out.

The countries have entered into a strategic partnership on education, research and innovation. Russia participates with significant financial shares in research infrastructure projects in Germany (e.g. it covers around a fourth of the costs of the German XFEL laser project), and a German-Russian scientific year starting in the second half of 2011 shall provide further impetus. The dense cooperation network is confirmed through data on co-publication, which indicate that German colleagues are the second most important co-publication partner of Russian scientists, only narrowly behind scientists from the USA.

Tellingly, Prime Minister Putin launched in November 2010 the latest Russian charm offensive towards the EU in view of a visit to Germany. He proposed an enhanced cooperation in economic matters through a fuzzy "harmonic economic area" between the EU and Russia with a perspective of reaching a free trade area. Energy, R&D, innovation, mobility of students and researchers were also on his agenda.

The opening-up trend can be traced with several more examples, such as Russia's efforts to become a member of the WTO and the OECD, or Russia's repeated proposal to the EU to jointly lift the visa requirement. Lifting visas is

indeed a constructive proposal, as they are an annoying hurdle for researcher mobility.

**Barriers for cooperation persist**

But Russia has to tackle and overcome serious barriers that hamper cooperation. Bureaucratic procedures, uncertainty about protection of property and Intellectual Property Rights (IPR), and unreliability of the judicial system limit the expansion of R&D and innovation cooperation. Exchange of scientific material and equipment with Russia is complicated and may be costly because of taxation and customs duties. Lack of funding for joint projects, housing problems and harsh living conditions in Russia are further factors. Clear regulations, property protection and a proper legal system and functioning of the judiciary are necessary.

Another drawback concerns the fact that changes in R&D and innovation are mainly driven by the state. Private business takes only limited initiatives in this field on its own and more or less independent funding agencies, such as the Russian Foundation for Basic Research see their budgets being reduced or stagnate. Less state control and more room for manoeuvre for non-ministerial actors could set free a cooperation stimulus.

Nevertheless, R&D and innovation, where an obvious common interest for enhanced cooperation between the EU

and Russia and a solid basis for it are given, could provide a good practice example on how to advance jointly in a certain policy field. This would need to spill over to more critical fields such as human rights protection and democratisation. Windows of opportunity should be used and measures be taken in time. Russian proposals regarding visa policy and its interest in association to the FPs need to be taken seriously and negotiations not be delayed by diplomatic wrangles – notwithstanding the result of negotiations. Things may change quickly though, as one could learn just recently: in spite of a prickly relationship, a British-Russian oil deal was struck at top policy-makers level, when common interests came into play and were recognised.

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## Russian modernisation – technological or socio-cultural one?

By Jukka Pietiläinen

Modernisation became a key word of Russian discussion in November 2009, when President Medvedev launched it as a programme for the country's technological development. This has also been reflected in the Russian press.

According to the Integrum database, which contains a large collection of Russian newspapers and magazines, modernisation was mentioned over 300,000 times in 2010 as compared to 200,000 times in 2009 or 2008, or to merely 150,000 times in 2005. In the state newspaper Rossiiskaya gazeta, the increase has been even more rapid, as modernisation was mentioned in 250 pages of the paper in 2005 and in over 1,000 pages in 2010. Just as the increase in the mention of glasnost and perestroika in Pravda in the middle of the 1990s signalled a change in the State policy, the same has occurred with the word 'modernisation' at the end of the 2000s.

Medvedev's view on modernisation is predominantly technological, but modernisation is also related to social changes and to the move toward capitalism, industrialization, secularization, and rationalization, which have taken place in Europe since the Middle Ages. Russia has been on the edge of the modernising centre and the modernising influences have arrived to Russia later, and have interacted with local traditions. As for Russia, as for many other peripheries of Europe, such as Northern Europe, modernising has been often directed by the elite and state leadership. In these countries, some parts of society developed further while others lagged behind.

Russian social scientists and culturologists have discussed the nature of Russian modernisation since the early 1990s. New books and articles with the key word 'modernisation' have appeared regularly, and for example, several of them were published in 2010.

Many Russian scholars see the history of Russian modernisation as cyclic. According to this view, Russian modernisation does not lead from traditional society to a modern one directly and through a clear path, but it remains cyclic: modernisation begins, finds itself in a cul-de-sac and ends, and begins again.

As a consequence, Russian modernisation has been referred to as 'catching-up', 'delayed', 'recidivist', 'conservative' and 'near-modernisation'. Russia has also been described as a 'collapsing traditional society'. All these concepts are related to incomplete or late modernisation. Russia has also been following the processes which have occurred earlier elsewhere. Russian modernisation has included elements of counter-modernisation and recidivist modernisation, and even modernisation without modernity. For Russia, an additional issue has been the conflict between the modernisation led from above and the population which has been only partly modernised. Historically, a move toward modernisation has always been followed by a return to traditionalism.

During the Soviet era, many modern aspects of life were adapted on the surface level only. Whereas the forms were modern, the content remained traditional, even if the traditional forms had been destroyed. These phenomena made some Western scholars in the 1970s believe that the Soviet society has been modernised and would become closer to the Western modern societies. From this point of view, the collapse of the social system was a surprise. But analysing the nature of the Soviet modernisation with the concept of 'fake modernity' first presented by Piotr Sztompka in 1993, the collapse of the Soviet system can be explained

as a failure of this modernisation project. In fact, the society was not modernised even though seemingly modern features existed and many visible manifestations of the traditional forms of culture disappeared. Moreover, the Soviet cycle of modernisation was lead from above and achieved with little individual initiative: therefore the vital individual effort for modernisation was lacking.

The post-Soviet era presents a new cycle of modernisation which may have a better chance for success than the earlier cycles. The difference with the post-Soviet modernisation is that the market economy is now in practice and market processes are the ones which act for modernisation. A non-market alternative to modernisation, as was the case in the Soviet era, is gone and the process of modernisation is similar as in other peripheries of the Western world.

In a book published in 2010 by the Institute of Sociology of the Russian Academy of Sciences, the question, which was already found in the name of the book, was: 'Is Russian society ready for modernisation?' These scholars search for the answer by paying attention not only to technology, but to the question of how, by whom and under which conditions the modernisation in Russia can be successful.

The answer is that Russia has a significant socio-cultural potential for modernisation, although there are many paradoxes in the process of modernisation and it is dependent on many situational factors. Russians are characterised by an internal dynamism and a readiness for change. But achieving of this potential is rather complex.

While Russian leadership headed by president Medvedev argues for technological modernisation, social and socio-cultural modernisation is what Russia would mainly need. This would require progress in democracy, civil rights, good governance and the rule of law. Furthermore, Russian citizens have rather different perspective of modernisation as their President does. According to a recent opinion poll, most ordinary Russians see modernisation as equality before the law and as the observation of human rights (41%), fight against corruption (38%), social fairness and justice (31%) and effective innovative economy (by only 24% of Russians). The latter is among the priorities of the State but it might be not easy to attain without the fulfilment of the former elements. In addition, some Russians view modernisation as an enforcing power of the country (21%), as a renewal of Russian values and traditions (14%) or as creating opportunities for free enterprise and market competitions (12%). According to these results, it seems that most Russian citizens connect modernisation with good governance, social development and rule of law rather than with innovations and technology, as president Medvedev would like to see. In this respect, Russians are more realistic: innovations cannot take place if the social conditions do not favour them. This is the key to Russian modernisation.

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## Modernisation of Russia – moving beyond rhetoric?

By Félix Krawatzek

Expectations for a turning political wind in Russia were high when President Medvedev came to office more than two years ago. The increasingly used rhetoric of modernisation contributed to optimism amongst domestic as well as international actors about the future of the country. Even though former President Putin stressed already in February 2008 the necessity to modernise the Russian economy and its society, it was with Medvedev that the topic received its current attention. When Medvedev asked rhetorically in 2009: "Should we drag a primitive economy based on raw materials and endemic corruption into the future?" the answer given through his article 'Go Russia' and the Speech to the Nation of that same year was clear: "No!". The article and the speech constitute the core of how Russia's political elite officially intends to prepare the country in economic, political and social terms for the 21st century. Since then modernisation has made an impressive career in political discourse. The term is not only the *leitmotif* of the Kremlin itself but also widely used by the political opposition and Russia's international partners.

However, when these actors speak about modernisation they all refer to rather different processes and outcomes. International partners, such as the EU, would like its Eastern neighbour to become more 'like-minded', respecting inter alia rule of law or human rights, liberal voices in the country such as Igor Yurgens have emphasised the need for a deep, systemic and decisive modernisation, focussing on social innovation, a renewal of public and state institutions that goes along with a renewal of political culture. The Kremlin itself is advocating a modernisation that goes, in principle, beyond economic or technological aspects related with Medvedev's key sectors. The role of civil society as well as the importance of deep political reforms are repeatedly stressed as integral part of modernisation. The 'Partnership for Modernisation', signed last June between the EU and Russia, reflects upon that and includes a section on the development of people-to-people links. In other words: strengthening civil society in Russia.

Throughout its history Russia has certainly never lacked ideas and attempts of modernisation – however, the success of many of these measures is debatable, to say the least. What has all the current modernisation rhetoric left behind? The list of impressive economic projects that have been launched is long and amongst the better known ones is Russia's Silicon Valley in Skolkovo or cooperation agreements that have been signed between European firms (Siemens or Deutsche Bahn) and Russian partners. In particular the energy sector attracts European firms (E.ON Ruhrgas or Gaz de France). However, one rightly has to doubt whether modernisation of the country is an importable good. Russia's efforts that have so far concentrated on diversifying its economy risk being short lived if the nature of the political regime itself remains the same. Political and social modernisation has to come from inside as we can see looking at the transformation of Eastern Europe. Despite the involvement of international actors, the situation in those countries only changed lastingly, once the domestic situation

had evolved and when these countries were themselves willing and able to reform state and society structures.

In Russia however this willingness can hardly be found amongst the political elite. Public debate is having difficulties taking place due as well to restrictions on freedom of assembly and media freedom. Critical journalists live a dangerous life as the recent killing of Kommersant reporter Oleg Kashin illustrated again. The fact that Khodorkovsky and Lebedev have to stay in prison for almost exactly the duration that was requested by the prosecutor raises doubts about the independence of the judiciary system. That list could be continued for a long time and it all illustrates that there are not many things that have been undertaken to help Russian society modernise itself.

If Russia has not made much progress on the comprehensive modernisation, what about potential leverage from outside? The 'Partnership for Modernisation' was meant to bring urgently needed new dynamics to the EU-Russia relationship – hard to be confirmed. The last progress report mentioned advances in energy efficiency and transport. Beyond that no tangible progress was noticed. The leverage of the EU on policy dynamics within Russia, in particular beyond the economic sphere, can reasonably be doubted. In particular concerning the enhancement of the cooperation between civil society in Europe and Russia the EU lacks ideas, tools and resources.

The upcoming elections (Parliamentary December 2011, Presidential March 2012) will soon begin to shape the political debate in Russia. If Medvedev's revolutionary promises of modernisation had translated in corresponding actions, he could have emerged as a genuine political alternative. However, as it stands, he has not proven being any different from Putin wherefore it might not be a major surprise to seeing Putin coming back to office – following the change of the constitution for six years to follow. Eight years of Putin showed what can be expected of him – what can be expected of Medvedev beyond hopeful words remains unclear. These words are unlikely to translate into any political or social change in the country if Russia continues to rely on its current system of personalised rules and weak institutions. In that case the auspicious words of the comprehensive modernisation agenda will not expand beyond political rhetoric and will not contribute to transform society more broadly.

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# Internationalization activities of German cluster initiatives – the role of CEE

By Thorsten Posselt and Mathias Rauch

During the last two decades, the concept of economic clusters became increasingly popular among policy makers, economic agents or researchers. The formation of clusters typically leads to improvements in competitiveness and innovative capacity and output, for the individual company within the cluster as well as for the region, in which a cluster is located. Whereas clusters in general are characterized mainly through the close regional proximity of companies along and across the value chain, the term cluster initiative augments this with an institutional dimension. Cluster or network initiatives, both are used interchangeably in German policy, include a—normally explicit—commitment between the different actors to collaborate in various fields, often in the area of research and development (R&D). Initiatives focusing on the latter aspect are sometimes referred to as research clusters. In addition to companies, these networks comprise a variety of actors, such as independent research institutions, universities, public administrative institutions, professional institutions, financing institutions or other intermediaries.

Analyzing the structure as well as the internal and external relations of these networks can deliver important insights for innovation research. A number of international studies found that the close collaboration of companies, research and public institutions (*triple helix ap-proach*) in such networks could further innovation success, economic growth and subsequently employment growth as well as international competitiveness and prosperity of the respective regions. In recent years, Germany experienced a proliferation of such network and cluster initiatives thanks to broadly based public support. The aim was to establish and deepen the exchange between research and commerce to overcome a perceived deficit in the commercialization of research results, particularly compared with the US or some smaller European countries.

In recent years, the topic of internationalization of companies and clusters gained substantially in importance in economic policy discussions. Especially for clusters and networks, the establishment and expansion of contacts to—geographically—outside actors is seen as essential. As results of such transregional relationships and collaborations, maintaining and fostering the existing agglomeration advantages and the inclusion of external expertise or resources are mentioned in the literature. Other aspects are the avoidance of *lock-in* effects, i.e. the loss of innovativeness due to increasing self-referentiality and therefore increasing distance to customers and markets or potential market entries and developments.

As part of an ongoing research project at Fraunhofer Center for Central and Eastern Europe, a broad range of German cluster and network initiatives were surveyed for their internationalization activities. Major topics were regions of interest, motivation and objectives as well as actors and instruments of internationalization activities. Almost all questions were once asked without any regional focus and a second time again with CEE as the specific regional focus. This approach provides on one hand a reference measure for the assessment of CEE and on the other hand it permits a first assessment of strengths and weaknesses of CEE as the target and partner region for German clusters.

As a sample, cluster managers or central contact persons of around 200 cluster initiatives were chosen, which participated in one of the many cluster and network competitions initiated by federal or state public agencies. This guaranteed that all participants have an institutionalized cluster structure with professional management and at least some strategic planning. The response rate was around 1/3 with almost all respondents already implementing at least some internationalization activities.

Central and Eastern Europe (51% of respondents) together with North America (58%) and China (53%) formed the group of most important world regions for German cluster managers besides Western Europe (83%). Russia (38%), which was not included in the CEE category, was the next highest mentioned region, slightly ahead of the rest of the BRIC countries and South-East Asia. The individual CEE countries were also classified. Poland is by far the most important country in CEE, followed by the Czech Republic and, with considerable distance, Hungary. If weighted by the response rate of the entire CEE region, Poland is as important as Russia and the other countries follow, with Czech Republic on the level of India or South-East Asia.

Market development is the most important objective of internationalization activities. However, whereas this is in general followed very closely by knowledge and technology transfer (to increase the own knowledge base), this is not the case for CEE. This is further validated in questions about central areas of activity and their direct targets. Market entry and the expansion of contacts are in this context the most mentioned categories (around 60%). Generally, though, market entry is not rated in the most often mentioned group (around 70%), which includes, in addition to expanding contacts, increasing the international recognition of one's cluster and the cooperation and collaboration in R&D. Furthermore interesting are the differences in response rates for the individual categories. Market entry is mentioned as often for the CEE region as in general, whereas especially recognition of the cluster, but also R&D cooperation are mentioned significantly less often.

Such differences are again recognizable concerning actual activities. The reduced importance of the CEE region for brand building and related activities is supported by the low usage of joint external communication and marketing in the region compared to general answers (33% vs. 50%). In contrast, working together in joint projects is of relatively higher importance in the region than in general. Altogether, the most important and most often used activity is simply mutual official visits. And the higher the individual commitment of the partners, the less often used are instruments, with exchange programs between clusters the least frequently used (around 20%).

With respect to external partners, the CEE region is characterized by comparably low participation of companies and independent R&D institutions compared with the general assessment. All other potential partner institutions (universities, intermediaries, cluster management) show no differences. The low response for independent R&D institutions may, on one hand, simply be a result of their lower number in CEE compared with other regions, or, on the other hand, it may be an expression of comparably low international recognition and reputation. Differences in potential and actual obstacles between general internationalization activities and those focused on CEE may explain the lower participation of companies. Especially language barriers were more often mentioned for CEE, and these may be more acute in companies than in research institutions or the other potential actors. Also, lack of trust seems of higher priority in CEE than otherwise and again this may aim more at companies than at the rest of potential actors.

The generally high importance of the region and the view as an interesting market for German clusters let to expect a further intensifying of activities from German clusters. Additionally, with increasing familiarity between companies from CEE and Germany, a reduction of the voiced concerns seems likely.

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# Innovation and “innoflation” – challenges of creative processes, systemic innovations, and ubiquitous technologies

By Sam Inkinen

A creative economy is the fuel of magnificence.

– Ralph Waldo Emerson, essayist and philosopher (1803–82)

Discovery consists of seeing what everybody has seen and thinking what nobody has thought.

– Albert Szent-Györgyi, a Nobel Laureate and Scientist (1893–1986)

Creativity, innovations, creative economy, and creative industries are examples of key concepts that spark a great deal of general interest and ambitious research as well action.

These concepts have, however, been somewhat “innoflated”: *creative this* or *inno-that* have often lost their true meaning or purpose. The same kind of exaggeration and unrealistic hype was earlier directed to all things beginning with *cyber*, *digi*, and *mobile*.

Thus, a thoroughly analytic view and a Hegelian *Anstrengung des Begriffs* (testing of the concept) in the debate on creativity and innovation would be very welcome. The use of the words “innovation,” “creativity,” “social,” “sustainable,” “ubiquitous”, etc. should be examined more analytically and critically.

The classical distinction between “ideas,” “inventions,” and “innovations,” for example, might turn out to be rather useful in this discussion. According to the traditional definition, an *innovation* is a new product, a new process or a new organizational structure that enables an actor to be successful in the market. In the popular discourse, it is quite common to misuse the concepts and confuse between an “invention” and an “innovation.”

On the other hand, the key notions and buzzwords used in today's academic and popular rhetoric belong to the *Zeitgeist* – i.e. “the spirit of the Age” of our contemporaries. The word “creative,” for instance, is used extensively, and, among other contributions, the ideas concerning the *creative class* by Professor Richard Florida have become key issues of dynamic regional development. The values and principles of the creative class also seem to be directly linked with the processes of the “creative economy.”

*Openness* is another significant keyword in our age. The traditional, *closed innovation* model is built upon the idea that one's own organization and community possesses all necessary knowledge and knowhow. Protecting these knowledge assets is considered a way of securing a competitive edge in the market and society. In recent years, however, debate over *open innovation* has gained a lot of ground.

This change in the discussion is drastic enough to be called a paradigm shift. In addition, there is increasing interest towards *holistic approaches* and *systemic innovation*. In the Nordic countries, the main feature of innovation dynamics and policy making is the so-called *triple helix* model, i.e. co-operation and interactions between the universities, industry, and the government.

In addition, the rise of “innovation journalism” and “innovation media” reveals that the significant role of (social) media and journalistic practices has not been taken into consideration sufficiently in the traditional innovation models. In the ecosystemic view, the role and impact of media and communications is evident.

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“When memories exceed dreams, the end is near. The hallmark of a truly successful organization is the willingness to abandon what made it successful and start fresh.”

These words of Professor Michael Hammer seem relevant in the discussion on creativity, creative industries, and innovation. The debate has been by no means scarce, but are economies, businesses, research groups, and technology developers heading in the right direction?

Maybe, maybe not. The main goal of the European science and technology policy is to develop innovativeness and related processes into a more sensitive, efficient and result-driven direction. This

standpoint is listed as a goal in various instances with regard to economic, science, and technology policies, and it concerns the public sector, higher education, and business life alike.

How to meet this challenge in practice? Contacts, connections, and serendipitous meetings in the in-between of various scientific and business fields and between different organizations are of great importance. One of the main concerns is how to understand innovation processes thoroughly. Recent research on *innovation environments* and *innovation ecosystems* includes wider and deeper viewpoints than the traditional research on *innovation systems*.

It goes without saying that tomorrow's innovation potential lies to a great extent in technological developments and various R&D activities. Already existing and emerging key trends and approaches that can/will create structural changes in the global innovation ecosystems are

1. the (r)evolution of ICT and digital media (including so-called social media, web 2.0 solutions, mobile environments, and ubiquitous technologies)
2. increased *global competition* in various industries
3. increased global pressure to create new *service innovations* to achieve a more innovative and productive service economy
4. increased pressure to find a better balance between business developments and *sustainability* demanded by global warming, climate change, energy issues, and related challenges.

Albert Einstein (1879–1955) once stated that “imagination is more important than knowledge.” The main question in today's innovation dynamics and policy is how to create something new and valuable; how to enable creativity to take place, to “happen” in the context of individual personalities, organizational strategies, operational principles, and in the context of human interaction.

In addition, we might add that futures are not found only through observation (trends, weak signals, wild cards, black swans...) but they are also an outcome of discovery and imagination (scenarios, roadmaps, creative thinking...). In the words of Nobel Laureate in Physics, Dennis Gabor (1900–79): “The future cannot be predicted, but futures can be invented. It was man's ability to invent which has made human society what it is.”

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In this article I have shortly discussed and commented the concepts, aspects, and future trends of creative processes and innovation ecosystems. Such issues as synergy, network building, and “positive accidents” (*serendipity*) have been in focus.

In addition, innovation networks, various business models, and innovation quality are of importance. Finally, it is important to concentrate on effective foresight systems and processes, strategic agility, and the challenges of systemic innovations.

From policy makers' and corporations' viewpoint, real innovations and structural changes are wanted instead of unrealistic rhetoric and hype. Ever too often, concepts are used vaguely and imprecisely. On the other hand, we should encourage and support a more open-minded and boundary-breaking dialogue and sharing of ideas.

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## The Kaliningrad Region as a modernization model of modern Russia

By Alexey Ignatiev

The world financial and subsequent economic crisis stipulated Russia's acknowledgement of the necessity and inevitability of changes in its current economic policy based on raw material export, which is mainly the export of hydrocarbon, through large-scale import substitution policy to high technology export-oriented industries. This is, generally, the economic modernization policy of the country supported by the authorities.

What could be the role of the Kaliningrad Region in this new strategic doctrine of Russia? A complete and thorough answer requires appeals to Russian modern history.

At the beginning of the 90-s when the region turned out to be separated from Russian mainland and its economy being fully integrated into the economic system of the USSR was on the edge of collapse, the region's authorities managed to persuade country's authorities to establish free (special) economic zone on the territory of the region. New economy based on a well-known import substitution policy was formed due to this regime. Components, raw materials and significant number of released products were and are still imported to the region from abroad on the terms of free customs zone which means import duty-free, while the products assembled in the region are sold on the territory of the whole country without any restrictions. As a result, enterprises established in the Kaliningrad Region gained advantage over similar enterprises from Russian mainland and gradually gained the foothold on Russian market.

At the beginning of the XXI century it became obvious that this scheme cannot always exist as stimulating import-substitution in one region impedes similar industries development on other territory of Russia due to artificially created favourable conditions for Kaliningrad entrepreneurs. It was nonsense from macroeconomic point of view. It was one of the reasons to adopt a new law on the special economic zone in 2006. The law was to change the image of Kaliningrad economy transforming it into a complex of large export-oriented industries and many small and medium enterprises oriented at requirements of "the largest". I believe that this ideology justifies the decision on Baltic Nuclear Power Plant building, the support of large energy-consuming enterprises (electrical power produced in excess must have a credit-worthy consumer!). Perhaps, this scheme of the Kaliningrad Region "modernization" has future but I am not sure that Kaliningrad citizens will appreciate large metallurgic enterprises and oil processing plants allocation in the tiniest region of the Russian Federation. In this case we shall forget about the unique nature of the region.

The world crisis of 2008 had a significant negative impact on Kaliningrad economy. Oil price drop determined Russian government's decision on stimulating import-substitution in the whole country by cutting import duties on number of imported assembles. As a result, many Kaliningrad enterprises functioning on this scheme moved to Russian mainland where logistics is better and resources are cheaper. Thus, the Kaliningrad Region having been an example of establishment and development of import-substitution sector in economy, is now back at the bottom of the ladder. Taking into consideration Russia's persistent eagerness to become a WTO member, the perspectives of import-substitution type of economy in the Kaliningrad Region are vanishing.

New authorities of the region seem to have two ways out in such a complicated situation. The first one is simple and proved – asking the federal center for resources for large region-forming objects such as the Baltic nuclear power plant

with obvious export potential. The other one is more complicated but more pragmatic – not to ask but to offer! To offer the things which the federal center intends to do but due to different reasons (high rate of persistence, resource limitation, pressure of external and internal factors) cannot do it quickly. The question is what Kaliningrad can offer to the Center? As I see it, it should be, first of all, deep real modernization of regional economy and development of all regional society.

In order to make a decision on ways of region modernization, it is worth examining the potential and real advantages of the region. First of all, the region is located almost in the center of Europe, within the European Union, on the cross point of traditional transport routes East-West, North-South. On the other hand, the Kaliningrad Region is a part of a big country which means that if Russia wants to activate the potential of traffic arteries on Vladivostok-Western Europe route, the region could play a key role of a large Russian multi-mode logistics center working both from East to West (Asian raw materials and assembles for European enterprises) and from West to East (European goods for Asia-Pacific Region market). Even rather preliminary calculations show that this course of country's economy development can become very important under competitive railroad rates (which is exclusively prerogative of Russian government) and completion of customs union formation. The Kaliningrad Region where the regime of free customs zone can be implemented fits well into this transcontinental project as a gigantic common European customs warehouse with a developed transport infrastructure and efficient pilot system of customs clearance of cargoes in all directions. It is obvious that this project is of Russian or even international significance as its implementation is not possible without coordinated and thoroughly considered activities of Russian government and a number of other countries concerned as well as large national and transnational companies.

Another evident advantage of the region is that being situated within an hour and a half – two-hour flight to the leading centers of European economic development (Moscow, Saint-Petersburg, Berlin, Warsaw, Stockholm, etc.) it is a natural oasis for comfort living. At the same time, as it has been noticed in one of Moscow newspapers, the Kaliningrad Region "is not devoid of European gloss" for Russian citizens while for Europeans it is a convenient and relatively safe launching pad for a start in big Russia. Thus, having this advantage, the region can attract not only "Gastarbeiters" from former USSR republics but those whose intellectual, creative and entrepreneurial potential can be and should be involved into innovation economy or, as it is said, economy of knowledge. But re-naming IKSUR into Baltic Federal State University is not sufficient for becoming Russian innovation leader within the EU. "Skolkovo" alone is not enough to modernize the country. We need a powerful center of mass transfer of the existing technologies into Russian market. We need a state programme for a system which traces all current innovation technologies and adopts them to the practical requirements of the country as the whole. Moreover, the adaptation should concern not only permitting certificates for these technologies but new businesses based on European innovation technologies formation and their promotion in Russia. The creation of such common Russian system in the Kaliningrad Region will not require federal investments as it has a unique Russian-

European instrument of development: Cross-Border Cooperation Programme Lithuania-Poland-Russia 2007-2013. The main priority of the programme is joint active development of innovation processes. At the same time, joint creation of innovation products, researches, elaboration of test samples of new products can be done within the Seventh Framework programme which incorporated Russia a couple of years ago. And this implies billions of Euros not only for academic institutions but for small and medium business as well in the sphere of new developments and innovations.

Of course, we need scientific schools and well-considered migration policy. The region requires not only working hands but clever minds. Federal University infrastructure and priorities and fields of scientific researches should be defined in coordination with the major Russian and European research and education centers to draft joint projects, programmes and establish new scientific schools. Both Russia and Europe are acquiring a deeper understanding of the fact that the consequences of global crises can be overcome only by joint efforts as well as a new leading center of modernization can be established.

Taking into consideration the latest activities and declarations of Russian leaders (Putin's speech in Berlin, November 2010), common European integration is becoming a cornerstone for not only country's modernization but its foreign policy. Agreements with the EU on four common European spaces and detailed roadmaps for their gradual formation confirm political will of the parties for

unprecedented rapprochement. The problem is that this process is very slow due to the abovementioned reasons. The process can be accelerated by convincing Moscow and Brussels that the Kaliningrad Region jointly with cross-border regions of Poland and Lithuania can create a realistic model of these spaces in economy, safety, science, education and other spheres. It is obvious that it is not that easy to implement this project without support of federal authorities, the European Commission and governments of Poland and Lithuania. But such a project of European significance is in line with integration political and economic tendencies and there are good chances to implement it by joint efforts. But it should be taken into account that initiative, definite suggestions and political will should come, first of all, from the authorities of the region. The first annual address of a new governor Nikolay Tsukanov made at the end of the previous year buoys definite optimism.

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## How to make the challenges of Kaliningrad to become true?

By Jouko Grönholm

One of the most interesting slogans in the Kaliningrad region demonstrations during the last few years has been: "Dmitry Anatolevich, please re-establish the normal circumstances in our region."

These words contain an allusion to the beginning of Medvedev's presidency, when he was openly criticising bureaucrats of making difficulties to the increasing business life in Russia. Now Kaliningrad inhabitants are showing that the leaders of "big Russia" have forgotten these principles at least in Kaliningrad.

"Big Russia" (bolshaja Rossiya) is expression that Kaliningrad citizens are using talking about the enormous rest of their country. It is hard to estimate do Kaliningrad people really believe in the possibilities to fight against corruption in the region if the central of Russian state does not have the leading role in this proces.

Russia's smallest region of Kaliningrad is an exclave located far away from the western border of Russia proper. Kaliningrad was a spoil of World War II, allocated from Germany to the Soviet Union at the Potsdam Conference that divided Europe between the allied powers in 1945.

The region (in Russian oblast) is a wedge-shaped piece of land along the Baltic Sea between Poland and Lithuania, approximately one-half the size of Belgium, 15 100 square kilometres. The oblast's primary and port city is also known as Kaliningrad.

The absence of a clearly defined policy from Moscow with respect to Kaliningrad has been evident throughout the past decade or past two decades. This lack of central policy has been one of the important causes behind the inability to turn Kaliningrad into a well prospering economic area.

Frequent changes in customs and tax regulations led to the difficulties of such ventures as the Free Economic Zone Yantar established in 1991 and its successor Special Economic Zone in 1996. In the coming years one should not expect changes which would enable business activities to be conducted in accordance with EU standards, either in Russia or Kaliningrad.

In various international studies and reports it has been fashionable to articulate a future for the Kaliningrad on the basis of choosing between two alternatives: either a military base or a very well prospering economic zone. The experiences of the 1990s and the first decade of the 21st century however show that this would be an inappropriate model. Contemporary Russia will choose neither scenario. It should rather be expected that central policy vis-à-vis Kaliningrad will remain vague, although probably with a tendency toward exercising greater control at the centre.

Moscow-Kaliningrad relations need to be perceived in the wider context of Russia as a whole. The centrist tendencies already of President Vladimir Putin and nowadays of President Dmitry Medvedev which far outperform those of Boris Yeltsin, exert a direct impact upon the situation of Kaliningrad. The establishment of seven Federal Districts (Kaliningrad belongs to the North-Western Federal District with its capital in St. Petersburg) reinforces central control over the regions and reduces the scope of autonomy for the governors.

This mechanism has already for a long time been visible in the case of Kaliningrad. One of the important causes of Moscow's unwillingness to accept a more self-directed development of the Kaliningrad enclave will be fear of the potential disintegration of the Russian federation. It should be expected that the policy of the Medvedev administration concerning enclave relations with the EU will correspond to the provision contained in the medium term Strategy for the Development of Relations of the Russian Federation with the EU.

The authors of that Strategy clearly underline the necessity to assure the full authority of Moscow over Kaliningrad, adding only that the district could still all the time, to such an extent as may be feasible, fulfil the role of a pilot region in the relations between Russia and the EU.

The ice-free port of Kaliningrad on the Baltic Sea was home to the Soviet Baltic fleet; during the Cold War 200 000 to 500 000 soldiers were stationed in the region. Today only 25 000 soldiers occupy Kaliningrad, an indicator of the reduction of perceived threat from NATO countries.

Railroads connect Kaliningrad to Russia though Lithuania and Belarus but importing food from Russia is not cost effective. However, Kaliningrad is surrounded by European Union member states, so trade on the wider market is indeed possible.

Approximately 400 000 people live in metropolitan Kaliningrad and a total of nearly one million are in the oblast.

The Russian exclave of Kaliningrad on the Baltic Sea is sandwiched between Poland to the south and Lithuania to the north and east. So Kaliningrad has still also big strategic importance for Moscow.

Since Lithuania joined the EU it has been impossible to travel between the exclave and the rest of Russia over land without crossing the territory of at least one EU state. There has been friction, particularly with Lithuania, over transit regulations. The Russian leaders have described as a matter of Russian national security the inauguration of a new sea route linking the region with Ust-Luga, near St. Petersburg.

The European Commission provides funds for business projects under its special programme for Kaliningrad. The region began to see increasing trade with the countries of the EU as well as increasing economic growth and rising industrial output. To fulfil all these goals enormous efforts are needed both from the side of Brussels and the side of Moscow – but little by little it would be positive if the Russian side would give bigger autonomy for Kaliningrad in the decision making.

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# Kaliningrad as an international tourism destination – still a challenge

By Tatiana Chekalina

Kaliningrad region of Russian Federation is an area with rich natural, historical and cultural resources and favourable location. The Old Prussian, German, Soviet, as well as the contemporary Russian periods blend together to form a unique cultural and historical landscape of the region. The Baltic Sea coast locates the spa resorts Svetlogorsk and Zelenogradsk. The National park "Curonian Spit" is included into the UNESCO world heritage list. Yantarny settlement, where the amber is excavated, actively develops into a new tourism centre in the coastal zone. The inland area of the region provides possibilities for various types of tourism activities, including the rural and ecological tourism, rafting, biking etc.

Kaliningrad region received substantial international attention, when the neighbouring Lithuania and Poland were entering the European Union. In 2004 Kaliningrad region became the Russian enclave within the borders of the enlarged EU, which created both opportunities and problems for the development of Kaliningrad region and inevitably affected the tourism industry.

The region, which has no direct border with the mainland territory of Russia, is affected by the EU-Russia regulations in terms of visa regime and transport transit. An increased international awareness in the result of the EU-Russia dialogue regarding the Russian enclave was an additional outcome for Kaliningrad. While the name of the region became well known in the Baltic Sea region and beyond, the image of the area was far from being favourable.

At the same time, Kaliningrad is one of the most active Russian regions when it comes to international cooperation in business, governance, culture, education and many other activity areas. Thus, business and congress travel is an important direction of tourism development in Kaliningrad region, including meetings, exhibitions, conferences etc.

Not surprisingly, the region considers tourism as one of the priority areas for development. The tourism development remains an acute issue on the agenda of both the regional and local authorities. The tourism infrastructure develops rapidly, including the new hotels, greater variety of restaurants, cafes and bars, reconstruction and development of cultural and historical sites and attractions. The region puts a great effort to organize tourist events, including the international festivals of jazz music, organ music, handicrafts etc. The Immanuel Kant State University of Russia offers education programs for tourism and hospitality industry. One of the recent initiatives is the competence development programmes for the tourist guides. The tourism department at the Kaliningrad Regional Government coordinates the marketing policy of the region, including collaboration with the tourism industry stakeholders, participation in the international tourism exhibitions, information policy, on-line and off-line marketing communication etc.

The regional and local authorities, as well as the cultural and educational institutions actively participate in international cooperation aimed at the development of the cross-border tourism routes and products, joint marketing activities, development of human assets etc. Particularly, a number of projects have been implemented with the EU funding allocated within the Baltic Sea region and Lithuania-Poland-Kaliningrad region cooperation programmes.

According to Kaliningrad Regional Government, in 2005-2008 the number of tourists was steadily growing from 333 thousand tourists in 2005, including 256.6 thousand tourists from Russia and 76.4 thousand tourists from other countries, up to 520 thousand tourists in 2008 (425 thousand Russian and 95 thousand international tourists). However, in 2009, which was the year of economic crisis, the overall number of tourists declined down to 380 thousand tourists and somewhat increased up to 420 thousand in 2010.

The problems with transport accessibility greatly contributed to the decline of the tourist flows into Kaliningrad region. Particularly, the local airline company KD Avia, which operated as the hub and directly connected Kaliningrad with 23 cities in Russia, Europe and Asia, became bankrupt. Today Kaliningrad is connected with the European countries via Riga and Warsaw.

The problems of the transport accessibility primarily affected the domestic (i.e., Russian) tourism. As for the international tourism, the notorious visa issue remains an important obstacle, as well as the registration procedure for the foreign citizens. The regional authorities continuously appeal to the federal bodies arguing for the simplification of current regulations to make the region more attractive for international tourists.

The border-crossing issues hold back the implementation of one of the most awaited and promising international tourism projects. Particularly, the agreement between Russia and Lithuania on shipping in the Curonian lagoon was signed by the President of RF in 2009. However, international cruising can start only after construction of the border-crossing point on the Russian side in Rybachiy. At the same time, according to the magazine "Jura", the construction will not start before 2016.

So far, Kaliningrad region primarily serves the domestic Russian market (mainly Moscow, St.-Petersburg and the North-West of Russia). According to Kaliningrad Regional Government, the majority of Russian tourists (43%) arrive to Kaliningrad region with the purposes of spa and recreation, 35% are interested in history and culture and 22% of domestic tourists visit the region with business and other purposes. On the contrary, the history and culture of Kaliningrad region is the main purpose of visitation for international tourists (i.e., 70%). Business and congress travel accounts for about 18% of international tourists, while spa and recreation is interesting for only 12% of international visitors.

The greatest share of international tourist comes from Germany, mainly for the purposes of the so called "nostalgic" tourism. The estimations of the share of German visitors among the international tourists vary from 56% to about 70%. Other main sending countries are the neighbouring Poland and Lithuania. The regional authorities expect that further development of event tourism, cultural and historical tourism, as well as ecological tourism can attract the new visitors from Germany, Poland, Ukraine and Sweden.

Obviously, there are many improvements, which still have to be done in terms of tourist infrastructure, entertainment, external and internal transport accessibility etc. At the same time, Kaliningrad region already has a lot to offer to the international tourist. The tourists' reviews of their experience, which can be found on travel websites, are quite positive. However, an important and not yet addressed challenge for the region is how to properly offer its unique resources to the international market.

It seems like the region is too focused on the development of infrastructure and promotion of activities, and simultaneously neglects more abstract experiential and symbolic components of the destination experience. In its marketing strategy the region should switch the focus from the types of tourism available for international visitors to the experiential and symbolic outcomes of the trip for both potential and actual international tourists. Thus, the destination promise communicated through the brand should provide guidance on how to assemble the resources offered by Kaliningrad region into valuable destination experiences.

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# The middle class in Russia – emerging reality or old myth?

By Ivan Samson and Marina Krasilnikova\*

## The theoretical foundations of the middle class

Is there a middle class in Russia? The father of the theory of social classes is Max Weber, with his famous definition: *the class* reflected by the wealth, *the status* measured by the prestige attached to each position and *the party* as an expression of power, the ability of a group to reach its objectives. New inputs are provided by descriptive American sociology, with the pyramid model with three classes based on the criterion of shared attitudes<sup>1</sup>; its criticism by Lipset and his diamond, broad in the middle, following the development of consumer goods and more equitable access to education<sup>2</sup>. There is no such thing as analytic theory of the middle class. The descriptive analysis of the segments of the middle classes may become infinite because they depend heavily on criteria: income, authority, autonomy in work, education, subjective perception, etc.. Gilbert concedes: " *there is really no way to establish that a particular model is 'true' and another 'false'* ". Aristotle brought the idea of a moderator or stabilizing function of democracy exercised by the intermediate classes of society, whereas if class balance leans toward the rich or the poor, democracy turns into oligarchy or tyranny. But this thesis is far from unanimous and it is far from being verified.

## The reality of the intermediate segments of Russian society

Several studies have been conducted by the Russian Institutes which have resulted in recent publications. They show that these intermediate segments or so-called middle class are still in their genesis.

A study done in 2008, just before the 2009 crisis and after 9 years of euphoric growth of the Russian economy provides a more precise analysis of the structure of the intermediate segments in Russia<sup>3</sup>. According to the material criteria, in 2007 26% of Russians were considered as middle class, according to professional criteria middle class were 19, 5% and according to subjective criteria it was 30%. The three criteria are met simultaneously only by 5% in average Russian households - it is the core of the middle class (13% in Moscow and St Petersburg). If we consider only two criteria among the three, it was about 20% of households in 2007, but it is already a very broad definition. The comparison with 2000 is instructive because the intermediate segments have not grown. The heart of the middle class has even decreased from 7% to 5%.

Why did not the increase in wages and education levels enable the growth of the middle class? The explanations of stagnation or even decline in Russian middle class during the years of growth are: the absence of an economic environment conducive to the development of small entrepreneurship, limited access for the population to property income, non-transparent systems of wage formation, low social assistance programs for families with children and the stagnant situation of public sector employees, as the primary source of middle class growth during the years of economic takeoff.

This study is complemented by a detailed analysis of attitudes and opinions conducted by the Levada Center, for which the existence of a middle class in Russia is not demonstrated<sup>4</sup>. Whereas for the whole population, the main concerns are economic (prices, employment) for the "middle class", the most threatening signs are violence in society, aggression, corruption, weak courts, pollution, the influx of immigrants and the poor state of health care systems and pensions. The majority of them consider that their position is not legally and politically safe, and 83% admit they can not influence the

country's policy in any way, not only for decisions taken by the government, but even in debates on the situation of the country or the issues vital to them. 63% want their children go to study or work abroad. Other forms of compensation mechanisms may be xenophobia, resentment or fear of foreigners and of the inflow of non-residents.

## The non-existence of a middle class in Russia

The most common methodological error is that the descriptive approach of the Russian middle class focuses on quantitative approaches, without a theory or a conceptual definition of the middle class. In other words, the researchers measure an object, forgetting to base the existence, or rather acting "as if" it went without saying. For Maleva the middle class represents 20% of the richest households in Russia, and its upper segment is non-existent. . Other social groups are: 10% the excluded class, and 70% "the class below average." One should keep in mind that with this social stratification, the "middle class" brings up the basket, there is no upper class. It could better say that the social stratification of post-Soviet Russia is not yet incorporated, and that Russian society is still in transition.

If one measures income distribution in Russia and assumes that the "middle classes" are in the third and fourth 20% of the population, we can observe that their weight has decreased from 41.6% in 1991 to 38 % in 2009. Apart from a certain material comfort in some segments of the population, which in itself is not enough to found a class, virtually all the attributes of the middle class are absent in Russia. It has not the stability of its financial situation, has little or no savings and cannot, even economically, exercise the stabilizing function identified by Weber. This is easily explained: the new incomes are less generated by an entrepreneurial activity that would ensure its independence than by the redistribution of the rent from the large raw material resources of the country. It has no more authority in the meaning of Weber and Dahrendorf<sup>5</sup> than those below. The surveys confirm that the influence on political decisions and the sense of control over its affairs do not habit these intermediate segments as described by Mills<sup>6</sup>. Chilly, the Russian middle class is far from the intrinsic optimism associated with a growth that is supposed to be irresistible. A quarter of them are tempted to emigrate and three-quarters expect to send their children to live abroad. If we look now for a stabilizing role of political opinion, for the promotion of moderation and consensus, we may become disappointed. There is no *habitus* which constitutes a group and their very image is blurred by the new rich. Without class, status and party, the intermediate segments of Russian society can not exist as a social group. That reveals that the Russian middle class is a myth. Speculations on the middle class in Russia serve little understanding of Russian society. They serve to substantiate the myth that the whole world will eventually converge towards the Western model, and more specifically American. Myth that is echoed in Russia, where followers of the middle class say, "Look, we're almost like you!"

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## Russian military reform – what's next?

By Andrey Pavlov

Military reform in Russia became a hot topic in the Russian political discourse immediately after the collapse of USSR. For the last two decades it was one of the most important issues in governmental and presidential agendas. Occasionally militaries reported about successful completion of a certain stage. Analytics in Russia and abroad were criticizing the reform's development, calling it "ill-conceived", "illusory", "failed", etc... The Russian society has gotten accustomed to the military reform, perceiving it as a permanent process. In November 2004 Defense Minister Sergey Ivanov has announced the completion of military reform. But in fact the discussion about the reform continued in the political establishment, expert community as well as in media and the society in general. In 2008, the governmental decision to create a "new appearance" of the Russian army demonstrated once again, that the military reform continues.

But if the reform was a permanent process for almost twenty years, was it really a reform? Examination of the basic distinctions of the Russian army from its Soviet predecessor may show that until recently, the substance of the reform could be better described as "adaptation" and "modernization". Basically, the military force in Russia was organized in a similar Soviet way, having the same geographical principle of the forces distribution between military districts ("okrug"), using conscription, being headed by military-dominated Ministry of Defense and preserving the large-scale mobilization capability. In 1990-s, reduction of the army, merging of military districts and some command structures were aimed mostly at adaptation to the economic constraints.

Only once, in 1996 president Boris Yeltsin during his re-election campaign issued the decree on transition to purely professional army in 2000. However, nobody really took this populist act seriously. Later, having greater funds for military expenditures, the government was spending the money mainly to soften social problems in the Army and modernize it. The success in both spheres was rather limited.

Today we may admit that the changes that began in 2008, represent the first attempt to create a military force of the new age. In fact, the 2007 appointment of the first civilian Minister of Defense Anatoliy Serdyukov was a serious signal of the coming changes. This appointment infuriated the Russian military leaders who were ready to resist the new minister's policy. But the war of 2008 became an important threshold. Soon after, the new minister demonstrated that he will not hesitate to use his power when he needs to overcome the resistance of his military subordinates.

Today the changes are fundamental and comprehensive. For the first time since general Milyutin's reform in 1864, Russia has no traditional military districts. Though the new Western, Central, Eastern and Southern territorial commands are still called "okrug"; they cannot play the same role. Creation of a more flexible brigade structure instead of divisions and creation of the new command system remind very much of the widespread in the West network-centric concept. According to the reform plan the new military force will consist only of ready for combat units while previously, the general mobilization capability required the existence of numerous bases and units whose task just was to maintain the mobilization system. This shift from maintenance of the large-scale mobilization capability to the new structure of permanent ready units also reflects the deliberation to implement a definitive change in strategy long ago officially declared in the Russian Military Doctrine. A total war on a

state possessing a big modern army is not at the top of list of possible armed conflicts any more.

The new reform was developed in a quite unusual manner. Public discussion, testing of concepts, clarification of the intentions and aims, have not preceded, but have followed the decision and the government still has a lot to do to succeed in this way. There is still an urgent need to demonstrate that the army with the "new appearance" not only looks better on paper but can perform better. At least, soldiers and officers of the Russian Army have to be convinced that this new reform is not just another poorly thought-out and ill-prepared experiment which will inevitably bring nothing but confusion and disorder. Taking into account the recent developments in military, it is quite difficult to achieve. For example, the widely advertised experiment in 2004-2005 on creation of units with only professional personnel and attempt to increase the number of professionals in other units proved to be unsuccessful.

The decision to change nearly everything was made and already implemented – but only formally. To reorganize the magnitude of the Russian military system, one needs much more time than just a few years. It is not too difficult to divide a division on battalions and then combine them in brigades, but it will take years to train their commanders to operate in the new network-centric system. It is easier to break the resistance of high-rank militaries than to convince the society that there have been good reasons to do it.

It seems that the next natural step in the reformation of Russian military forces may become a reform of the Ministry of Defense itself. The main goal would be the division of power between civilian Minister of Defense and military Chief of General Staff, so that the first would be responsible for policy and finances and the second would be in charge of the training and commanding structures. However, I believe that this step will not be made soon. Political component of the Ministry of Defense is too weak to play an independent role, and the Ministry is still mostly a military institution. Yet some efforts to increase the political influence of the defense authority, at least in the domain of national security, could be made. Besides, the General Staff, today a part of the Ministry of Defense, have until recently been the center of opposition to the new reform and some other decisions of the Minister. Independence from the Ministry may cause the revival of the opposition.

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# The perspectives of Russian radical nationalism

By Joachim Diec

Nationalist tendencies, unexpected in the post-internationalist space, woke up in Russia in the very end of the Soviet era, discrediting the universalist utopia. The early post-communist nationalism took two basic forms. One kind was an outspread of previously suppressed ethnic identity combined with xenophobic feelings, which was expressed in the anti-Semitic and ethnocentric ideology of the National-Patriotic Front "Pamyat". The origins of the group go back to the 1970s but its time of success began in 1986, when "Pamyat" took a well-structured organizational shape and got much popularity. The other side of Russian nationalism of the early years is associated with the imperialist doctrine of the Liberal-Democratic Party of Russia. Its leader, Vladimir Zhirinovski, used to proclaim the necessity to reconstruct the empire but in a state-controlled capitalist version. This statist approach refers neither to tribal traditions nor to the heritage of Russian Orthodoxy.

The next years brought about a relative stabilization of the nationalist trend and the appearance of some new groups. Their ideological image was quite diversified. Some focused on the religious and cultural grounds (like the Union of Orthodox Gonfaloniers), some emphasized the need for ethnic predomination of Russians within the Federation (Russian National Unity), some tried to support the Russian diaspora in post-Soviet states, especially in the Baltic countries (the Congress of Russian Communities and Rodina Party), some, like Russian National Union (later People's Will, People's Union), took a moderate and quite unspecified nationalist image.

In 1994 the situation changed radically initiating a new period of development. The Chechen wars worked out a feeling of hostility toward Caucasians. Paradoxically, the first years of the third millennium despite the terrorist attacks in Moscow (which are interpreted by some commentators as Russian secret service inside job) could be even called a golden age of Caucasian business in Moscow. However, a lot has changed after some symbolic events, which took place after 2003: the attack on Dubrovka Theater, the Beslan tragedy, which resulted in the death of Osetian children, blow-ups in Moscow subway. In addition, the local Russian tiny merchants began to feel fed up with the Caucasian mafias which took control of the markets in some cities.

In the eyes of ordinary Russians the Putin era is a time of relative stabilization and prosperity. Russia got a lot of unexpected opportunities to develop its economy, especially in the metropolitan areas and in the territories explored by gas and oil companies. The construction works in Moscow, St.Petersburg, Khanty-Mansiysk and other prominent places required cheap labor force, which was not always easy to find among the native Russian population. The time of stability in Russia combined with economic difficulties, authoritarianism and corruption in the southern part of the post-Soviet area took crowds of Central Asian workers to Russian metropolies. On the one hand they filled an essential gap in the reservoirs of labor force but their underdog lifestyle, religious beliefs and cultural standards provoked hostile attitudes among the ethnic Russian element.

The North Caucasian and Central Asian flows could have become less triggering if it had not been for serious demographic decline within the native Russian population. Even a very superficial insight into the data referring to the demographic situation in some administrative units prompts that vast territories in central and Northern Russia may be entirely abandoned within a century whereas the number of Chechens will triple according to the most tempered estimates.<sup>1</sup>

The growing awareness of these tendencies fosters some Russians to take part in organized forms of xenophobic activity such as the Movement Against Illegal Immigration (DPNI) established in 2002 by Alexandr Belov (Potkin). It is usually described as one of the most extremist national groups in today's Russia. Not only does the DPNI organize actions against immigrants, its members provide legal help for people who suffered from real or imaginary aggression from the immigrants. DPNI uses advanced PR techniques and thanks to its horizontal organizational structure gets involved into the

process of forming other extremist groups such as the Russian Social Movement (ROD).

Despite their internal instability the organizations are sometimes able to collaborate in several actions such as the yearly nationalist celebration - the Russian March in Moscow on Nov 4. In some areas DPNI cooperates with a militarized national-socialist group - The Slavic Union (Slavyanskij Soyuz, SS), which was delegatized in 2010. Another nationalist organization called National-State Russian Party (NDPR) is supposed to collaborate permanently with the DPNI.<sup>2</sup>

Contemporary Russian nationalism has several faces and its perspectives for the future are not equally distributed among all branches of the ideological tree:

1. The **religious traditionalists** probably overestimated the trends in the early 1990s. Although the links between religious traditionalism and nationalism are still strong within the ethnic Russian population, their offer still does not seem to be the main pillar of Russian solidarity.
2. The anti-western **imperialist** trend seems to keep its previous position. However, an internal shift of stock within this market might be taken into account as well. Despite the vigorous publication activity of the neo- Eurasianist leader, Alexandr Dugin, the Eurasian Youth Union does not seem to become more influential than it used to be. A similar kind of stagnation seems possible in the case of LDPR, which is loyal to the Kremlin and accepted by RF leaders but has not been a leading force of the Russian souls for a couple of years yet.

Therefore the nationalist stage in Russia will probably belong to two actors: Dmitry Rogozin with his Congress of Russian Communities and to anti-immigrant activists, especially anti-islamic organizations with DPNI in the head. The abilities and provenance of the two forces differ significantly:

1. **Rogozin**, despite his critical rhetoric toward the Kremlin is rather an entire part of the corporation. One cannot doubt it taking into account his latest posts such as his function of Russia's ambassador to NATO.<sup>3</sup> Rogozin's comeback from Brussels will provide his charismatic personality with additional opportunities.
2. The **xenophobic groups** cannot enjoy Kremlin's support, their leaders like Belov might be easily marginalized by the Kremlin but they are spontaneous and have many supporters who are able to act without being steered by the authorities. Their plan to take advantage of the cold civil war by stimulating it in order to monopolize power has been working so far but the natural continuation of demographic and mental processes can make them get out of control.

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<sup>2</sup> Comp. Commentary: D.Shlapentokh, *The Evolution of Russian Nationalists and the Perspective of Russian's Relationship with Caucasian Minorities*, Central Asia-Caucasus Institute. Analyst, Johns Hopkins University, Sep 17, 2008, <http://www.cacianalyst.org/?q=node/4936>

<sup>3</sup> Comp. Е.Михайловская, *Фракция "Родина" в контексте националистического дискурса в Государственной Думе*, in: *Русский национализм. Социальный и культурный контекст*, p. 71. The author (as well as some other commentators) believes that Rogozin's „Rodina" is a Kremlin project.

<sup>1</sup> See: Федеральная Служба государственной статистики, [http://www.gks.ru/scripts/db\\_inet/dbinet.cgi](http://www.gks.ru/scripts/db_inet/dbinet.cgi)



## Kremlin takes its sport seriously

By Markku Jokisipilä

On 1 March 2010, only a day after the Winter Olympics in Vancouver had ended, President Dmitri Medvedev demanded the resignation of people responsible for the Olympic preparations. The three gold medals and 11th spot on the medal table represented the worst ever performance of by the traditional winter sport powerhouse. Two days later the president of Russian Olympic Committee Leonid Tyagachev handed in his resignation.

Although some of the criticized tried to do so, blame couldn't be put on the economic downturn of 2008-2009. On the contrary government had invested an unprecedented amount of money in sports during the preceding three years, in total almost 120 million US dollars. With the all-important first ever Russian Winter Olympics in Sochi only four years away, Vancouver fiasco created a nation-wide uproar.

During his eight-year presidency Vladimir Putin took the promotion of sport as his personal mission. He announced that Russian athletes should strive to equal the excellence of their Soviet predecessors and put his personal authority on the line to secure them the facilities and funding to achieve this.

Putin has also decidedly pursued to raise country's international profile through hosting of high-profile international sports competitions. Largely thanks to his tireless efforts Russia will host a historical royal flush of sports events in the coming years: World Championships in athletics in 2013, Winter Olympics in 2014 and World Cup of soccer in 2018. Granting of these mega-events is interpreted by many in and out of Russia as a symbolic indication of country's political resurgence on the world stage. Russia is also bidding for the 2016 ice hockey World Championships, again on the initiative of Putin himself.

Kremlin's keen interest in sport is hardly surprising. Many governments are deeply engaged with sportive nationalism, i.e. using sport for political purposes of constructing national identity, fostering of national unity and promoting country's international prestige. Because of the Soviet traditions of success, however, in Russia sport is something even more important. Putin and Medvedev have repeatedly stressed its value as a role model and display window for national vitality, and governmental subsidies have continuously grown especially through sponsorships by state-owned corporate giants.

Ice hockey with its huge stock of historical victories (seven Olympic and 22 world titles) has become a special protégé of Kremlin. After the disappointments in 2006 Turin Olympics and 2007 World Championships Putin commissioned Vyacheslav Fetisov, the former Soviet national side captain and sports minister of Russia, to completely renovate the Russian league system with the explicit aim of challenging the big and rich North American National Hockey League.

With Kremlin's backing the new Continental Hockey League (Kontinentalnaja Hokkeinaja Liga, KHL) was launched in autumn 2008. Besides talent from Russia, Belarus, Kazakhstan and Latvia it attracted a host of NHL-stars from North American teams, such as Stanley Cup – winners Jaromir Jagr, Sergey Brylin and Chris Simon. With its 24 teams from four countries, 720 players representing 15 different nationalities and the gigantic 6150-kilometer East-West span from Khabarovsk in the Russian Far East to Riga by the Baltic Sea KHL is truly an exceptional project.

Establishment of the KHL coincided with the first Russian hockey world championship in 15 years, conquered

dramatically by an overtime goal against the biggest rivals Canada on their home turf in May 2008. This tour-de-force was repeated a year later, testifying the competitive standard of the new league. In Vancouver everything seemed to be set for a third title in a row, but Canadian revenge smashed Russian dreams of ending the 18-year Olympic drought already in the quarterfinal game.

Regardless of its already huge geographical size the KHL is planning to expand. It has negotiated with two dozen teams from 12 countries, including Lithuania, Sweden, Finland, Germany, Austria, Czech Republic, Ukraine, and Croatia. The super heavyweight political and economic supporters of the KHL provide these seemingly fanciful plans with a degree of seriousness. Putin's role in the establishment of the league was instrumental, and after him President Medvedev has taken it under his wings.

In terms of political and economic weight the KHL top management is probably one the most influential sports bodies in the world. Director-General of Gazprom Export Alexander Medvedev is the league president and the board of trustees is headed by Presidential Chief of Staff Sergei Naryshkin. Board of directors includes Deputy General Director Sergey Batekhin from industrial conglomerate Interros, Vice President Igor Solyarsky from Transneft, General Director Shafagat Takhautdinov from Tatneft, and the Magnitogorsk oligarch Viktor Rashnikov.

List of sponsors is impressive as well: Gazprom, Rosneft, Rosoboronexport, Evraz Group, Russian Railways, Magnitogorsk Iron and Steel Works, VTB Bank, and SOGAZ Insurance Group among others. After the 2008 economic recession many Western experts predicted that sports funding in Russia, largely dependent on oil, gas and steel, would plummet. Several KHL teams indeed had to resort to budget cuts and streamlining, but the league was able to pull through and finish its second season successfully.

With the dawning recovery KHL President Alexander Medvedev remains convinced of the expansion potential: "Beginning with the 2012-2013 season, we plan for the KHL to be a pan-European competition involving 24 clubs from the current KHL, and probably about 30 of the leading clubs in Europe". Kremlin's hockey enthusiasm hasn't diminished either. In January 2011 Russia captured the world junior championship title by beating the Canadians in the final. Only moments later Dmitri Medvedev congratulated the team on his Twitter account.

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*The text is based on the author's forthcoming book on the role of hockey in international politics from Cold war era to present day*



## Szczecin – center of a truncated border region with geopolitical dilemmas

By Thomas Lundén

The Polish city of Szczecin (pop. c. 400 000) is situated at the German border, around 50 kilometres from the Baltic Sea coast, but separated from it by the large lagoon of Zalew Szczeciński/Stettiner Haff. The Baltic seaside is a stretch of land dominated by the resort area on the island of Uznam/Usedom where, at the eastern tip of the island, the land boundary directly connects to the outskirts of Świnoujście (c. 40,000). Its urban centre is located at the western side of the river Świna and it only has ferry connections to its eastern suburbs and to the mainland of Poland, while since only a few years back, two roads and one railway line connect with the German part of the island and the German mainland.

Both cities were included in the territory ceded by Germany after World War II, and the earlier population was expelled and replaced by in-migrants from central Poland and the eastern territories that Poland ceded to the USSR.

For a long time, Stettin played the role of a harbour for the export of coal from Silesia and agricultural products from the river Oder/Odra and its tributaries and the canal systems of Prussia including Berlin, but also for imports including iron ore and steel from Sweden. Stettin also developed shipyards and other industries related to the handling of goods. Swinemünde was a fashionable beach resort and a military garrison. After becoming Polish, Świnoujście became an important ferry terminal for goods and persons with lines to Sweden and Denmark, especially important during the years of relatively good relations to neutral Sweden.

After the establishment of the German Democratic Republic the border was closed for local crossing, except for certain times of 'thaw' in the rather strained relations between the two 'socialist' states. With the transitions since 1989, border crossing has been successively eased, leading to situation today where both states since Poland's entry into the Schengen area late 2007 have no formal checks on the border. Old roads and railway connections are being reopened. Szczecin is connected to Berlin (150 kilometres) by high quality motorway, whereas the road distance to Warsaw is 521 kilometres by roads of varying quality and through several towns. Train connections also favour Berlin; daily connections take around 2 hours while Warsaw is at best within 5½ hours. The local airport near Goleniów has daily flights to Warsaw and weekly connections to Britain and Norway, evidently for migratory workers, partly as a result of layoffs at the shipyard. Several shuttle bus companies connect with Berlin airports and train station. The Heringsdorf airport less than 10 kilometres from Świnoujście across the border operates during the summer season only, with flights serving the German seaside resorts.

Together with Gdańsk/Gdynia, Szczecin was the shipyard city of Poland and took active part in the uprisings in 1970 and 1980. After Poland's return to market economy the shipyard met with increasing difficulties and after several attempts of reconstruction the plant is now idle. A repair shipyard is active, and the harbour is increasingly used for pleasure boats and water tourism.

Świnoujście has a better location in relation to shipping, but the town is hampered by its location with the urban centre on one side, and shipping activities on the other side of the Świna River. Two local ferries link the two sides, a tunnel has been discussed for many years, but it has to be deep enough to allow for the ships from Szczecin to pass into the Baltic. Świnoujście has been prepared for a location of a terminal for deliveries of LNG (liquefied natural gas) to be completed in 2014, but two obstacles seem to impair an implementation. One is geopolitical and technical: the shipping route from the Baltic Sea into the mouth of the Świna will cross the NordStream gas pipeline, and Polish attempts to persuade the NordStream consortium to dig the pipeline deeper for the LNG vessels to safely pass have failed.

Another obstacle is the image of the area as an unspoiled beach resort, trying also to reach the German market.

The energy sector is a bone of contention between Germany and Poland. The Nordstream pipeline lands at Lubmin, the place of the East German nuclear plant, which was shut down in 1990, and continues near the Polish border southwards. Lubmin is only some 50 kilometres away from Świnoujście. In the negotiations between Poland and the German-Russian interests, Poland was offered a branch line, but declined. The LNG project can be seen as a direct response to the pipeline project, sometimes maliciously referred to as a new German-Russian pact.

In the energy debate between the two neighbouring states, nuclear energy has been launched as a Polish way to combat pollution from burning coal and gas. One location suggested for a plant has been at Gryfino, on the Odra River just 20 kilometres south of Szczecin and almost on the border. Bearing in mind the German popular resistance to nuclear power, such a location will be politically unrealistic. A recent offer from Russia is to provide to Germany an electricity line from the proposed nuclear plant in the Kaliningrad area, since the plant will be producing substantially more electricity than needed in the area, and that Kaliningrad's neighbours, Lithuania and Poland, have rejected deliveries from this plant. But Germany is unlikely to accept this offer of 'atomic energy'.

What will be the future of the Szczecin region?

On the market side, the opening of the EU borders has led to increasing possibilities for the region to open up to the neighbouring areas of Germany, for mutual benefit. The German local area has a dual structure. The Baltic Sea resort areas are modernizing and attracting wealthy tourism, but with the seasonal problems typical of Baltic area. The German areas near Szczecin are characterised as poor, declining and with high unemployment rates, but because of German subsidies still with higher formal wealth than the Polish area. As long as the price and wage level in Poland is lower, there is a market for shopping and services into the local borderland, but price levels are levelling out. Instead, Szczecin may take the role of an urban centre to the nearest German areas, but differences in language and culture will make the relation a skewed one. At the same time, Berlin is taking the role of a dominant centre to a small but important segment of Szczecin's population. Housing shortage in Poland and the opposite in the German side have led to a certain migration of Polish settlers into the small towns, but most settlers commute back into Poland for work.

From a geopolitical point of view, the relation between energy provision and sustainability aspects form the most problematic juncture. Local interests provide for border-transgressing solutions, while decisions made in Warsaw and Berlin may have other implications, leaving the area in the periphery of both states.

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# Protecting the Baltic Sea – a challenge to the international environmental policy

By Markku Ollikainen

## 1. Introduction

The action plan for the protection of the Baltic Sea (BSAP) was concluded in the year 2007 (HELCOM 2007). One of its main purposes was to cut down drastically the nutrient loads. The situation today, however, shows that protection work is ineffective, and the Baltic Sea fares badly. Sadly, this situation is all too familiar. None of the former protection agreements have been honored, and, unfortunately, the same goes for the Baltic Sea Action Plan. One of the shortcomings in the latest plan lies in the following actuality: the recommended reductions set for the good ecological status of the Baltic Sea were set without taking into consideration the fact that the costs of reducing the nutrient load together with its benefits are unequally distributed among the various countries along this sea. Implementing BSAP incurs great costs to Poland, Russia, and the Baltic countries, while Finland and Sweden benefit from load reductions. It is precisely this asymmetrical distribution of net benefits that accounts for the major failure of the BSAP. Further, this asymmetry is directly tied up with features that are typical of the Baltic Sea, and it is of utmost importance that we get a clearer picture of these features.

## 2. The Hydrography of the Baltic Sea and the Asymmetry of the Nutrient Loads

The preconditions of the international protection policy of the Baltic Sea may be derived from two specific features. First, the Baltic Sea is a common property resource belonging to each and everyone, which, in turn, means that it does not exclusively belong to any specific country. Second, in comparison to other seas, the Baltic Sea has unique hydrographic features. It is my contention that the particular way in which these two factors combine together forms the basis for understanding the challenges of protecting the Baltic Sea.

The Baltic Sea has an unusually low amount of water, and it is this feature that makes it more vulnerable to nutrient loads than any other sea in the world. Further, the brackish water in the Baltic Sea has the tendency to stratify: salt water sinks to the bottom layers and stays there for a long time. As time goes by, the amount of oxygen keeps on diminishing, until it becomes hypoxic and no longer can bind the phosphorus, which rises up to the surface water as an internal phosphorus load. The less-salt surface water circulates counterclockwise, which means that it transfers from the coast of Poland via the Estonian coast to the Gulf of Finland, and from there along the Swedish coast to the Danish Straits, until it finally reaches the Atlantic.

This specific manner in which surface water circulates from one country to the next along the Baltic Sea unfortunately “ensures” that the nutrient load of each country visits the neighboring coastal borders of this sea. Consequently, each and every country is responsible for polluting its neighbors—thus, all are simultaneously polluters and victims of pollution. But the amount of loads makes a difference between heavy polluters and victims. This fact accounts for the asymmetry between countries: the greater the polluter, the higher the benefit from pollution: the polluter actually benefits, because the neighbor countries have to shoulder a large portion of the damages caused by nutrient loads. The polluting country saves in clean-up costs, while others pay the price. Thus Russia and Poland in particular, but also the Baltic countries to some extent, make Finland

and Sweden the payers by transferring nutrient loads to Finnish and Swedish coastal and open sea areas.

What further augments the asymmetry of nutrient loads is the fact that the general principle of “the polluter pays” cannot be implemented among the countries along the Baltic Sea. From the perspective of international law, this sea is a common property resource to which all nations have an equal right—including the equal right of pollution. The coastal states of the Baltic Sea are sovereign, and there exists no supranational regulator who could force these states to comply with its decrees. Consequently, no country may evoke the law in order to stop other countries from polluting the Baltic Sea. It is entirely up to the country itself to curb its nutrient load. Hence only the voluntary dedication of the countries along the Baltic Sea to protect their shared resource can change its current status for the better.

What poses a further challenge to the protection of the Baltic Sea is the non-simultaneous, uneven socio-economic situations of the coastal states. The greatest polluters are transitional economies. The living standard of people in these countries is low, and business enterprises and other societal functionaries have as yet no established practices for environmental protection. The countries that suffer the most from nutrient loads—such as Finland and Sweden—enjoy a high standard of living as well as acknowledging the need for implementing various environmental policies.

Reducing the nutrient load in transitional economies in accordance with the Baltic Sea Action Plan means simply that those countries in which the standard of living is low to begin with will end up paying a great price for protecting the Baltic Sea, while the affluent countries reap the benefits. The key question is: why would these less well-off countries shoulder this payment voluntarily, when there is no one who could force them to do so?

## 3. The Incentive for the Protection of the Baltic Sea and a Fair Protection Agreement

In an symmetric situation like in the Baltic Sea economic theories suggest that the “polluter pays” principle be substituted with another policy that accords better with international environmental policy: “the victim of pollution pays” policy. What this means as regards protecting the Baltic Sea is that the countries that benefit from cleaning the sea up carry the costs together with the polluters. If the big polluters are compensated for their efforts to clean up the environment, and if their net profit for such clean up is made positive, these countries will have a real economic incentive to protect the Baltic Sea. In other words, making protection attractive presupposes that Finland and Sweden finance an increasing amount of the costs of reducing pollution in Russia and Poland. (To be sure, Finland and Sweden already shoulder a heavy responsibility for this work even today, which shows that this is the right direction to go.)

Reaching a binding agreement requires that a mechanism be created to divide equally the costs and benefits of protection among the participating countries. A binding agreement must be cost efficient and fair. In this context, cost efficiency means that the desired total reduction is achieved with the minimal costs. By speaking of fairness one alludes to distributing the net benefits among the participating countries in such a way that satisfies everyone. Economic theory cannot supply an unambiguous way of distributing net benefits in a fair way, but it does provide suggestions for various conceivable ways of doing so. Choosing among

these suggestions involves searching for a satisfactory compromise, fierce negotiations about costs and benefits, as everyone who has ever been engaged in drawing up international climate negotiations well know.

#### 4. Baltic Sea Action Plan—an Anatomy of a Failure

The Baltic Sea Action Plan allocates Lithuania, Russia, and Poland really high targets of reducing phosphorus, while Lithuania, Poland, Sweden, and Denmark shoulder the highest targets in reducing nitrogen. The total costs of BSAP are 3975 million euros according to Ing-Marie Gren. They are 1000 higher than an alternative, cost-effective solution. Thus, BSAP is costly. Moreover, Poland, Latvia, Lithuania, and Russia together would bear 94% of the total cost burden and Poland alone 78%. If the cost burden is related to the solvency of the participating countries—that is, if it related to the number of tax payers and their prosperity as illustrated by BKT—the burden of these countries is even higher.

The economic analysis of the agreements previous to BSAP showed that any divergence from the cost-benefit principle is costly to the participating countries. In the light of the above mentioned figures it is evident that in drawing up the BSAP this criticism was not sufficiently taken into account. There is only one conclusion to be drawn: transitional economies and, in particular Poland, who carries the greatest responsibility for pollution, have no economic incentive whatsoever to commit themselves to the BSAP. Grounding the BSAP solely on ecological targets without consideration of net benefits is doomed to fail, because such a program forgets the hydrography of the Baltic Sea and asymmetries engendered by the common resource that this sea is. An ecosystems approach may help us picture the long-run goals, but it supplies no grounds for reaching a binding and fair protection agreement.

#### 5. What Is to Be Done?

It is most likely that a new protection agreement is not foreseeable in the near future. Yet we may look to two directions for promising signs that promote protection. The urban waste water directive by the EU applies to all its members. This directive must be implemented in Poland and the Baltic countries, although it does not address Russia. If

phosphorus and nitrogen are reduced as decreed by this directive, it means considerable reduction of nutrient loads. Yet in all other respects, whatever success we may expect in the near future is dependent on what actions the two most active protectors of the Baltic Sea, Finland and Sweden, will take. They should actively search for cost beneficial solutions, while simultaneously investing in their credibility and negation initiatives as regards the well-being of the Baltic Sea in its entirety.

In my view, there are two specific ways in which Finland and Sweden can make their actions more effective. Without doubt, channeling money to environmental protection in Russia and in Poland gives currently the fastest and greatest protection benefits; thus offering investment support and forcefully supplying environmental education to these two countries would be smart moves. Moreover, both Finland and Sweden should reduce more effectively their own nitrogen loads. Finland, for example, should require that its bigger urban waste water plants reduce the nitrogen load up to 90 percent. This reduction would unarguably be the most efficient way of furthering the protection of the Finnish Archipelago, for which Finland alone is responsible. Contrary to what is commonly believed, the costs of reducing nitrogen are actually relatively low. If an aggressive nitrogen policy is coupled with a gradual reduction of phosphorus from agriculture, Finland would finally live up to its word in protecting the Archipelago.

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## Baltic Rim countries in pole position in the eco-efficiency race?

By Håkan Knutsson

The countries in Northern Europe, the Baltic Rim (BR) countries, are in a good position to be successful in the race towards eco-efficiency. Eco-efficiency can be measured by the ratio of CO<sub>2</sub> emission to GDP. In these terms, Northern Europe is in a leading global position, which has also led to thousands of new jobs being created and less dependence on imported fuels like oil.

When it comes to eco-efficiency the US is lagging behind. The USA is painfully dependent on oil. A slight price increase in oil can destroy the recovery of the economy. There are a number of factors that will slow up the transition in the USA, but which favor Europe. This article will present some of these factors: climate, geography, regional infrastructure, urban design & solutions and public property management.

### Climate

During the past 50 years there has been a population shift in the USA, with people moving from the North East of America to the South West. It is more attractive to live in sunny Arizona than in snowy Detroit. The South West States are suffering from chronic constraints related to water and energy. Living in a hot and dry climate is obviously much more energy consuming than living in our cooler Nordic climate.

### Geography and Regional Infrastructure

The Baltic Sea has always been important for transportation, with sea freight being the most energy efficient way of transporting people and goods. The Baltic Sea gives us a long coast and plenty of ports. Improved inter-modal goods transports, changing from Sea Freight, Railway and Trucks can make transports even more energy efficient. Maybe it is time to refurbish our old inland canals?

North America, like China, is an enormous in-land continent, with relative short coast lines and few ports. The second most energy efficient transport system - the railway network - is in North America much weaker than the infrastructure in Northern Europe.

### Urban Design and Solutions

The Baltic Rim Countries, as along with the rest of Europe, have maintained the traditional, medieval, formation of the cities – a dense city center. USA and Canada led global economic development during most of the 20th century. Huge low-density, low-rise city zones have been constructed. Urban sprawl makes it impossible to construct efficient Urban Technical Solutions for energy, heating, cooling, waste, sewage, buildings, communication and transports.

The Baltic Rim countries have a common Urban City System, an unique and valuable asset. This system- District Heating - has an “enabling function” that connects surplus energy with energy demand. Sweden has almost entirely phased out the use of fossil fuels (oil, gas, and coal) for heating purposes. This was largely as a result of the fact that in 1973, when the first Oil-Crisis struck, almost 100 % of all buildings in Sweden were heated by oil imported from Middle East. Today, the oil is replaced by waste, surplus heat from industries and power plants, biomass and electricity. For instance, the whole of Malmö City, with more than 250, 000 inhabitants, is heated by waste and surplus heat. Smaller towns like Bromölla and Sölvesborg are heated by surplus heat from a nearby Pulp Mill. All countries around the Baltic Sea have a great potential to develop a similar, more secure

and sustainable energy supply. A transition will enable the cities to close down worn-out and dirty coal-fired boilers.

A region like Skåne in southern Sweden has a regional government and city municipalities with very high ambitions in the area of sustainable urban resource management. The waste collection is very efficient, starting with sorting at source. Some waste fractions are recycled, toxic waste (batteries etc) is separated and other fractions are refined to electric power, heating, biogas and bio fertilizers. The regional government, responsible for all public transports and healthcare, has a goal to be fossil fuel free. Soon half of all city buses are fuelled with biogas, produced from waste and sewage.

Germany has also heavily promoted the development of biogas plants. There are more than 5, 000 biogas plants in the country, most of them producing small scale electric power. The trend now is to make the system more efficient by refining the biogas and injecting it into the natural gas grid. The gas can therefore be better utilized in Combined Heat and Power Gas Turbines. This recent biogas expansion in Germany has created 20, 000 new jobs.

Modern Cities are no longer competing for new industries. They are competing for the best and most capable people. Smart and well-educated people create new companies and jobs. This category of people requires attractive and green urban living. In Skåne, Malmö and Helsingborg have both created new attractive, green and sustainable city zones. It is very much a win-win situation. New fashionable areas have been developed on brown field sites, such as contaminated industrial zones in harbor areas. The value creation of such projects is enormous.

### Public Property Management

The market price for supplying energy to buildings is usually not high enough to encourage full scale energy saving programs. Many countries have introduced policy instruments in order to drive energy savings and the introduction of renewable energy production. Carbon taxes and general energy taxes are common, although these are not usually sufficient. It is important that some property owners take the lead and start energy saving programs, even if the investments are not fully paid off by lower energy expenses. Large property owners are able to build up or buy professional energy management. In northern Europe, municipalities, universities and regional public hospital organizations are large property owners and in fact also the show cases to save energy. The US has fewer public owned property companies that can be in the forefront.

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## Carbon markets in transition – opportunities and challenges

By Juha Ruukonen

The growth of the global carbon market has been rapid – in 2010 the carbon markets totalled €92 billion which is ten times more than in 2005. The largest market is the European Union Emissions Trading Scheme (EU ETS) which accounts for almost 80 % of the market with Kyoto Protocol's project mechanisms CDM and JI ranking as the second largest market. The foundations for the market are created by the Kyoto Protocol which is an international climate treaty that sets binding emission reduction targets for industrialized countries for the period of 2008-2012. Intensive negotiations are ongoing for the future emission reduction commitments, and the EU has already committed to reducing greenhouse gas emissions by 20% by 2020 and is willing to set more ambitious reduction targets provided other countries will make similar commitments.

GreenStream Network is one the pioneers in the carbon markets. The company was established in 2001 and it currently employs 40 experts in eight countries. The services offered by GreenStream include asset management, advisory services and market intermediary services. The company has outstanding experience and expertise in identifying, assessing, developing and managing high-quality projects, including JI and CDM projects under the Kyoto Protocol. Currently the company has €150 million worth of assets under management in several carbon and renewable energy funds and vehicles.

The carbon markets are in a transition. The market set up, commitments and rules are clear for the 2008-2012 period but at the same time the uncertainty over the international climate agreement for the 2013-2020 period and beyond renders the market outlook cloudy. However, there are certain issues that are clear: the EU ETS will continue and the EU will seek to achieve the -20% emission reduction; the project based mechanisms, in particular the CDM, will continue to exist after 2012; countries will implement emission reduction policies despite developments in the international negotiations, and developing countries will play an important role in curbing climate change. By and large, the greenhouse gas emissions will have a value after 2013 and low cost emission reduction possibilities in the developing countries will be within the reach of compliance companies in one way or another under various emissions trading schemes.

As in other markets, uncertainty brings also opportunities. From the European perspective there is currently a window of opportunity to invest in the emission reduction projects in the developing countries through CDM mechanisms. Companies included in the EU ETS can use project based emission reductions credits from CDM and JI mechanisms for compliance in the EU ETS, and currently it seems that the supply of credits can relatively easily exceed the demand, putting downward pressure on emission reduction credit prices. At the same time, international negotiations are seeking to reach an agreement that would most likely include at least the CDM and create new demand outside Europe for the CDM credits. Moreover, let us not forget developments in the USA, Australia, Canada, Japan and South Korea that are developing national trading schemes that will create additional new demand for the CDM.

For the financial investors the main challenge in grasping the current market opportunities is making the right choice as to the most likely project types and the most likely host countries to provide emission reduction credits that can be widely used in the world carbon markets and consequently

will have a high value in the future. Moreover, at least in the mid-term, the carbon market is fragmented into several markets which are partially linked and finding a suitable target market for the credits is not necessarily a straightforward exercise. For companies such as GreenStream this provides the opportunity to take advantage of the in-depth understanding of the complexities of the international climate policy, rules of the national and regional emissions trading schemes, challenges of pushing projects through CDM and similar project cycles (documentation, verification of the emission reductions etc.) and legal challenges of contracting an abstract product that is used in the uncertain and complex legal frameworks.

Another interesting issue regarding the current climate and carbon market is the financial support that developed countries have pledged to provide for developing countries. In the Copenhagen climate negotiations in 2009 countries failed to reach an ambitious global climate agreement but they managed to agree on a "fast start climate financing". The developed countries pledged to provide financing of USD30 billion during 2010-2012 and to increase it to 100 billion annually by 2020. The aim of the fast financing is to finance climate change mitigation and adaptation. Channelling this additional financing to the developing countries efficiently and effectively is not an easy task. Part of the financing is provided through existing development programmes and vehicles but also new means will be needed. For private companies, such as technology providers and project developers, fast financing can open new markets and business opportunities. GreenStream is actively participating in various clean tech networks and programs, and the discussion over how the private sector thinks that the fast financing should be channelled to the market has been moderate. We believe that as private companies will play a key role in implementing and actually constructing and operating emission reduction projects they should be very keen on participating in designing how the financing should be distributed and channelled to the market.

Overall, the carbon markets are in an interesting phase. The market has grown fast and many lessons have been learnt and at the same time there is an uncertainty regarding the future direction of the markets. For companies this situation provides unique opportunities. GreenStream has actively participated in the carbon market from the beginning and will continue to do so. We have no doubt that greenhouse gas emissions or emission reductions continue to have value in the future – the question is rather in which market can you fetch the highest price and which markets are the most lucrative for various project types. Indeed, carbon markets and climate policies will provide opportunities for both financial investors and companies that are seeking cost effective solutions to meet their legal obligations under the emissions trading schemes.

*Juha Ruukonen*

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## Through the integration in the Nordic Europe to the global value chains

By Sigitas Brazinskas

The Baltic region has ended year 2010 with optimistic signs where all three Baltic countries have demonstrated positive indicators in the economic recovery. The GDP grew, export figures started exceeding volumes which were achieved in 2006-2008 before the latest economic crisis. Large investment projects reached development phase or were completed. Estonia has made historical achievement by joining euro zone. Currently export still remains one of major recovery driven engine in the Baltic states where local consumption is still lacking far behind the level of years 2006-2008.

According to the latest statistics the entire Nordic Europe region is among the leading in Europe and has shown the most optimistic indicators in economic recovery throughout 2010. Growing internal integration within the Nordic Europe region could further strengthen its competitiveness through balance of innovation, knowledge, available multiple capital and attractive costs. Companies can export competitive products and services worldwide.

The Nordic countries (Denmark, Finland, Norway and Sweden) have long and close ties to the Baltics (Estonia, Latvia and Lithuania). Nordics have become a launching pad for business in the Baltic states because other multinational companies wishing to reach these Baltic countries as well as others in Eastern Europe have found the Nordic Europe to be an excellent base of operations. And in reverse, the Baltic region companies looking for higher integration degree have explored business ties with Sweden, Denmark, Norway and Finland. Value chains and value operations already exist within countries with an unique chance for the Baltic states to be "pulled" into global networks.

When it comes to trade, all three Baltic states have similar common export figures as the Nordic countries. However, when it comes to an individual Baltic country's export destinations, situation changes - Lithuania is still catching up with its trade figures with Sweden where Estonian and Latvian companies are more successful. However, Lithuania has larger volumes in trading with Denmark than Estonia and Latvia.

Wider global integration for the Baltic states can be reached not only through a closer cooperation with competitive neighboring Nordic European countries, but also through other countries. Companies from the Baltic states mostly utilise export opportunities in traditional sectors such as construction, furniture, apparel and sewing, transport and logistics. Services are forthcoming. Eight tenders out of ten in construction sector in Sweden are won by foreign companies from other European countries. Thus integration in the global value operations might depend on multiple opportunities, not only searching for new business in the geographically close areas across the Baltic Sea.

The challenges are huge in particular when Scandinavian manufacturing companies from traditional sectors (where enterprises from the Baltics have the most established business with the Nordic companies) start relocating their potential to China, Brasil and move along with their clients in value chain. Supplier villages expand and become more and more global.

The representatives from Western countries and business do not see the Baltic countries as a low wage locations any longer. This is a place of well trained, talented individuals who are available at a fair wage level. Baltic countries have a competitive advantage in medium to high technology industries because it will never be as cheap as Southeast

Asia but at the same time, the costs for a multinational company of employing a skilled specialist or graduate in the Baltic countries will never be as high as it is in the Western and Nordic Europe. Currently strong Swedish krona to euro makes concern for Swedish manufacturers and exporters. As the Baltic countries act directly or operate through their currency models in euro zone, current favourable situation could lead to their enhanced trade opportunities.

A recent author's survey was carried out among 50 Lithuanian companies from traditional manufacturing sectors which have developed their business opportunities towards Nordic countries. The survey aimed to evaluate degree of integration into global value chains through the Nordic Europe according to four criteria.

Firstly, Lithuanian companies have already developed different market entry strategies within the region based on real expectations and demands. Own brand development and relocation are used within the Baltic countries where subcontracting and private labelling dominate in cooperation with Nordic companies. Near-shore locations for Nordic companies across the Baltic sea still have a potential to be developed wider when it comes to complex, flexible and quick deliveries to maintain operations (which still remains in the Nordic Europe and not relocated overseas) in the value chain, recall and replace of manufactured and delivered goods. Services are on the way (shared service centers, design, data center hosting and others).

Secondly, Lithuanian companies which have established business with Scandinavian countries, have also had increased value added in their products and services. For those companies which do business within the Baltic region, the value added does not change significantly.

Thirdly, Lithuanian companies have achieved better integration degree into global value chains through cooperation with Danish companies. Potential with other Nordic countries is under development.

Finally, when it comes to high requirements for quality, state-of-the-art technologies, competitive transport costs and appropriate future based planning these remain the key criteria.

The survey has proven once again that close cooperation within the companies in the Nordic Europe region could enhance and strengthen competitive features.

Stable economic recovery largely depends on Lithuanian business success and integration capabilities into global value chains. Country has to demonstrate and expose economic recovery achievements along with measures which lead to improving business environment. Value for investors, competitive costs, competence and trained individuals, logistic opportunities, EU structural funds all together as a platform bring unique preconditions for sustain recovery and economic growth.

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## The Baltic States – moving together or apart?

By Andres Kasekamp

With Estonia just having joined the eurozone on January 1st, the question whether the trajectories of three Baltic states are diverging is once again relevant. Looking from the outside, Estonia, Latvia and Lithuania are commonly viewed as a single unit. Two years ago as Latvia turned to the International Monetary Fund for assistance, speculation was rife that Latvia would be unable to make the necessary draconian cuts in its public expenditure and would be forced to devalue its currency. At the time, practically all the international media stories concluded that Estonia and Lithuania naturally would have to follow Latvia and devalue their currencies as well. Commentators failed to differentiate between the three states and did not examine the specifics of each individual economy.

The Baltic states as a term specifically denoting Estonia, Latvia and Lithuania is relatively recent, and only solidified in international parlance as a result of World War Two. Prior to the Twentieth century, Lithuania's history was connected more with that of Poland than with its northern neighbours. Cooperation among the three nations was strongest when confronting an external foe during their struggle to achieve independence from the Soviet Union.

Following the Nordic pattern, various formats of cooperation were established in the early 1990s, such as the Baltic Assembly and Baltic Council of Ministers. Perhaps the best known examples of cooperation were in the field of defence, starting with the formation of the joint peace-keeping battalion BALTBAT in the mid-1990s. External actors expected Estonia, Latvia and Lithuania to cooperate among themselves in order to demonstrate their maturity for membership in larger international organisations, such as NATO and the EU.

However, at an emotional level cooperation was not so appealing as the three pursued their own independent agendas. Their economies were not complimentary but rather rivals since they produced similar goods for the same markets and vied to attract the same foreign investors. 'The Baltics' - sometimes erroneously confused with 'the Balkans', which were embroiled in violence and ethnic cleansing in the 1990s - was not an attractive moniker and was usually linked with the unedifying term 'post-Soviet'.

Estonia sought to rebrand itself as a 'Nordic' nation while Lithuania began promoting its Central European identity. Both had good reasons for differentiating themselves from the Baltic states' label. Estonia had better prospects for early accession to the European Union while Lithuania was in a stronger position to obtain NATO membership. Both wanted to avoid being lumped together with the other two less advanced countries because they feared that this would delay their bids to join these two exclusive clubs. In the end, the EU and NATO both opted for the 'big bang' enlargement, treating the three Baltic states as equal, lest one be left behind to fend for itself. It is amusing to recall that ten years ago the conventional wisdom regarding enlargement was that absorbing all three Baltic states at once would be too much to digest!

As members of the EU and NATO, Estonia, Latvia and Lithuania have cooperated closely, but have naturally also pursued differing policies in various areas. The desire for cooperation is not always enough: when it comes to the issues of practical implementation and each country has its own priorities. A field of paramount importance where reaching a common goal has unfortunately encountered

hindrances (unintentional as well as intentional) is energy security. A prime example is the joint Baltic undertaking to construct a new nuclear power plant to replace the decommissioned Ignalina plant in Lithuania. Because of the confusion and delays surrounding the project, Estonia is now seriously considering building its own nuclear power plant instead – an idea that would have been considered absurd a few years ago. Another example are the rival proposed Liquefied Natural Gas terminal projects in each of the Baltic states, when obviously the region can economically sustain only one.

Returning to the question posed at the outset, it is clear that in the short-term there will be further divergence between the three states as Estonia's adoption of the euro gives it a competitive edge and helps attract foreign investment. However, in the longer run, there will once again be convergence as Latvia and Lithuania eventually achieve their goal of joining the eurozone (their present target being the year 2014).

Though eurozone membership gives Estonia a significant advantage in the short-term and appears to distance it from Latvia and Lithuania, Estonia's achievement should also benefit the other two Baltic states. First, because it sends a positive signal to international investors about the Baltic region as a whole, in a similar but contrary fashion to the media stories of two years ago. Second, Estonia's success will provide Latvia and Lithuania with a positive example and stimulate them to strive to emulate Estonia's path. That was the case in 1997 when Estonia was the only Baltic state initially invited to begin accession negotiations with the European Union. At the time, there were concerns about the negative impact on Baltic cooperation and solidarity, but it soon became apparent that the invitation of Estonia motivated Latvia and Lithuania to speed up their reforms and they rapidly caught up with Estonia. We can expect to see a similar scenario over the next few years.

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## 'Focus on the Baltic' book sums up the facts

By Päivi Toivanen

The Europe Information section of the Finnish Ministry of Foreign Affairs has contributed to Baltic Sea joint efforts with the publication of the 'Focus on the Baltic' book – *Kansalaisen Itämeri, Fokus på Östersjön* – in Finnish and Swedish in March 2010.

**Matters to do with the Baltic will not cease to become relevant, although projects to save the sea hopefully will proceed and new innovations emerge. When all is said and done, it is essential not to give up hope of improving the condition of the sea.**

The Baltic Sea is a government priority; the condition of the marine environment and the security of maritime traffic must be improved and cooperation in the region must be consolidated.

In February 2010, the Baltic Sea Action Summit gathered an eminent expert group from nine of the Baltic Sea's coastal states to consider how to bring the sea back to life and to give commitments to achieving improvements. Various companies and communities made more than 100 commitments. Since the Summit, the participants have continued their own work to save the Baltic Sea and occasionally we learn of new projects and improvements. Even so, some commitments remain unrealized.

There is sufficient work in this field for politicians, companies, authorities, researchers, organizations and other actors. But ordinary citizens can also do their share by following the progress of projects and considering how their own choices affect the condition of waterways and other environments.

Europe Information's 'Focus on the Baltic' is targeted at everyone interested in the environment and habitat. Although the condition of the Baltic Sea touches especially coastal habitants, vacationers and people earning their living from the sea, everyone should be informed about how the sea provides a highway for 85 per cent of Finland's external trade as well as how future visions can continue to benefit the nine coastal states.

The target of the book is to give concise and diverse information from the perspectives of economy, transport, fishing, recreation, culture and security policy.

Expert contributors are **Susanna Niinivaara, Jari Luoto, Eeva-Liisa Poutanen, Jouni Lind, Hiski Haukkala, Björn Grönholm, Marko Joas and Kjell Westö. Alexander Stubb, Kaisa Kononen, Anni Sinnemäki, Anita Mäkinen, Carl Haglund, Liisa Rohweder, Juha Nurminen and Ilkka Herlin** are among featured interviewees.

According to the experts, the main threat to the Baltic apart from eutrophication is the risk of an oil spill caused by heavy marine traffic. Over 2,000 vessels operate in the sea every day and it has been estimated that the total will increase to 3,000 in around 20 years. Even so, it is hard to place risks in order of importance.

In the book, **Ilkka Herlin** from the Baltic Sea Action Group asks if it is possible to make comparisons between a sea that is eutrophied by algae with one that is polluted by an oil spill or filled with dangerous chemicals.

The articles and interviews make it easier to summarize what should be done to benefit the sea: because the problems are so diverse, it is important to work towards solving each of them in order to be able to rehabilitate the Baltic Sea.

The respondents in Fact or Fiction interviews are asked to make a choice. Foreign Minister **Alexander Stubb** is challenged with the following statement: *The European Union does not take seriously the possibility of an oil spill in a situation where oil transportation in the Baltic is increasing faster than measures to safeguard maritime traffic or to prevent an oil spill.*

*"Fiction! The best preventative work is in the improvement of the maritime traffic transport security," he replies. "Finland, Russia and Estonia have maintained a vessel registration system for many years, which has significantly decreased the risk of an accident. The EU is currently one of the financers of the*

*monitoring system's development processes, together with authorities from ten states."*

Under the title **Act!** the leader of BONUS Baltic **Kaisa Kononen** considers what a citizen can do for the Baltic Sea:

- Ask a politician what he is going to do to benefit the Baltic Sea
- Move to an environmentally friendly workplace
- Raise children in an environmentally aware manner
- Use environmental friendly products and recycle
- Write letters to the editor

During the editing process, it was especially pleasing to find that all those who were asked to participate did so in a whole-hearted fashion despite their other pressing engagements. Author **Kjell Westö**, for example, had just embarked on a substantial writing project but he considered the book personally important and found the time to write an excellent essay, *Nine Short Chapters on Love for the Sea*. The essay includes fragments from Swedish author's **Tomas Tranströmer's** book *Itämeriä* (1974), presented to the book by the author and translator **Caj Westerberg**.

I'd like to conclude the presentation of the book's content by expressing the wish that all Finnish and Swedish speakers will order it or acquaint themselves with the electronic version on Europe Information's homepage.

**Ilkka Herlin** offers an apt way to sum up why the Baltic Sea case remains relevant and why we have to be happy and proud, despite our anxiety, of the work we do for our shallow Northern Sea - no matter if we call it the Eastern Sea in Finnish, the Western Sea in Estonian, or the more widely-known Baltic Sea:

*"It is worth recognizing that the Baltic Sea is truly a pilot area for the world, with problems that do not concern only saving this one individual stretch of water, but that are relevant also to the future of the globe, of all people and of the natural environment."*

Focus on the Baltic can be retrieved from Europe Information's customer service points in all countries or ordered free of charge on the webpage [www.eurooppatiedotus.fi](http://www.eurooppatiedotus.fi)

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The purpose of the Ministry of Foreign Affairs' Europe Information is to produce and supply information in Finnish and Swedish on the European Union and Finland's foreign policy and to generate discussion on matters related to the EU. Europe Information's publications are all free of charge and our regional information officers hold seminars and lectures by request.

Päivi Toivanen

Publishing Editor

Europe Information

Ministry for Foreign Affairs

Finland





## Political and social stability in Ukraine after the first year of Yanukovich's presidency

By Alexander Kulakov

In the interview with Rostislav Khotin, editor of BBC Ukrainian service, in Davos, Switzerland, the President of Ukraine Viktor Yanukovich summed up his first year in office. In particular, he said the following: *"I think the main thing is that in Ukraine the political and economic stability was established. That is, the result of this work – this is a positive statistical data on almost all fronts."*

I will try to analyze this statement of the President of Ukraine. To begin with, as a result of the presidential elections on February 7, 2010 the President of Ukraine Viktor Yanukovich was elected. His advantage over the main rival, Yulia Tymoshenko, was 3.5%. The key provisions of the election program of Viktor Yanukovich, entitled *"Ukraine – for the People"*, were aimed at implementing the systemic reforms in the country and fundamental changes in society. As a result, the proposed measures suggested that in 10 years Ukraine could become one of the most economically developed countries.

To achieve these goals Viktor Yanukovich in his Program proposes to introduce *Investment – Innovative Model for Economic Development* of the national economy. It was declared that through changes in tax laws, as well as through the implementation of integrated action to improve access to markets of the country Ukraine could be made more attractive for investments in Eastern Europe. The election program of Viktor Yanukovich also stressed the need to implement a system of measures for the revival and development of Ukrainian agriculture. In addition, it highlighted the importance of supporting small and medium-sized businesses through improving their access to credit, reducing the tax burden and reducing their tax payments to companies that create new jobs. The program also included an intention to reform the system of local government, health and education. In the election program of the future president much attention was also given to social guarantees of citizens of Ukraine, including support for young families and retirees. It should be noted that the concept of "political and social stability" is never mentioned in this document, but the significance of its achievements implied as such, which would enable the authorities to carry out the implementation of assigned tasks.

It should be recalled that as a result of the global financial crisis, 2009 was the year of the catastrophic fall of the Ukrainian economy, which naturally affected the socio-economic situation in the country: GDP contracted by 14.8%, inflation stood at 12.3%, unemployment rose to 9.4%, volume of foreign trade declined by more than twice. Against this background the political standoff between President Viktor Yushchenko and his political supporters, Prime Minister Yulia Tymoshenko and Bloc Party, to which she relied, and the largest opposition party, the Party of Regions, headed by its leader Viktor Yanukovich had extremely aggravated. The result was paralyzed parliament of Ukraine – the Verkhovna Rada of Ukraine – and draft laws that were necessary to meet the challenges of overcoming the crisis in the economy were trapped. If the growth of ideological confrontation between different groups of citizens of Ukraine – based on linguistic differences and different assessments of historical facts and encouraged by both internal and external forces – is also added to this, a political-economic portrait of Ukraine on the eve of presidential elections in Ukraine in 2010 looked dismal. Note also that the outcome of the elections once again underscored the "split" of Ukraine to almost two equal opposing camps.

Since coming to power, Viktor Yanukovich considered as a priority task to build a so-called "vertical of power". By this it is meant to make legislative, executive, and local authorities to act in one direction, performing the tasks assigned by the President. And the first steps of Viktor Yanukovich were aimed at creating

a parliamentary majority on the basis of the Party of Regions at the Verkhovna Rada of Ukraine. Rather quickly such a coalition was formed. On March 16, 2010 the agreement on forming a coalition of factions *"Stability and Reforms"* was signed by representatives of the Party of Regions, Communist Party of Ukraine and Lytvyn Bloc.

The next step of Yanukovich became resonant action on the abolition of the political reform of 2004. (It should be recalled that during the "Orange Revolution" the compromise was gained, under which the constitutional reform in Ukraine was carried out. As a result, the President's powers were considerably limited, and the Verkhovna Rada of Ukraine had the opportunity to form a government of the country). On the basis of an appeal to the Constitutional Court of Ukraine of deputies of the Verkhovna Rada, the Constitutional Court made a controversial decision that the Constitution of Ukraine of 2004 was revoked. The Constitution of 1996 entered in the action and, thus, recovered very extensive powers of the President of Ukraine.

The final effort in the direction of building "a vertical of power" was the local elections in 2010. As a result of elections held on October 31, 2010, the Party of Regions had significantly increased its representation in local government in regions where it previously did not have much influence. It should, however, be noted that, according to representatives of opposition parties, the ruling party has widely used so-called "administrative resources", as well as pseudo-legal means for removal of these parties from the elections in some regions.

Concurrent with the work of the President and his government, aimed at concentrating power in the hands of one (pro-presidential) political force, General Prosecutor's Office initiated the investigations of a significant number of criminal offenses related to abuse of office, causing significant material damage to the state. The suspects in these cases were a large number of top-level government officials who worked in the government of Yulia Tymoshenko, and the former prime minister herself was among the defendants. To date, it is difficult to say if the accusations are valid, but the overwhelming majority of Ukrainian citizens consider these actions of the current government as political persecution. The decision of the Czech Republic with respect to the granting of political asylum to Bohdan Danylyshyn, the former Minister of Economy of the Tymoshenko's government, especially reinforced this view.

In the economic sphere, President Viktor Yanukovich and his government have focused on the country's withdrawal from the deep economic crisis. The urgent steps have been taken to stabilize the economic situation in the country. In 2010 official statistics recorded a noticeable progress, compared to the previous year. Thus, GDP growth for the three quarters of 2010 amounted to 3.4%, compared with the 14.8% fall in the previous year, inflation has declined somewhat, the foreign trade turnover increased by one third. The industrial production increased markedly and the agricultural output increased slightly. Statistical agencies have also reported an increase in real wages across the country and its regions. It should be noted, however, that many Ukrainian analysts believe that the main factor in the economic growth of the country has been the improvement of the economy of other countries – major importers of Ukrainian production.

In late 2010 the new government adopted two important laws that will govern the economic development of Ukraine in 2011: the Tax Code and the Budget 2011. As conceived by the government the Tax Code will classify the tax laws of Ukraine and facilitate their use by business entities. In addition, this document provides lower rates for income tax and VAT. So, from April 1, the tax rate on profits of enterprises will decrease by 2% to 23% in 2012 – up 21% from 2013 – up 19% from 2014 – up to

16%. VAT will be reduced from 1 January 2014 from 20% to 17%.

At the same time, this law has substantially limited the possibility of using so-called "simplified" taxation system, which applies with respect to small entrepreneurs, as well as some other provisions that make their continuing operation unprofitable. The result of these innovations was the "Tax Maidan", which was attended by over 700,000 entrepreneurs throughout Ukraine. They demanded the abolition of this document. Eventually a compromise was reached whereby in the near future the Code will be amended, which, apparently, will satisfy the requirements of the protesters. Nevertheless, according to the forecasts of Ukrainian business associations, more than 150,000 business owners have to shut down their operations after April 1 this year.

As for the Budget 2011, in the opinion of experts, this paper shifts the tax burden from large taxpayers on the shoulders of small businesses and ordinary citizens. Most of the tax revenue will be paid by final consumers, one way or another. Experts believe that shifting the tax burden from large enterprises to small businesses and consumers is extremely risky and can put an end to the planned wage increases in 2011, which in turn automatically leads to a shortfall in the Pension Fund.

In this regard, attention should be paid to the January forecast of the European Bank for Reconstruction and Development, which noted that the growth of Ukraine's economy will slow down, and the result of 2011 will be 4% – not 4.5% as previously expected. Thus, the bank has lowered its estimates of GDP growth in Ukraine in comparison with its own previous estimates, made in October 2010 at 0.5%. In the official statement of the bank, the changes in the forecast for Ukraine are not clearly justified. However, one of the main causes of its decline is the concern about the "fiscal stability". It is not excluded that the increased risks of a slowdown in the Ukrainian economy appear because of changes in tax laws, as the single most important – from a macroeconomic point of view – event for the period from October 2010 to January 2011 was the adoption and entry into force of the Tax Code.

Since the second half of 2010 the President of Ukraine Viktor Yanukovich and his government embarked on the reform package. First, in accordance with IMF recommendations, the development of pension reform has been started. The draft law "On measures for the legislative support of the pension system", developed by the Government, in particular, provides for progressive – until 2020 – raising of the retirement age for women (from 55 to 60 years) and since 2013 - raising of the retirement age for male civil servants from 60 to 62 years, and sets term limits for public service. In addition, the bill proposes to increase the regulatory length of labour service required to obtain the minimum pension from 20 years for women and 25 for men to 30 and 35 years respectively. These proposals provoked a wave of protests. In several cities of Ukraine, in particular, Simferopol (Crimea), there were rallies of citizens (mostly women) who expressed opposition to the plans of the government. According to the protesters, the model of pension reform only puts the social responsibility on the shoulders of citizens and "presents" to public the raising of women's unemployment, lack of jobs for young people, and will worsen the pensions of military personnel. Apparently, due to the sharp criticism of the public on January 31 it was reported that the Government intends to withdraw the bill from Parliament for further elaboration.

Next step on the path of reforms was the administrative reform. It should be noted that from the point of view of Ukrainian and European experts, this reform is a key to the implementation of economic reforms in Ukraine, since it provides power tools for their implementation. According to the Decree of President Viktor Yanukovich, the Committee on Economic Reforms was asked to "work out within a month the issue of optimizing the system of central bodies of executive power, to eliminate duplication of their powers, and to ensure reduction of administrative personnel and expenses for its maintenance." Shortly after the Decree, the new structure was introduced, under which the number of ministries was reduced to 16, and members of the Cabinet of Ministers of Ukraine to half. In addition, it was stated that the total number of civil servants working in the central organs of executive power will be reduced by 30% and will soon be approximately 130 thousand people. Appreciating the first stage of administrative reform, it should be noted however, that the "arithmetic" of action in this direction is still insufficient. It is necessary to clearly delineate the functions and powers of ministries, services and agencies, which are defined in the system of government. In addition, it would be necessary to think about what to do with 56 thousand mostly highly skilled public servants who may soon be in the labour market.

In conclusion, it should be noted that the president's team has also started very important reforms in the housing and communal services of Ukraine and system of education, working on a new Labor Code. All these areas have long needed a drastic change, and, therefore, the intention of President Viktor Yanukovich to bring all these spheres of public life in accordance with the requirements of modernity should be welcomed. At the same time, these spheres are all very "sensitive" as they affect the interests of the vast number of Ukrainian citizens. For example, according to statistics, 8.5 million people receive a pension of up to 1000 hryvnia per month. At the same time, February 1, 2011 electricity prices for the population which consumes on a monthly basis over 150 kilowatts increased by 30%. Tariffs for water supply also increased: in Kiev for 11%, in other cities up to 15%. In general, according to the National Forum of Trade Unions, in 2011 the average cost of each Ukrainian family for utilities will increase by 1,700 hryvnia.

Thus, the political and economic stability in Ukraine that the President of Ukraine Viktor Yanukovich was speaking about in his interview with BBC Ukrainian service is, in my view, in a state of unstable equilibrium. Any hasty actions to implement reforms that are unpopular to the public in the context of difficult economic situation of the large number of citizens of Ukraine can cause massive protests (an example of what can become a "Tax Maidan" of small businesses). And given the actions of the authorities to suppress opposition, the aforementioned "economic" objections may be combined with political slogans, aimed at putting pressure on the President of Ukraine to change his policies.

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# From industrial structures to agile global service networks – a disruptive revolution or led transformation?

By Markku Tuomola

Large production units, competitive edge by scale, organized global logistics and shaped ISO and quality manuals on the shelf are terms mounted to every western leader's mind educated in the 80's or 90's. These terms describe the spirit and foundation of the late industrial age. After the fall of Berlin wall, there has still been an accelerating growth moment of industrial production in the west. The opening of the Eastern market and especially China has created huge new demand still boosting the old industrial structures.

Behind the curtains we could have recognized another big starting wave. While production has started to find cost effective production plants in developing countries, old global companies and brands are trying to maintain their market shares in many ways.

Transformation of a global organization is a challenging process. It is like transforming the former Soviet Union to dynamic modern Russia. For this reason, it is possible that the top transformation professionals hail from former socialistic countries.

When we are talking and writing about transformation, we are usually not defining what we mean with transformation and change? Change management is a process, where we professionally lead a process or an organization to a new mode. In change management it is important to focus and support new methods and processes and give enough resources to key people. An even more crucial is to step by step fade out old processes and the resources empowering them. This is usually the most difficult leadership task. When old processes still work and normally make excellent profit, it is hard to shift our focus on something else.

Right now we have an excellent example of this kind of phenomenon here in Southwestern Finland. The old ship yards have made excellent profit and brilliant products in ship building for years. Last year we delivered the biggest cruise ship of the world and now many subcontractors are still waiting for the next big order to come. The point is the mindset. In visionary change management we are always ready for something else. While producing components to the last cruiser, we already plan and market our services to some other markets – however we still make profit in the old stage.

Transformation is something more than change management. While change management is focusing on a process or company, transformation is taking place at the scene of a branch, a nation or a market. Transformation is changing the whole ecosystem forever.

Where does the power of transformation come from? When we are talking about technology, we are talking about disruptive innovations. A disruptive innovation is a phenomenon that just "comes over of the wall" and the old ways are not able to compete with it. When a true disruptive technology arises, it normally just wins without extremely talented transformation leadership. This is what I call disruptive revolution. This has happened with microprocessors and mobile phones. This can also happen with processes: Classified advertisements moved from newspapers to the Internet within a few years, and we will see also public services moving fast to the web when we just understand that e-government is something more than just opening some websites for people.

While discussing transformation and leadership, it is always important to focus on perspectives. We have to understand our history and have a strong vision of the future we want to create. It is not enough to understand that the way we are doing business or politics right now is not the best way. We need a picture of the future.

In addition, we need a wide perspective of current market actors – organizations and ambitions of current leaders – to offer "something more" for them.

I have said that to start real transformation, we need a mass of people hungry for change. And in addition we need a clear vision and a change leader – brave enough to put the vision in words and wise enough to take "the red army choir" with him in processing the change. Transformation can start quickly – as it did in Ukraine's orange revolution a few years ago – but true transformation is a process for years and that's why transformational leadership focuses also on the possible opposition. A wise leader always takes his red army choir to the band. This is the only way to see some solid new establishment in 10–20 years.

The power of transformation comes from leadership.

Let's step from the past to this week and the future. I wrote about political transformation examples here, because we have a great global transformational window open right now in economy and business. The industrial age is behind. For over 100 years we have lived mainly by producing goods and making good profit out of it. We still have a short moment when we can deliver western luxury brands to east, but the manufacturing profits have already moved to developing markets.

What comes after industrial age? I believe that we have already moved to ubiquitous economy stage, where most of the people are living out of producing information and services – and where micro economies are transacting globally with other micro economies without massive enterprise layers in between. The key word is trust.

The other key of future success is how we can deeply understand that producing information and services is not a technology driven business. It is mainly a mindset of service and flexible networking. There will be a list of new professions and also a list of new terms defining bookkeeping balances when we move further. Of course the values of buildings will remain in balances, but it is a must to value also immaterial capital, because the main part of company turnovers come from producing services – not any more in material resources. Media content and IP delivery is just one example of this phenomenon. The bankers are not used to appreciating immaterial balances, but they have already started to learn it while valuating goodwill in corporate acquisition processes. Actually these goodwill valuations already exist strongly in the market valuation we see everyday in stock ratings. That's everyday life in macro level, but still hard to implement in SME's discussions with a bank.

Learning a new mindset is an extremely challenging thing. And learning a new mindset as a group or a nation is even more challenging. The more we have strong traditions and processes still making profit, the harder it is to take a crucial step towards our future.

When we are stepping out of industrial age, we have to forget "the good old industrial processes" and step in the presence of continuous transformation, networking and "neogrowth". To create our future is about leaving the past behind. On this stage, the Baltic Rim has a wide-opened window. Together we have already learned new ways to cooperate and network in multicultural and multi-language environment. After doing this in nearshoring, we can implement our skills in outsourcing new mindset. If we just want to take the leadership.

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