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**CARL HAGLUND**

The Baltic Sea as an example of regional maritime security cooperation



**ROKAS MASIULIS** Klaipeda LNG terminal – the game changer in the Baltic region



**MARTIN LIDEGAARD** The rising importance of the Baltic Sea region



# BALTIC RIM ECONOMIES

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CARL HAGLUND

# The Baltic Sea as an example of regional maritime security cooperation

Expert article • 1595

**T**he importance of the Baltic Sea for Finland is evident. A clear majority of our foreign trade is transported via the Baltic Sea. Similarly, about half of our foreign trade takes place with the countries around the Baltic Sea. In other words, our wellbeing is in many ways dependent on the Baltic Sea. No doubt the sea is equally crucial for all other countries around it.

With that background in mind, it is not surprising that Finland has an interest in identifying security challenges linked to the Baltic Sea and creating the most effective ways of addressing them. Recent developments in Europe have underlined the need for enhanced cooperation, as risk for increased tension is now more concrete than in years. In maintaining security and stability in the region the role of NATO is the most crucial.

Environmental challenges continue to be enormous. The volume of maritime transportation in the Baltic Sea has doubled in twenty years and is heavily concentrated in the Gulf of Finland. The risk of an environmental catastrophe is real and poses by far the biggest threat to the region. Considering the volume of maritime traffic in the Gulf of Finland, it is almost a miracle that no major oil accident has taken place. A concerted effort is needed in order to prevent environmental catastrophes from happening in the future.

Strengthening regional cooperation in the Baltic Sea area is important, as it enhances the stability of our neighboring areas and contributes to situational awareness. The cooperation solutions in the Baltic Sea area can be used as an example when discussing and developing ways to enhance regional maritime security. Finland has consistently strived for better and more effective coordination in the area.

In the early 1990's various agencies in Finland dealing with maritime issues saw the need for coordination at national level. Multi-agency cooperation between the Finnish Navy, Finnish Border Guard, Finnish Transportation Agency and Transport Safety Agency was initiated. Gradually it led to the establishment of the National Common Information Sharing Environment (NCISE). NCISE is an excellent example of well-functioning civil-military cooperation and has shown the advantages of comprehensive approach to security.

However, it is clear that cooperation at national level is not sufficient as the Baltic Sea is surrounded by nine countries. In 1999, Finland and Sweden started to inform each other about their naval exercises. There was clearly a need for a platform for sharing information. Later on the exchange of information led to the establishment of Sea Surveillance Cooperation Finland Sweden SUCFIS, which has been operational since 2006.

Based on the SUCFIS experience, Finland and Sweden had a vision of wider cooperation between the Baltic Sea countries. As a result, Sea Surveillance Cooperation Baltic Sea (SUCBAS) was created, under which for example vessel data and reports are exchanged. All countries around the Baltic Sea, except Russia, participate in the

cooperation. It is worth emphasizing that SUCBAS cooperation does not only comprise of technical sea surveillance but consists of exchanging views on current issues. The general aim is to strengthen common understanding between the participating countries, as building trust is a crucial element of successful cooperation and leads to increased security.

In the EU, similar kind of cooperation takes place within Maritime Security Surveillance MARSUR, which for the first time integrates sea surveillance at the European level. Even if built by the military, MARSUR is not only meant for armed forces. It is intended as the defence layer of Common Information Sharing Environment (CISE) of the EU which can be used by any agency in the EU. Again, it is not just about technology. Instead, the key is in networking and building trust.

The recent adoption of the EU Maritime Security Strategy demonstrates the importance Finland and the other EU countries attach to maintaining open, protected and secure waterways. The EU Strategy provides a framework for addressing maritime security challenges.

The EU has also a Strategy for the Baltic Sea Region (EUSBSR), which has three main objectives: save the sea, connect the region, and increase prosperity. While the focus of the EUSBSR is on safety rather than security issues, cooperation between civilian and military authorities has been extensive, including for example areas of maritime rescue, natural disaster and border control, research and sea surveillance. There is a common interest in a better and shared situation awareness which enhances safety and security in the Baltic Sea area.

If secrecy has earlier been seen as part of security, in today's interconnected world security builds on transparency, information sharing, situational awareness and trust between actors. All this is equally important as we seek enhanced defence cooperation. Finally, while increased cooperation is crucial, it does not substitute the capacity and readiness of a nation to defend itself militarily. In close cooperation with its partners and with a view to maintaining its own defence capacity, Finland is determined to do its part in order to increase the security and stability in the Baltic Sea area. ■

There is a common interest in a better and shared situation awareness which enhances safety and security in the Baltic Sea area.



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ROKAS MASIULIS

# Klaipeda LNG terminal – the game changer in the Baltic region

Expert article • 1596

**P**olitically and economically Lithuania is an integral part of the EU, yet unfortunately, this cannot be said about its energy sector. Lithuania with other Baltic States are still being compared to the “energy island” in the context of the EU internal energy market, due to lack of gas and electricity interconnections with other EU Member States and extremely high dependency on energy resources supply from Russia.

However, this situation is about to change irreversibly. As one of the key measures to increase the security of energy supply and to create the environment for effective competition, Lithuania has finished the construction of the first liquefied natural gas (LNG) terminal in the Baltic States. The LNG terminal, located at the port of Klaipeda, is based on FSRU (Floating Storage and Regasification Unit) technology, it will have a regasification capacity of 4 billion cubic meters (bcm) natural gas per year and that will be a key game changer in the completely monopolistic gas market of three Baltic States, which in total consumes approx. 4,8 bcm of natural gas per year. Considering its benefits, Lithuanian LNG terminal is also included in the recently released European Energy Security Strategy, being one of the top key projects in the list.

In this context, October 27th, 2014 – the Opening ceremony of Klaipeda LNG terminal – was a historical day when Lithuania, together with its regional partners, has celebrated the arrival of a newly-built FSRU vessel “Independence” to Klaipeda seaport.

Although the primary goal of Klaipeda LNG terminal is to satisfy national needs, the terminal will operate under the so-called *third party access* regime, which means that our neighbors and partners will also have the possibility to use terminal's capacity for their own needs on the regulated and non-discriminatory basis.

Klaipeda LNG terminal will also provide possibilities for cooperation in LNG reloading which is a new type of activity in the Baltic Sea region. Gas in liquid form would be pumped to smaller tonnage vessels at the all year round ice-free Klaipeda port and shipped to small terminals. Since the Baltic Sea and the North Sea are being classified by the International Maritime Organization as the *Sulphur Emission Control Area*, starting from January 1, 2015 ships sailing in these seas will have to use low-sulphur fuel, which means that LNG will become one of the preferred alternatives.

On August 21, 2014 state-owned natural gas supplier and trader LITGAS has signed LNG supply contract with Statoil ASA which offered the most favourable conditions to supply 0,54 bcm of natural gas per annum through the LNG terminal for the 5 years. This contract is a guarantee for Lithuania that we will no longer pay a political-based price for natural gas – it will establish a new natural gas pricing policy linked to the natural gas price movements on the international markets. The price of LNG in Lithuania will be in a range of € 260 – 290 per 1000 cubic metres, which is considerable achievement having in mind that just one year ago (in the 2nd quarter of 2013) Lithuania was paying the highest wholesale price for natural gas among all EU member states – € 395 per 1000 cubic metres.

Lithuania has already undergone legislative reforms which will allow to effectively ensure diversification of gas supply, including regulation which ensures that not less than 0,54 bcm of natural gas (~20% of annual gas consumption) must be supplied annually via LNG terminal for a period of 5 years. Lithuania is also encouraging Latvia and Estonia to consider applying such mandatory gas supply diversification requirements. Baltic States, with the support of the European Commission, should prepare the favourable regulatory environment for alternative gas sources to enter our regional market in order to increase the competition among suppliers.

Considering the peculiarities of Baltic States gas market (small size vs. a need to implement large-scale projects) we need to promote an efficient use of existing gas infrastructure in the region. Therefore, our main focus in gas sector should be given not only to the construction of necessary infrastructure but also to the harmonization of the regulatory environment among Baltic States. Otherwise, market players may not be able to interact with each other which also mean that regional market may not react with a sufficient speed in emergency situation, or even may not react at all due to legal formalities. In order to prevent such scenario Baltic States need to actively cooperate on implementation of the necessary legal, economic and technical measures for effective functioning of a common regional market.

To sum up, the Klaipeda LNG terminal will be the first large scale LNG terminal in the Baltic Sea area with the capability to provide reloading opportunities from all year round ice-free port. The LNG terminal “Independence” will be the “ice-breaker” for the region, helping to ensure an alternative gas supply and create a functioning gas market. However, construction of the necessary infrastructure is only a part of the task – we have to continue our work on the harmonization of the regulatory environment among Baltic States to form a well-functioning regional gas market. ■



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Minister of Energy  
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MARTIN LIDEGAARD

# The rising importance of the Baltic Sea region

Expert article • 1597

**T**he Baltic region is unique in many respects. It shares many commonalities. History, culture, economic development and not least economic potential are but a few examples.

The Baltic Sea area is a region with immense potential. And the EU membership of Poland and the Baltic states has given the area more clout. We work together, trade together and share a common culture and approach to many issues. But it is also an area where – as the latest developments have shown – global politics influence our citizens. We need to ensure that the Baltic Sea area is a low tension area where cooperation, not insecurity, is the name of the game.

Baltic Sea cooperation is at its best when we create concrete results to the benefit of the countries around the Baltic Sea. At this point in time, energy is perhaps the best example and where we stand to gain most by enhancing our concrete cooperation. We have shared interests when it comes to protecting the environment, adapting to climate changes and reforming our energy policies.

Apart from the benefits to our environment, concrete cooperation on energy security will contribute to reducing tensions and furthering economic cooperation and growth. Therefore energy security in a broad sense is a central priority for the Danish Government – also in the Baltic Sea area. It reflects the Government's Green Growth agenda and Denmark has many good experiences from building our green policies and sector.

Energy security is important as well as multi-faceted. There is broad scope for increased cooperation within several fields, in particular regarding energy efficiency, interconnectivity and variability of energy sources. Excessive dependence on one supplier is a real risk – both in our region and to Europe in general. The region also holds extensive commercial potential, in particular within energy infrastructure, the maritime sector, and transport/logistics. I am pleased to see a number of projects in these fields already prospering. And I see an important role for our countries in advancing this agenda.

Politically, Baltic Sea cooperation is at its best when it means building confidence and dismantling tension. In fact, this was a main reason for establishing the Council of Baltic Sea States (CBSS) in 1992. I believe we should seriously consider reinvigorating this aspect of our regional cooperation and devote more attention to this.

The need for building confidence and dismantling tension is obvious when you look at the members of the CBSS – as it includes both Russia and the EU members around the Baltic Sea as well as Iceland and Norway.

Russia's recent behavior towards Ukraine is a serious concern to us all. But understandably not least to our Baltic neighbours. For Denmark it is a priority to contribute to reassuring the Baltic states that they will remain free, secure and prosperous.

Through the CBSS we cooperate on issues that are not high politics and can hopefully help influence the values held by Russian decision-makers. Moreover, cooperation with Russia within the CBSS is also relevant in order to make progress in areas where we have shared interests with Russia, such as protecting the Baltic Sea environment.

Baltic Sea cooperation is a priority for the Danish government because it is our local area. Commercially, the region offers a host of opportunities. The region is a local market for Denmark and of

major economic significance. 40% of Danish exports go to the Baltic Sea states amounting to almost 55 billion euro. Growth in the area means more jobs.

The Baltic Sea cooperation has come a long way since the CBSS was founded more than 20 years ago. Despite the recent tensions in the broader region, the outlook is promising. I see firm signs of a common will to intensify and deepen cooperation in our region to new levels. I would like to see more focus in our cooperation. The number of priorities should be limited and clearly defined.

I would also like to see a more result orientated approach to Baltic Sea cooperation. Our results must be visible, provide added value and communicated effectively to the public. Our aim should be to concentrate on areas with the largest potential for results.

Finally I would like to see increased involvement of the private sector in our regional cooperation. All three aspects would benefit growth and employment in the Baltic Sea region. And all three are at the top of Denmark's Baltic Sea agenda.

Since the establishment of the Council of Baltic Sea States (CBSS) more than twenty years ago, Denmark has played an active part in the development of Baltic Sea regional cooperation. Not only within the CBSS but also in cooperation formats such as the EU Strategy for the Baltic Sea Region (EUSBSR), The Northern Dimension and the Helsinki Commission (HELCOM). The prominent Danish role as coordinator for several of the priority areas under the EU strategy is a case in point.

Last year, we decided to step up our involvement in regional cooperation. To do this, we developed a new Danish policy framework for the Baltic Sea region. We aim not only to raise our political profile in the Baltic Sea context but also to increase our focus and impact in the Baltic Sea cooperation.

The Danish policy framework outlines what we would like to achieve through cooperation in the region. The framework is based on this:

It has one main goal: to tie the Baltic Sea Region together in an ever stronger cooperation between all Baltic Sea States, including Russia.

It has two priorities: to protect the environment and climate as well as to create growth in a broad sense.

We have chosen to focus our efforts mainly on three main fora for cooperation: The Council of Baltic Sea States, the EU Strategy for the Baltic Sea Region and the Northern Dimension. Our efforts in other regional for such as HELCOM pull in the same direction.

The economic potentials and the challenges to secure a sustainable region will only grow in the years to come. We must work – inside and outside the EU and inside the CBSS – on both together. ■



**MARTIN LIDEGAARD**  
Foreign Minister  
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HANS-PETER BARTELS

# Cooperation in European security policy with the prospect of a European army, and the topical relevance of this debate for the Baltic Sea region

Expert article • 1598

When the subject of a European army is reported on, it is almost always in connection with the problem of declining defence spending in nearly all EU Member States and the resulting need for greater multinational cooperation. There is no denying the necessity of enhanced cooperation and, in the long term, a European army – but reducing the idea of a European army to the issue of financial constraints fails to do it justice. Since the first steps towards European integration were taken in the 1950s, the EU has become a union of states which is unmatched anywhere in the world in the extent of its economic and political cooperation. In many areas, the Member States have already transferred far-reaching sovereign rights to the EU: the single currency is just one example. This partial surrender of national sovereignty is what paved the way for successes such as the internal market or comprehensive freedom of movement for EU citizens. And at the same time, it brought peace to what was one of the world's most warring regions in the last century.

This can also serve as an example in the field of security and defence policy. Naturally, the idea of an integrated European army cannot be implemented overnight; a step-by-step process will be required. It will also continue to be the subject of contentious political discussions. For example, as we all know, the concept of "Pooling and Sharing" developed by the European Defence Agency (EDA) requires countries not only to specialise in certain capabilities, but also to forego others. This is a step which many countries find difficult. In addition, the power of command over one's own armed forces is a core area of national sovereignty. Rethinking this centuries-old concept of security policy requires a great deal of courage and determination. The Netherlands is the first European country to have shown this courage, by placing an entire brigade of 2100 personnel under the command of the Bundeswehr's Rapid Response Forces Division in June 2014.

Current examples in the Baltic Sea region show that military cooperation can work very well. One example is the Multinational Corps Northeast in Szczecin, which was established in 1999 and now involves 12 partners. In mid-2013, Germany and Poland agreed to engage in enhanced naval cooperation, ranging from joint training and surveillance to, potentially, joint missions and cooperation on shipbuilding. And in June 2014, BALTOPS, an annual multinational exercise, took place for the 42nd time, led by the US and with the participation of 4700 service personnel from 15 countries. Here too, the aim is to increase the interoperability of the forces involved.

When it comes to the use of the Baltic Sea, whether for economic or military purposes, it is important not to lose sight of the fact that this is a highly sensitive region. Not just in terms of its biodiversity and natural resources, which require protection, but also from a security-policy perspective. This is true of maritime areas in general, as their

shared use always holds a certain potential for conflict. In the case of the Baltic Sea, however, there is a heightened degree of sensitivity, particularly at the moment. After all, the Baltic Sea is bordered not only by EU and NATO members, but also by Russia.

It is no secret that the crisis in Ukraine has severely disrupted relations with Russia for the EU, NATO and their members. The tensions between "East" and "West", if we choose to think in such terms, are today reaching heights not seen since the end of the Cold War. And these tensions mean that a high degree of level-headedness is needed from both sides with regard to the Baltic Sea. After all, there is a thin line between a routine military exercise and a provocation, and crossing it could have disastrous consequences.

None of the countries bordering the Baltic Sea can seriously have an interest in extending the Ukraine conflict to this region. The region is far too important in terms of business and trade, and, in Russia's case, as a gateway to the west. Since time immemorial, business and trade have depended on peace above all else.

This does not rule out a military presence and cooperation in the Baltic Sea region, however. Indeed, part of the Russian navy is also located there, in the form of the Baltic Fleet. The situation requires particular care from the countries concerned and from the service personnel deployed there. In any case, the ability to operate and co-operate in a fragile situation without provoking others is, looking to the future, an essential capability for a functioning European army. If this can be achieved, a military presence can safeguard stability rather than endangering it. After all, a balance of military forces guaranteed peace for many decades in the past.

Nevertheless, jointly resolving crises like the current one in Ukraine remains our aim, of course, and I am optimistic that we will succeed. But a way must also be found to avoid extending a regionally contained conflict to other areas in times of political and security-policy tension. So far, despite the legitimate concerns of the Baltic states and Poland in particular, this has generally been achieved in the case of the Baltic Sea region.

If this remains true, the Baltic Sea region could become an example of how peaceful coexistence is possible even in times of crisis. ■



HANS-PETER BARTELS

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JETTE NORDAM

# The importance of cooperation across the Baltic Sea region

Expert article • 1599

**T**he Danish government has chosen an ambitious approach to the Baltic Sea regional cooperation and to the many networking and project-based activities that are underway in the region. The collaboration is now closer and more branched than probably even Hans-Dietrich Genscher and Uffe Ellemann-Jensen could have hoped for. So much has gone well, and it has created significant improvements for those living around the Baltic Sea. However, some areas still need an intensified effort. We have come a long way in the cooperation among our region but we should strive for ever higher aspirations. We should focus on collaborating on our joint challenges and opportunities.

In a time where everybody speaks about the importance of BRIC countries we should remember that the Baltic Sea region is the nearest marked for Denmark. 40 pct. of our export is directed to this region. Therefore, Denmark is focused on ensuring that the conditions for Danish exports to the Baltic Sea region are in order and continually trimmed and developed. When the bridge between Copenhagen and Malmö was built it had a huge impact on the labour market and economic growth in Denmark and southern Sweden. It is so popular that some are even voicing the idea of another bridge across the Sound.

In about seven years we will be opening the fixed link to Germany across the Fehmarn Belt. It will be the longest immersed tunnel for trains and cars. An ambitious approach to the region's future, but major investments in infrastructure does not realize the entire economic potential by itself. It also requires an effort to strengthened cooperation in business, education and research - in the Baltic region there is space and room for more targeted regional cooperation.

Most of the countries around the Baltic Sea are relatively small with open economies in which trade and foreign investment are having great importance. Attracting investments play a major role in the development of these economies. However, we shall be better to draw attention to our skills and qualifications to foreign partners.

In maritime safety, Denmark and Finland together are leading the work of taking the objectives of the EU Strategy for the Baltic Sea Region into action. One of the ambitions is that the Baltic Sea should become a pioneer of so-called e-Navigation. E-Navigation is a model for how to implement the gradual introduction of modern digital communications in the maritime transport sector so it can increase safety and environmental protection, increase efficiency and at the same time reduce administrative burdens and costs to the benefit of crews on board the ships, ship owners and authorities inland. Based on the Baltic Sea Strategy, the Danish authorities and companies - in close cooperation with partners in other Baltic countries, developed and tested the concept of e-Navigation. It is now being accepted as a new global standard in the UN Maritime Organization. Danish companies should to seize this opportunity as e-Navigation has a great potential for Danish exports. Denmark is already strong in the maritime sector and it should be exploited even further in the future.

Furthermore, Denmark has taken a special responsibility in the energy sector under the EU's Baltic Sea Strategy. The so-called Baltic Energy Market Interconnection Plan (BEMIP), which focuses on interconnecting all Baltic countries to the EU energy markets and the security of supply, is worth mentioning.

Lastly should be mentioned some of the cooperation fora where the practical implementation of the political directions take place. They deserve to be highlighted as they represent good and constructive cooperation in so many areas. This applies to e.g. HELCOM, which focuses on a cleaner Baltic Sea and is in charge of the implementation of the Convention on the Protection of the Baltic Sea environment.

The Council of Baltic Sea States, the EU Strategy for Baltic Sea Region and the Northern Dimension have largely the same overall objectives. Environmental protection, economic growth and education and culture are high on the agenda of all three forums. The widespread regional cooperation in these organizations is characterized by not only involving governments and authorities in the Baltic Sea States but it also includes a wide range of businesses, community organizations and representatives of civil societies as well as various financial institutions and development banks.

Twenty years after the creation of the Council of Baltic Sea States, there is little doubt about Denmark's interest in Baltic Sea cooperation. Denmark has over the years expressed support for the development of close cooperation in the Baltic region and in several areas followed up with concrete action. This is the case in all the three central forums and the creation of the Danish Baltic Sea Policy was the answer to the need for increased focus and a shaper Danish profile within the Baltic Sea cooperation. ■



JETTE NORDAM

Ambassador of Denmark in Helsinki  
Finland



RIITTA HEMMI

# Hazardous waste landfill near the Baltic Sea

Expert article • 1600

**T**hanks to international cooperation, environmental awareness is growing in Russia - especially around the Baltic Sea. With the help of international grants and loans, St. Petersburg is soon reaching the HELCOM requirements in the sewage treatment. Finland, Estonia and Russia have dedicated year 2014 to the Gulf of Finland and they are, among other things, improving the joint monitoring of the ecological condition of the sea. Even though major progress has already occurred, there is still plenty to be achieved. One of the examples requiring remedial actions is the emissions of hazardous substances ending up to the Baltic Sea.

Krasnyi Bor polygon, a hazardous waste landfill located in Tosno, Leningrad region, 35 km south of the City of St. Petersburg, is one of HELCOM's hot spots. Notwithstanding its location in the Leningrad region, the St. Petersburg officials manage the landfill. Dangerous solid and liquid waste is transported to the landfill from the industrial enterprises in St. Petersburg as well as in the entire Leningrad region and further off in the Northwest Russia. The landfill started operating as a temporary landfill in 1973. The 72 hectare territory is no longer temporary as it stores today nearly two million cubic meters of chemical, medical and metallurgic waste in underground basins isolated by Cambrian clay. The basins are not hermetic, but they are overloaded and they leak during heavy rains and snowy winters. Toxic emissions find their way to the nearby rivers Izhora and Tosno, both discharging to the river Neva and all the way to the Baltic Sea. Moreover, the landfill has faced several major fires during the past few years releasing hazardous air emissions. Urgent measures are necessary for eliminating the detrimental effects on the Baltic Sea.

Already in the beginning of 1990's the landfill was in an alarming condition causing health and environmental danger. Then the City of St. Petersburg officials arranged tours to the modern Finnish hazardous waste treatment plant Ekokem in Riihimäki. Since those days, the officials have learned how the hazardous waste is treated abroad in special recycling and treatment plants. Hazardous waste should be separated from other waste and every potential recyclable part or component should be recovered and utilised as raw material for secondary production. The remaining waste fractions should then be incinerated with the most efficient technology and the strictest possible gas purifying systems. The ashes could be used in green building, if the remaining heavy metals were purified. The officials realised Krasnyi Bor needs a modern treatment plant.

Planning a well functioning and ecologically safe treatment plant was started. Grant and credit funding negotiations with the European funding institutions were almost completed in 1995, but the city officials decided that the plant was to be executed by Russian resources and technology. Building has been in process for the past 15 years, 1.5 billion roubles have been spent but there is no sign of a new treatment plant.

In spring 2013 high political levels in Moscow still made promises to establish a new treatment plant by the end of 2015. The mass media, experts and environmental organisations opened the Krasnyi Bor's bad situation to the public. It was obvious that no plant will be built within the promised time.

At the end of 2013 new city officials were appointed to take over the 40 years' accumulated catastrophe of Krasnyi Bor. The federal controlling organisation closed the landfill in February 2014 after the license for its operation had ended. The same has happened several times before, but the license was always prolonged in lack of any other landfills not to mention a treatment plant for the hazardous substances. Now the officials have demanded clarifications on the basins' contents of mercury, obsolete pesticides, PCB transformers, oil refinery wastes, pharmaceutical substances etc. A report on the impacts on health and environment is required. The landfill's clients, industrial companies, are in trouble with their own storages getting full. Thus, environmental organisations and people fear for a reason that the hazardous waste will be dumped into forests or gravel pits.

The officials know that Krasnyi Bor needs urgently remedial measures. The established expert group concluded in June 2014 that the technical plan from early 1990's is undoubtedly out-dated. Renewing the plan was put out to tender in July 2014. A Finnish-Russian company Pöyry RUS won, and is now working on the plan until the end of 2014. The technology and implementation will be also publicly procured in the beginning of 2015 after public hearings.

Along the plant construction the emptying and restoring of the existing basins and making the territory safe will be an enormous and expensive task. To meet the modern standards and best available technology will require a lot of money. Hopefully the international expertise is not cut out this time even though today's geopolitical situation does not support new funding projects by the European financing institutions. The list of priority investments in Russia may look somewhat different compared with the past few years. Nevertheless, the hazardous waste problem of Krasnyi Bor does not vanish, but becomes more and more dangerous, if the area's current waste disposal continues under the present circumstances. ■

RIITTA HEMMI

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KATARIINA KIVILUOTO

# Cooperation vital in insular oil spill response

Expert article • 1601

**B**altic Sea has seen a steady increase in marine traffic, and oil and chemical freighting in the recent years. For example the Finnish Environment Institute (SYKE) deals with around 50 oil spill related cases concerning either actual oil spills or close calls only in the Finnish sea areas every year. Though bigger oil catastrophes have fortunately not occurred in the Baltic Sea, the risks are ever growing and a major incident is inevitable.

The costs caused by major oil spills are often astronomical. According to SYKE a minor 500 ton oil spill could in some cases grow into catastrophic proportions and result in both major damage and considerable cleanup costs. A 5000 ton oil spill could amount to a grand total of tens or even hundreds of millions of euros including the direct costs of onshore oil combating as well as the indirect costs caused by the destruction of nature and livelihood, and the damage done to shoreline settlements. It's been estimated that the direct costs resulted from the 1989 Exxon Valdez oil catastrophe of 50 000 ton climbed up to two billions.

Oil accidents are massive disasters, which require coordinated national and international response cooperation. Baltic Sea states have been involved in oil spill response work especially through the work done within HELCOM's Response Group. The HELCOM Response group is responsible for the Response manual, which contains operational guidelines and procedures to be followed in international oil spill response. International cooperation is put to a test every year in HELCOM's BALEX DELTA exercises, which have been organized by each Baltic state consecutively since 1989. In addition to international cooperation each Baltic Sea state has organized both strategic and operative national oil spill response to a varying degree. Although major steps in Baltic Sea oil spill response have been taken on both national and international level, responding to a plausible 30 000 ton oil spill would be a struggle even as a joint international effort.

As marine traffic grows steadily throughout the Baltic Sea, navigating the narrow and treacherous coastal waters will also increase. The archipelago area spanning from Stockholm to Åland and Turku is especially challenging from this perspective. Depending on how you count, there are between 60 000 to 80 000 islands and islets in this area many of them featuring rocky shorelines, protected nature reserves, and livelihoods highly dependent on ecosystem services. A feasible 20 000 ton oil accident would have devastating effects in this area leaving shores covered in toxic oil, and livelihoods, nature and settlements compromised. Even after a time-consuming, logistically challenging and incredibly expensive oil spill response effort the affected area could still remain polluted for decades to come. Bearing in mind the growing accident risks stemming from increased marine traffic, the challenges of insular oil spill response should be firmly and swiftly addressed.

Turku University of Applied Sciences decided to tackle these challenges by launching a project concentrating on oil spill response in the insular areas of Stockholm, Åland and the Archipelago Sea. The 16 month ARCHOIL project, financed by the Central Baltic IVA Programme, was an international undertaking with project partners from Sweden, Åland and Finland.

ARCHOIL project's first objective was to develop oil contingency plans specifically tailored for archipelago conditions. These were made in cooperation with local and national authorities responsible for oil combating and special attention was paid to the challenges posed by logistics and difficult conditions. The other objective was to develop training materials for municipal authorities responsible for operative and strategic oil response. As a part of this work practical scenario-based tabletop exercises were organized both locally and internationally. These tabletops gave a unique possibility for the responsible authorities to sit down and discuss the challenges of insular oil spill response in an informal setting. These tabletops were especially useful in revealing potential bottlenecks in both the operative and the strategic level making future cooperation in emergency situations much easier.

A very important step was also taken during ARCHOIL by introducing Åland into the international oil spill response arena. As no single region can handle a major oil accident by itself, cooperation is vital especially when facing a major challenge like an oil disaster. Oil slicks float across regional borders unpredictably and need to be combated in close regional and international cooperation. ■

KATARIINA KIVILUOTO

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KSENIA YUDAeva

# Introduction of inflation targeting in Russia

Expert article • 1602

**B**y the end of 2014 the Bank of Russia is completing its previously planned transition to inflation targeting. This decision is made at a time of significant challenges for monetary policy, such as increased uncertainty arising from geopolitical problems, the associated weakening of the rouble, and sanctions combined with the now exhausted traditional sources of economic growth, which have been applied in previous years. Nonetheless, we do believe that it is a right decision, taking into consideration the current need to increase long-term domestic investment and economic growth.

## The right policy depends on the right diagnosis

In Russia the question of the effectiveness of monetary stimulus is discussed intensively. However, the policy depends on the diagnosis. If Russia's current economic growth decline is due to a cyclical slowdown, which is usually accompanied by an increase in unemployment and a fall in inflation, monetary stimulation would help. But if it is due to a structural slowdown growth accompanied by falling production, monetary stimulation would lead to stagflation.

In fact, the current deceleration is not leading to reduced inflation, and many indicators point to the structural character of Russia's economic slackening, including declining unemployment, the negative demographic trends, including a drop in the working-age population, decline in external demand, and the poor business climate. These factors applied even before the sanctions. Seasonally adjusted unemployment is just 5.1%, which is extremely low, while several other factors such as the number hours worked, compulsory holidays and low productivity point to near full employment. Therefore, inflation has increased due to both endogenous and exogenous shocks, but is not discernibly influenced by the declining growth rate in production.

Given that the situation in the economy cannot be improved by monetary stimulation - long-term structural measures are necessary, in particular shifting labour to more effective sectors and production and increasing productivity. The second well-known factor pointing to the structural character underlying the slowdown is the level of capacity utilization. Admittedly, this is not a very reliable indicator, but the utilisation of production capacity has now practically reached the same level of the pre-crisis period in 2008 and competitive facilities are working close to full capacity. The third factor is lower external demand for Russian goods, largely due to the deceleration in the Eurozone and China, although in this case it is difficult to assign a structural or cyclical character.

## Domestic criticism of inflation targeting based on wrong cyclical diagnosis

Domestic criticism of this decision is based on the assessment of the growth decline as cyclical, which is, as just shown, largely not the case. International criticism of inflation targeting is based on economies experiencing very low inflation. With inflation of almost 8%, Russia does not fall into this category.

The Bank has successfully reduced inflation in recent years, but as noted, 2014 has seen a significant acceleration in inflation. According to the Bank's forecasts, inflation will exceed 7% by the end of 2014, substantially above the target level of 5%. It is therefore important to continue with a monetary policy aimed at slowing the growth in consumer prices. Our goal is to reduce inflation to 4% in the medium term, and according to our forecast, if sanctions last for

one year and no new negative shocks occur, consumer prices could fall to 4% by 2016, with no significant cooling of the economy. In scenarios, when sanctions last longer and/or oil price decline more significantly, the targeted level of inflation is expected to be reached by 2017.

The Bank of Russia adjusts interest rates to achieve its inflation target, but directly controls only the short-term money market rates. The interest rates on banks loans and deposits are influenced through short-term money market rates. Since monetary policy only affects the economy gradually, with a certain lag, the Bank of Russia relies on economic forecasts when deciding the level of the key rate. Unforeseen factors may result in significant fluctuations

in inflation and deviations from the target level, so the Bank's need to react is based on an evaluation of their effect on prices in the medium term since that could lead to an increase in inflation expectations.

## Intervention still possible

To improve the effectiveness of monetary policy, the Bank of Russia is moving towards a floating exchange rate regime which rejects intervention in order to maintain the exchange rate at a certain level. The national currency's exchange rate is then established by market forces, allowing the economy to adapt more easily to changing external conditions.

Floating exchange rates will allow the Bank of Russia to concentrate fully on managing interest rates and achieve its inflation target. Even so, in altering the level of the key rate, the Bank of Russia also influences the exchange rate. In the event of a threat to financial stability, the Bank of Russia may still use traditional foreign-exchange interventions.

By ensuring low and stable consumer price inflation within the framework of inflation targeting, the Bank of Russia is creating the conditions for Russia's sustainable economic growth.

Expert article • 1602

**Low inflation expectations encourages confidence**

Another important condition for a sustained reduction in the rate of growth of consumer prices is the formation of inflation expectations at a stable low level. This requires people to have a high level of confidence in the central bank's policies. The challenge for the Bank of Russia is to establish confidence in its policy despite volatile environment.

**Conclusion**

Inflation targeting has been applied successfully in many developed countries and emerging markets. Experience in recent years has shown that such an approach has also worked during periods of great economic uncertainty. A clear understanding of the ultimate target and, at the same time, flexibility during decision-making in response to changing conditions, make inflation targeting the natural choice for the monetary policy regime in difficult times. International experience shows that the transition to inflation targeting not only helps to reduce

the rate of growth in consumer prices, but also has a positive impact on economic growth, conclusions which are confirmed by numerous studies. By ensuring low and stable consumer price inflation within the framework of inflation targeting, the Bank of Russia is creating the conditions for Russia's sustainable economic growth. ■

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**BALTIC RIM  
ECONOMIES**

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LENE ESPERSEN

# Bridging the Baltic Sea

Expert article • 1603

**B**y 2021 the new Fehmarnbelt tunnel between Denmark and Northern Germany is expected to open, creating a new gateway to the entire Baltic Sea Region and paving the way for the development of an integrated Fehmarnbelt region. The fixed link across the strait of Fehmarn is a European project, which will bring positive impacts to the lives of people and companies, creating new growth and business opportunities in the Fehmarnbelt region and beyond. The 19 km long tunnel and improved connections on both sides will potentially half the transport time between the two metropolises, Copenhagen and Hamburg, thus serving as a milestone in development of a Scandinavia-Mediterranean corridor from Malta to the Russian-Finnish border.

A large number of stakeholders and project partners from several countries are involved in the process. In addition to the actual tunnel construction and the on land projects, there is a great amount of activities carried out by a diverse set of actors, whose individual and joint efforts would benefit from better co-ordination. Regional authorities, municipalities, local organizations, representatives from educational institutions and from business all have a strong involvement on different levels with the aim to strengthen conditions for growth in Malmö/Copenhagen – Lübeck/Hamburg.

In the light of this development a more streamlined, non-bureaucratic process and decision-making procedure – a modern multi-level governance at the regional level – is a key element and would benefit all stakeholders.

Baltic Development Forum (BDF) is therefore looking forward to the outcomes of the Baltic Sea Region TransGovernance project that will present new instruments to ensure better coordination and alignment of transport policies in the Baltic Sea Region. The results of the TransGovernance project will be presented at the final conference on 3 November 2014 in Bruxelles. The project has developed a toolbox with recommendations to ensure that all relevant public and private stakeholders at the European, macro-regional, national, regional and local administrative levels are involved in dialogue and decision-making when planning larger cross-border transport projects like the construction of the Fehmarnbelt tunnel.

The emerging global economy has transformed how we govern at the local and regional level. Governmental policies and decision-making are no longer developed and carried out in isolation but have gradually transformed into processes that include continuous interaction with and between groups of stakeholders. This requires a combination of reasoning, knowledge, responsibility, awareness, incentive and action in order to utilize the competencies of all players. This governance model is a flexible and efficient one, in contrast to rigid conventional decision-making structures where – due to the focus on institutions and regulatory framework – unexpected options and unforeseen impacts frequently are neglected. A new multi-level governance landscape of decision-making has emerged.

In our own way, BDF has been promoting the multilevel governance model for the last 15 years by offering a platform for regional development in the Baltic Sea Region, connecting private and public interests at both local, regional, national and macro-regional level and facilitating dialogue between business, media and academia. BDF has also supported the EU Strategy for the Baltic Sea Region, providing a framework for implementing concrete cross-border activities.

In the beginning of October, BDF served as the secretariat for organizing the Fehmarnbelt Days 2014 in Copenhagen. Under the heading “Creating Connections” the Fehmarnbelt Days 2014 brought together more than 700 participants from diverse sectors, regions and levels of decision making to exchange ideas and experiences and discuss cross-border cooperation and growth opportunities in the emerging Fehmarnbelt Region. The theme of bridging the Fehmarnbelt and connecting Denmark and Germany got put into a wider perspective: Bridging the Baltic Sea – Connecting people by creating a North-South fast transport corridor in Europe.

The final decision on the actual construction of the Fehmarnbelt fixed link has not yet been made and is expected later this year or in the beginning of 2015. But to quote a former Danish Minister of Transport: “No one has ever regretted building a bridge!” ■

**LENE ESPERSEN**

Chairman  
Baltic Development Forum  
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HANNA EKMAN

# Centrum Balticum – making the most of the Baltic Sea region

Expert article • 1604

**T**he Baltic Sea Region is bordered by Scandinavia, northern Europe and the western part of Russia. The region is unique in the sense of economic strengths, environmental questions and the tradition of co-operation. It is the home of over 60 million people and it comprises a highly competitive part of the European and even of the global economy. Today, more than ever, the need for mutual understanding is essential. Co-operation with all countries of the region is a necessity, when we want to save the sea, connect the region and create prosperity.

Centrum Balticum was founded in 2006 to promote Baltic Sea Region issues and to bring together all the actors and the stakeholders of the region. In the past eight years Centrum Balticum has become an independent expert between research and decision-making. It acts as an information unit and it coordinates a network of researchers and experts. In co-operation with cities, universities and other interest groups, Centrum Balticum generates new ideas for policy-making, facilitates best practice sharing and sets public debate in motion.

In times of international stress in state relations, the importance of regional stability, dialogue and co-operation grows. The need for impartial information has been critical as well as the easy access to the sources of information. For this requirement Centrum Balticum has created a web portal called Domus Baltica. It contains wide-range Baltic Sea Region related news from Finland and abroad, an ever-growing databank and a network of experts, timely blogs on variety of subjects and information about the events throughout the entire region. Currently Domus Baltica is maintained in Finnish, English and Russian.

There are many frameworks for co-operation in the Baltic Sea Region. One of the most ambitious mechanisms is the European Union Strategy for the Baltic Sea Region (EUSBSR). The EUSBSR was the first macro regional strategy within the European Union, when it was adopted five years ago. Now it has three main objectives: saving the sea, connecting the region and increasing prosperity. The purpose of the Strategy is to solve jointly problems and challenges facing the region and to take advantage of the opportunities that greater co-operation provides.

The EU Strategy for the Baltic Sea Region is not only a co-operation strategy for the governments. Actually it is meant before anything for citizens of the European Union. It is a strategy for regions, cities, businesses, universities, educational institutions and non-governmental organizations. One of the strengths of the EUSBSR is that from the beginning it was based on the involvement of multilevel stakeholders. It brings together initiatives in different sectors and is built on the understanding that one sector often has impacts on others.

So far the EU Strategy for the Baltic Sea Region has created multiple new networks, brought new ideas and achieved many concrete results in its priority areas. It is clear that there will be no simple or fast answers to the cross-border problems such as cleaning up the sea, mitigation against climate change or fighting the cross-border crime. The co-operation in the framework of macro regional strategy is also a long term effort. A lot has been done, but we are still far from using the potential of the region to the extent we could. The Baltic Sea Region represents a great potential for more sustainable growth.

In spite of the good results the strategy has reached so far, the awareness of its possibilities is still rather limited. Information about the EUSBSR has been scattered. It hasn't been easy to find or in other occasions there has been too much information. The language used in the communication of the Strategy has been somewhat difficult.

To tackle these problems in Finland, Centrum Balticum and the Ministry for Foreign Affairs of Finland started working together in June 2014. Centrum Balticum is supporting the Ministry in strengthening the EUSBSR's national communications and co-operation with interest groups. The objective is to raise the awareness about the strategy, gather and disseminate relevant information in Finnish and to get new stakeholders involved with the strategy. A great deal of information can already be found in Domus Baltica web portal and in the following months the amount of information will grow significantly.

This autumn Centrum Balticum continues to publish a Baltic Sea Region Policy Briefing series for international experts to discuss developments and future trends from the Baltic Sea region viewpoint. Centrum Balticum also publishes a weekly column called Pulloposti in Finnish. Currently, several thousand Finns interested in the Baltic Sea region affairs receive this weekly column written by the top Finnish professionals in their fields.

Centrum Balticum organises annually the Baltic Sea Forum, which gathers hundreds of region's leading experts to Turku to discuss topical issues related to the Baltic Sea region. The Baltic Sea Forum is a good example of the multilevel approach and the contribution of various actors. The aim of the forum continues to be promoting effective dialogue between the neighbouring regions. ■

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Development Director  
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MARIE-LOUISE RÖNNMARK

# Aiming for growth in the far north – Umeå's goal as Capital of Culture 2014

Expert article • 1605

**U**meå, the Swedish town in the far north, wants to grow on many levels. The year as a Cultural Capital will help putting Umeå on the map, and raise cultural interest and awareness. Mayor Marie-Louise Rönnmark tells us more.

In Umeå, we aim at growing in size and also at personal growth for the inhabitants, and the activities and experiences from this year as a Cultural Capital of Europe will serve as a lever to the next step. Being Europe's Capital of Culture is part of Umeå's long-term development strategy up to 2050. The award will accelerate investment and growth, and create new opportunities for development in cooperation with the rest of Europe and the world. Umeå will be more attractive to students, entrepreneurs, investors and creators, who will be some of the leaders in this progress.

We believe that towns and cities that don't put a lot of effort in development will risk to suffer from stagnation or even recession. As a geographically distant town, we must try even harder than some other towns and regions, and we think that culture could be one key to success. Umeå's objective as European Capital of Culture is to promote human growth, strengthen the role of culture as a driving force for sustainable development of society, and reinforce cultural life's international relations and dimensions. Umeå2014 is also building new networks for collaboration with municipalities, cultural institutions, associations and companies in Västerbotten, Norrbotten, Västernorrland and Jämtland, and strengthens co-operation and development in the northern region.

Umeå2014 goes by the motto of Curiosity and Passion — the art of co-creation. The concept stands on two legs. One is to arouse curiosity and involve people through dialogue and cross-border encounters, and the other is to further develop practical methods for co-creation. When people get involved in culture, their knowledge will rise together with their interest in taking part in or just enjoy culture. We think that this is very important, because culture is the heart of personal development. It opens creativity and raises the society's level of development, and where there have been major investments in culture, people thrive. The towns where creativity and open mindedness rule will flourish. Umeå's intention is to encourage new forms of cultural expression, new cross-border ways of working, and new methods for artistic dialogue and co-creation.

Umeå2014 has co-funded around 100 local projects, and also distributed around 100 "Cultural Boosts" — up to 20,014 SEK per project to local associations and independent actors for organizing projects or events during the year. As a result we have had more and better events than ever — Umeå in 2014 is a melting pot of different cultural expressions, raising the knowledge and interest in the cultural sector as well as with the general public. The museums, the opera and many other institutions and organizers have seen a dramatic and very pleasing increase in the numbers of visitors, and so has the tourist's office and Umeå Airport. To name just one example: Bildmuseet, Umeå University's centre for visual art, reported an increase from 28,520 visitors to 41,868 visitors comparing the first quarters of 2013 and 2014.

The year as a Cultural Capital of Europe has also put Umeå on the European map. More than 170 foreign journalists or teams of journalists have visited Umeå2014 during the first eight months, and the PR-value of articles and programmes about Umeå exceeded 210 million SEK from November 2013 to May 2014 (according to MediaPilot, who survey media in 11 countries on the behalf of Umeå2014). Our promotion tour Caught by Umeå was nominated for the Special Events Prize at the prestigious Sabre Awards in London, and VisitSweden brought us the news that Umeå was, along with the opening of Stockholm's Abba Museum, the most frequent topics in foreign media describing Sweden as a destination during 2013. This year we're nominated for the big Tourism Prize in Sweden as well as the national Place Branders of the Year.

The increase in visitors (hotel nights) in Umeå from the first two quarters 2013 to the same period 2014 was 20 percent. Visit Umeå's (the tourist agency) website had 64 percent more visitors on the first half of 2014 compared to the first half of 2013. The total turnover of the Umeå region is approximately SEK 1.3 billion, meaning that if we in Umeå increase the number of visits by 20 percent, more than SEK 200 million will be added to the city and the surrounding region. Transformed into jobs, this means hiring hundreds of people. I personally think that even before the end of this year, I can honestly say that we have succeeded. We're stepping up our game. You are very welcome to visit us and see for yourself! ■



MARIE-LOUISE RÖNNMARK

Mayor  
The City of Umeå

Chairperson  
Capital of Culture committee  
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PAWEŁ ADAMOWICZ

# A strong brand is fundamental

Expert article • 1606

**G**eographical location, transport accessibility, the labour market, dynamic business development, colleges and universities, research and development facilities, favourable conditions for innovative ventures and an abundance of tourist attractions are just some of the advantages of Gdańsk. They are founded on the city's strong brand. A brand that has been built and consistently developed for years.

Building the Gdańsk Brand is a long-term evolutionary process, written into the city's history, as it were. In 2008, Gdańsk completed a pioneering marketing project among Poland's cities and regions: an international research programme which brought about the "Strategy of the Gdańsk Brand until 2013." The in-depth analysis indicated 5 strategic goals aiming to determine the development direction for the Gdańsk brand, to inspire work on the designated areas and to develop an overall framework for initiatives and projects. At the top of Gdańsk's identity pyramid was the promise of freedom, inspiration and a creative environment. The consistent implementing of this strategy helped build a cohesive city brand and increase its presence in the global market.

One of main premises behind Gdańsk's promotion and communication measures is to present the city as a place where important things happen; important not only for Poland, but also for Europe and the entire world. Gdańsk's history and its location mark it out to build its identity around features associated with events of great magnitude, for a city that is nonconformist and ready to rebel for a higher cause, a city which moves with the times. Gdańsk's coastal location and its role as a seaport mean that it is perceived as a city open to the world, rich in new ideas, always a step ahead of the others. Curiosity of the world, courage to take on new challenges and an exuberant temperament make up a unique mix of features to create the city's magnetic atmosphere and spirit of freedom expressed in what goes on in the city. Gdańsk plays host to many prestigious cultural and sports events, while using anniversaries of important city events to build its brand. The European Solidarity Centre, a new international institution with great potential, will help to enhance Gdańsk's brand. Its mission and values are fundamental and based on the principle of freedom, in the broad sense of the term, which is permanently etched into the city's identity.

The European Solidarity Centre is a bridge that links the past with the future. It is a centre for dialogue about the most important issues of the contemporary world: the development of democratic communities, social justice, equal opportunities in market economies and freedom in the broadest sense of the word. It is also a museum which reaches out with the subject of Solidarity and the opposition movements of Poland and Europe. Freedom, as a certain temporal and spatial link, makes sure that the European Solidarity Centre will continue to grow and evolve together with the Gdańsk Brand, which is making a great leap forward right now.

Gdańsk's development in recent years and the pace of change in its environment are the main reasons to begin work on an updated vision of the city's brand. This new strategic document will include the evaluation of the previous efforts and a critical analysis of the brand's current condition based on, among other things, the results of the 2013 international research project. The chief aim of the new strategy is to present a vision of the brand's future from an evolutionary point of view and to indicate specific measures for its further development and growth in a cohesive and consistent manner.

The strategy will be a key signpost of inestimable value to the further economic development of Gdańsk and its consolidated role in the region's economic and geopolitical system. ■



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JOHANNA REIMAN

# Health in All Policies needs a boost in the Baltic Sea region

Expert article • 1607

**S**ocial and welfare costs remain to account for a very large share of both national and local budgets in all countries surrounding the Baltic Sea. Promotion of health and well-being requires coordinated action from all sectors of the society at national, regional and local level. It has been confirmed that investment in health promotion is cost-effective and that the best results are obtained if all sectors work together, taking into account the effects of policies on well-being. This means that, for example, education, economic and cultural sectors can strongly promote health. Also traffic and environmental departments should enhance human well-being.

The 8th World Health Organization Global Conference on Health Promotion in Helsinki in June 2013 concentrated on Health in All Policies. Experts from all over the world gathered to seek common understanding and to learn about good practices in cross-sectoral health promotion. The World Health Organization definition of health says that "Health is a state of complete physical, mental and social well-being and not merely the absence of disease or infirmity."

From November 2013 to February 2014, the Baltic Region Healthy Cities Association conducted a project – "Implementation of Health in All Policies on the local level for more effective prevention of non-communicable diseases in the Baltic Sea Region/Northern Dimension area – Healthification" to review the status of Health in All Policies (HiAP) approach in seven Baltic Sea Region countries: Lithuania, Latvia, Estonia, Poland, Finland, Sweden and Norway. The project was funded by the Northern Dimension Partnership in Public Health and Social Well-being (NDPHS). According to the analysis, the Health in All Policies concept is well-supported and widely understood in all these countries. However, its implementation needs a boost.

The final report on the state of play shows that common problems prohibiting the full use of Health in All Policies are: the lack of clear responsibilities on the part of the municipalities, weak leadership for health, and missing procedures. This results in insufficient budget allocations. Economic challenges continuously outweigh health in decision-making, even if choosing correct actions could bring considerable savings. Investments in family programmes and preschool education have been found to provide a 7:1 return (Melhuish E. 2011).

Some conducive conditions have been identified for the implementation of Health in All Policies. It is essential that the municipality or region knows the health situation in the respected area and has the resources and skills to analyse impacts of major policies from the health perspective. Political will and legal backing are also important in bringing HiAP into practice.

However, why should action on health be a priority of local, regional and national governments? The recent health data show that non-communicable diseases (NCDs) cause the biggest disease burden in all European countries. Illnesses such as diabetes, cancer, and cardiovascular diseases account for an ever larger share of fatal illnesses. In the Baltic Sea Region countries, NCDs cause 78 % of deaths. These diseases are preventable and can be avoided by the modification of unhealthy lifestyles, e.g. healthy habits: diets containing more vegetables, adequate physical activity and the avoidance of smoking should all be adopted. The national governments recognize

this necessity in their health programmes and strategies. How they are implemented depends on the capacity of the municipalities, their politicians, public health administrators and methods of working. The Health in All Policies approach allows for unifying the efforts of different sectors and making health promotion not only effective otherwise but also cost-effective.

The WHO Healthy Cities programme has promoted cross-sectoral well-being effort as well as comprehensive and systematic policies and planning for health since 1987. The Healthy Cities movement is present in more than 30 European countries and over 1400 cities and regions. The Baltic Region Healthy Cities Association has served as a World Health Organization Collaboration Centre for Healthy Cities and Urban Health in the Baltic Region since 2002. The Association assists cities in implementing Healthy Cities' goals and to build capacity for health and well-being. Furthermore, the Association is involved in health promotion projects, many of which concentrate on promoting Health in All Policies. The members of the Baltic Region Healthy Cities Association include the City of Turku, University of Turku, Åbo Akademi University and the Social Insurance Institute of Finland. The Baltic Region Healthy Cities Association – based in Turku, Finland – aims at increasing the awareness of local governments to in adopting health as a central part of the decision-making process in municipalities.

A positive outcome of the Healthification project was that there is a strong will for evidence-based decision making, investment in cross-sectoral health promotion, and a more practical adaptation of the Health in All Policies approach. To read more about Healthification, please check:

[http://www.marebalticum.org/brehca/images/stories/healthification/healthification\\_reportfinal\\_february2014.pdf](http://www.marebalticum.org/brehca/images/stories/healthification/healthification_reportfinal_february2014.pdf). ■



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JAAKKO LEHTONEN

# The appealing Maiden of Finland

Expert article • 1608

**M**ental images are becoming more and more important nowadays. People are generally lazy and superficial, making absorption a painful task for many. Prompt images are enough. Even on the Facebook pages of the Finnish Tourist Board, adorable animal pictures and short videos are the most popular features. Longer reports are left unread.

The international marketing of Finland has also progressed towards mental images. You could call it the image of Finland, or an identity, or even a brand. Branding has indeed become fashionable. There is no town so small that it has not claimed a brand for itself. This basically consists of a logo and slogan designed by an advertising agency, nothing more. "Turvettula – a good place to live and to do business. Nature and services nearby." About a couple hundred towns use this same slogan.

Of course, this does not have anything to do with brands.

An image of a country exists when a group of people think similarly about that particular country. This image is usually thin, old and simplified to the extreme. It is like judging a book only by its cover. Every country has some kind of image. It can be positive or negative, mixed, or even contradictory. The image strengthens or weakens the country's chances of success in international contests, whether about political influence, international commerce, tourism, investments or, for instance, organizing a major sports event.

## What exactly is a country brand?

The literature has not come to a consensus over whether a country can even have a brand. Is a nation too rich and diverse to be squeezed into the hard shell of a brand? Another problem is that no one can manage a country's brand, whereas product branding is a different matter.

An image of a country forms from nuggets of information a person collects. Such data can originate from media, other peoples' opinions, personal experiences or education. Surprisingly fundamental factors are a person's own preconceptions which are not based on anything at all.

The official communications of a country – or propaganda – represents only a fraction of the formation of the country's image. Such images were not born by propaganda and are thus not changed by propaganda. It is exciting that the image of a country will not change easily even when people visit the country and see everything with their own eyes. It is uncomfortable to admit that you have been wrong your entire life.

Country branding has multiple dimensions. Internationally acclaimed expert Simon Anholt has identified six different dimensions to country branding in his GFK-Roper's Nation Brands' Index research. These are:

- 1) Governance - whether or not laws are obeyed, if corruption exists, if human rights are respected
- 2) People – would you want to be friends with a person born in that country
- 3) Export and International business - if a product originating from that country is high quality by default, if corporations from the specified country are welcome elsewhere
- 4) Culture - cultural heritage, does the country have nice vibes, does it triumph in sports

5) Tourism - natural beauty, bustling city life and the appeal of the cities

6) Immigration and Investment - would you want to move to that country to live or study, would you invest in that country

## How to enhance a country's image?

A country's image can be changed by actions, not by talk. This is absolutely crucial, yet many governments refuse to believe it. Governments want to believe in communications, advertising in particular. At their wildest, people think that with a grand enough advertising campaign even a negative country image can be changed into a positive one. On the other hand, shockingly negative events do not degrade the image, contrary to what is commonly believed.

For example, the image of Finland consists of independence, payment of war debts, the Winter War, EU-membership, joining the euro zone, Nokia and to some degree Pisa. That's about it.

An exception to this is the tourism image, which can be affected by communications, meaning marketing. Credibility, creativity, positive contrast, freshness and trendiness have been selected as the foundation blocks of the Finnish touristic image. These form the backbone when we market Finland as a challenger brand, brave, even a little annoying, funny, witty, surprising and different.

Contrarily, it is completely useless to create a campaign which says that our prime minister is a great guy or in which we brag about the high quality of our sewage system. These aspects do not improve anyone's image of Finland.

## Finland punching above its weight

Finland is a small player in the grand world. By surface area, we're middle ground, about the size of Italy; but we are small on population and we are not used to making much noise about ourselves. This shyness is indeed our biggest weakness in the international arena.

Nevertheless, almost in every comparison of different nations we are in the top group, whether it is about honesty, paucity of corruption, almost anything. Our credibility is top notch. We are not used to drafting hundred-page-long contracts like the Americans. The shake of a hand is sufficient. The Finnish handshake is the most reliable handshake in the world.

We just need to learn to tell the world about it, along with our other strengths. Our current prime minister has said that an introvert Finn stares at the tips of his own shoes when he speaks; an extrovert Finn looks at the tips of the listener's shoes. ■



JAAKKO LEHTONEN

Director General  
Finnish Tourist Board  
Finland



ANU VALTONEN

# Tourism insights from the Arctic Circle

Expert article • 1609

**F**innish Lapland is a tourism region par excellence. No wonder, thus, that much of the research and education of the University of Lapland is linked, in some way or another, to tourism. The Multidimensional Tourism Institute is a unique expert organization that brings together the know-how at Lapland Tourism College, the University of Lapland and the Lapland University of Applied Sciences. The Institute boasts a student body of over 1200 tourism students and a staff of 120. Moreover, the four faculties of the University, Faculty of Social Sciences, Faculty of Law, Faculty of Arts and Design, and Faculty of Education, are all involved in solving various tourism-related issues.

Tourism-related issues are, indeed, numerous and various. They encompass questions such as management of small and medium sized enterprises; understanding the brand value of Santa Claus; commodification of local cultural history; the negotiation of different interests between local people and tourists; seasonality and issues of safety; specific nature of different forms of tourism, such as fishing tourism, nature-based tourism, or shopping tourism; service design of memorable experiences for ever demanding global customers; legislation of land use; and a broad range of wider political and ethical issues from sustainability to social responsibility, and to the reconciliation of livelihoods in the Arctic region.

While studies of tourism are a unique feature of the University of Lapland, they merit reaching wider audience. This is because the bear important implications beyond tourism industry and tourism discipline. In particular, the field of tourism has developed a sound body of knowledge of the production and consumption of experiences. Studies conducted in various empirical contexts bring to the fore, for instance, the significant role of the body and of all the senses in the co-creation of memorable and distinctive experiences. This kind of knowledge would be useful for a broad range of businesses from retailing to media that aim at developing their competitive advantage in the current economy, commonly characterized as experience economy. Moreover, as tourism is a service-intensive field, the theoretical and practical insights gained in this field, would benefit many other fields dealing with services.

One unique opening made at the University of Lapland is the study of sleep in tourism. The project led by the author, New Sleep Order, seeks to develop a socio-cultural approach to the study of sleep - this far dominated by medical and natural sciences - in the fields of tourism, organization and marketing. To us, the overnights, key strategic figures of tourism, are much more than statistical numbers. We seek to understand *how* those who come to Lapland manage to sleep; what is the role of sleep during the visit; what kinds of sleeping habits and preferences different customer groups have; what kind of sleeping place the Lappish nature affords, etc. While questions like these may seem simple, they have been overlooked in previous tourism research that has focused on investigating wakeful experiences and alert activities. Yet, sleep is, as our studies argue, a significant issue both for the development of tourism theory and practice. Sleep tourism, for instance, thus a type of tourism in which sleeping in extraordinary places constitutes the core of the experience, is a rapidly growing business in itself. For tourism theory, our study offers an expanded conceptualization of the players in the field: both the hosts and guests, visitors and locals, service providers and recipients are sleeping and waking beings and merit to be recognized as such. ■



**ANU VALTONEN**  
Professor of Cultural Economy  
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TEIJA RANINEN

# Turku – a European film city

Expert article • 1610

**T**urku has been a shooting location for 43 international and national feature and TV Films during the past 15 years. This is a respectable number taken into account there are an average of 20 to 25 fiction film releases in Finland annually.

There has been courage to invest in Film industry development in the City of Turku and in Turku Region. West Finland Film Commission (WFFC) has been the operational tool for this.

There are almost 400 Film Commissions in the world. The word Film Commission is quite unfamiliar to public. In general, Film Commissions exist at a regional and national level to attract inward investment to their relevant regions/nations and work closely with the local film and TV production industry to facilitate filming on the ground. They predominately have an economic mission like WFFC does, relating to growth and job creation. The production of a single film requires a crew of tens or hundreds of workers. The film crew stays at the filming location for several days if not weeks and utilizes local services such as equipment rentals, hotels, catering, car rentals etc. The publicity surrounding the film can also bring significant revenue to the region through tourism. In addition to employing film industry professionals, film productions bring direct financial gains to the region they film in.

West Finland Film Commission has been marketing Turku Region for international and national production companies for 11 years. In addition to this WFFC aims at development of the local Film Industry by proving financial advice and consultation services. WFFC has close co-operation with the universities in Turku. For a Film City both media research and Film and TV education in Turku are very important. Films employ various professionals. For that reason there has been co-operation with various academies to create Film professionals in costumes, props, make-up department and set design. Hundreds of students have had an opportunity to internship in Films shot in Turku. There have been also projects that give unemployed professionals such as sewers, tailors and costume designers a possibility to work in a Film.

The Girl King production which was shot early 2014 is a great example of this. Film is directed by Mika Kaurismäki, starring Malin Buska, Michael Nyqvist, Sarah Gadon and Martina Gedeck early this year. Film Commission together with the City of Turku and the Production team hired both unemployed young and more experienced professionals to make the 17th century costumes, jewelleries, arms together with the production's own costume department. In addition approximately thousand volunteers took part in film as extras. Film City is about participation where everybody has a possibility to take part. This is the reason why the City of Turku, The University of Applied Sciences and Linnateatteri (a local theatre) founded an association called Film City Turku.

Jobs for local professionals, internships for students, business for local companies and more tourists to Turku, these are goals for the European Film City.

Travelsat Competitive Index 2012 noted that around 40m international tourists chose their destination mainly because they saw a film shot in a particular location, and up to 10 visitors in every 100 choose a destination thanks mostly to movies. The survey also noted that this channel is particularly useful for attracting first-time visitors, young travellers and short-stay and city-breakers. European Film City Turku attracts more tourists to Turku because of the films shot here.

Turku is a Film friendly City. West Finland Film Commission has trained local companies with Film Friendly courses so that the companies serving Film Productions understand the specific needs of a film production. WFFC has also created an operational model for local companies to utilize the audiovisual content of Films shooting in the region. This means new film tourism services and products and more revenues. Film City Turku has brought companies new clients and co-operation partners that they could have never dreamed of. Film City Turku has already network of tens of companies who are informed every time a Film is coming. This network is growing all the time. The ideal co-operation process starts from the script phase and culminates in finished services and products at the premier.

If there is something a European Film City Turku would wish for, it would be a national tax incentive for Film Productions. Almost half of the European Countries have some kind of incentive for audiovisual industry. Incentives create new jobs and tax revenues and increase tourism. The Invested money pays back multiple times.

The European Film City takes a bow and welcomes new Films and tourists to Turku. ■



TEIJA RANINEN

Film Commissioner  
West Finland Film Commission  
Finland

JUHA AALTONEN

# Turku Airport

Expert article • 1611

**A**t the core of our strategy is ensuring the competitiveness of Turku airport in international air traffic.

Our task is to create, by means of functional air traffic, the prerequisites for the competitiveness, movement of people and goods as well as international reach. We accomplish this by producing safe and cost-effective air traffic services of high quality. Responsibility, such as producing services in an environmentally sustainable manner, is closely linked to our business.

Safety, customer orientation, efficiency and ability to reform – as well as collaboration, transparency and environmental and social responsibility – are our values.

Ensuring the safety of air traffic forms the basis for all airport operations. This requires seamless cooperation between the different actors in the air traffic service chain and the public authorities. Airport first-class safety culture and safety management system are the cornerstones of safety.

This allows comprehensive and smooth connections from and to Turku, a factor providing vital support to economic growth and possibilities to succeed in international competition. Success in international air traffic competition ensures easily accessible and also benefits the tourist industry regionally.

Turku airport provides smooth, individual services and positive experiences to passengers. We also provide quick turnaround times of airplanes and other customer-oriented airline services to airlines.

Our extensive route network enables rapid and smooth transport of passengers and goods from Turku to all around the world.

All of the airside areas and aprons will be re-asphalted in summer 2014. Also the passenger terminal will be updated in 2014 to respect present passenger volumes. Simultaneously, air cargo operations boomed as Turku Airport proved a competitive player in its field due to its excellent location and the other means of transport available nearby to complement it.

Today, Turku Airport is a modern, unique and versatile airport that continues to develop its operations based on customer needs. Its modern equipment and systems enable operation in all seasons on a 24/7 basis. Although other modes of transport compete with air travel, it is difficult to find one that could really compete with air transport.

The various players operating from Turku Airport include traditional commercial airlines, low-cost airlines, general aviation companies, skydivers, the Finnish Air Force, the Finnish Border Guard's Air Patrol Squadron, rescue services, and cargo, charter and taxi services.

We are proud of our performance since profitable growth provides new opportunities to further benefit from our route network and other services that we provide to airlines, passengers and other companies operating at the Airport.

Due to this profitable growth performance, a comprehensive land use plan has been created for the Airport area. This enables efficient operations of both existing and new players while providing opportunities for future expansion. In this way, especially companies already operating at the Airport can continue to operate profitably and even expand operations according to their needs.

Turku Airport provides a highly competitive operating environment for all players. We are focusing on excellent service and smooth travel to the world, and back.

For its customers, Turku Airport continues to be a reliable partner that implements Finavia's strategy and operating plan enabling growth.

Thanks to its excellent location, our airport provides an efficient and profitable operating environment in the field of air traffic for the whole economic region of Turku.

Turku Airport continues to develop its operations from the customer's perspective in collaboration with the City of Turku, the surrounding subregions and the whole economic region.

Turku is a pioneer city in Finnish civil aviation: the country's first civil aviation airport was inaugurated in Artukainen, a district of Turku, on 8 September 1935.

Smooth Travelling. ■



JUHA AALTONEN

Airport Manager  
Turku Airport  
Finland

FRØYSTEIN GJESDAL

# Baltic Management Institute – a success story in executive education

Expert article • 1612

**T**he Baltic Management Institute (BMI) was established in 1999 as an academic partnership among five European business schools for the design and delivery of an International Executive MBA (EMBA) programme of Western European quality for experienced high-level managers from Lithuania and neighbouring countries. The BMI partnership consists of HEC Paris (France), NHH Norwegian School of Economics (Norway), Louvain School of Management (Belgium), Copenhagen Business School (Denmark) and Vytautas Magnus University (Lithuania).

All four business schools are EQUIS accredited and are members of CEMS, the global alliance in management education. VMU ensures that the EMBA programme always meets local academic standards and legal requirements.

BMI's mission is to train management leaders in Lithuania and the wider region of Northern Central Europe according to the highest international standards of academic and professional excellence. BMI is unique in several ways: its focus on training high-level executives; its combination of the resources and experiences of five business schools in five countries and the related pool of international lecturers with strong links with the corporate world; and shared vision of responsible leadership and family spirit to relations among alumni, students, faculty and staff. These are the hallmarks of the BMI brand.

To date, 550 executives have graduated from the BMI EMBA. BMI admits one cohort of about 50 persons each year for the 18-month EMBA programme. If non-degree Executive Education Programmes are included, the BMI impact is even bigger.

On average, more than 75% of participants in the programme are top or senior-level managers in local or multi-national companies, a quarter is women, and two-thirds already hold a master's degree. Students have an average age of 34 and an average of 11 years work experience. The economic sectors of companies where students work are also consistently diverse, with well over a dozen distinct industries represented in each EMBA cohort.

The BMI EMBA programme is the only management programme in the Baltic countries to have accreditation from a top international body. The programme earned EPAS accreditation from the EFMD in 2006, renewed for the maximum term from 2010.

## NHH Links to BMI

NHH is a founding partner of BMI building on its experience in executive education in transition economies from the NORLET<sup>1</sup> programme in St. Petersburg, a project aimed at training Russian middle management involving in addition Stockholm School of Economics, CBS, Aalto Business School and Nordic based multinationals, and also in the creation of the Business School at Warsaw University of Technology together with HEC Paris and London Business School.

We have been involved since the very beginning in the design and governance of the EMBA programme, with representatives on BMI's Board and Academic Council. NHH Professor Rolf Jens Brunstad, who was also a key person in the St. Petersburg and Warsaw ventures, is the long-time chair of the BMI Academic Council. Over the years, a number of distinguished professors from NHH have taught at BMI, both in the EMBA and in Executive Education programmes.



- 1990 Lithuania declares restoration of independence from Soviet Union
- 1991 Independence recognized
- 1999 BMI created, 1<sup>st</sup> EMBA class forms
- 2004 Lithuania joins the EU and NATO
- 2009 Lithuania celebrates 1000 years since the first mention of its name in historical documents

## Wider context of BMI and its programmes

Since the restoration of independence in Lithuania and the other Baltic countries in 1991, the region has undergone tremendous social and economic change. Management training was been identified by the World Bank, the local business community and the government of Lithuania as a key priority for fostering the competitiveness of this small open economy. This vision was shared by BMI's founders. It was also shared by authorities of the European Union's PHARE programme, which supported the start-up phase of the EMBA programme.

One challenge which emerging economies face is the emigration of young talent, the so-called "brain drain". BMI helps Lithuania retain its intellectual potential and business talent. Courses taught locally by professors from prestigious international schools make it possible to get a top-notch management education without leaving the country. And because the lecturers come from business schools in a number of different countries, the result is an internationally enriched educational experience of global relevance.

## Reputation at home and abroad

BMI positions itself as the top educational institution for business executives in the Baltic region. Local media reports generally echo this claim in covering BMI events and achievements. News reports about new executive appointments often mention if the new CEO is a graduate of the BMI EMBA. Academic and social arrangements hosted by BMI and the BMI Alumni Association have been honoured by the presence of Valdas Adamkus, then President of Lithuania, Vytautas Landsbergis, who led the country's peaceful drive for independence from the Soviet Union, and others. The current Lithuanian President, Dalia Grybauskaitė, received BMI students on a study trip to Belgium when she was working as a European Commissioner. ■



FRØYSTEIN GJESDAL

Rector  
NHH Norwegian School of Economics  
Norway



<sup>1</sup> NOrdic Russian Leadership Executive Training

PER HOLTEN-ANDERSEN

# Copenhagen Business School in the Baltics – where university means business

Expert article • 1613

**A** **Global Institution with Strong Regional Ties**  
 With over 20,000 students and 748 faculty, Copenhagen Business School is a multidisciplinary business university, the largest institution of its kind in Northern Europe. CBS is an internationally recognized source of quality research and education in traditional disciplines and in creative new areas of study. We align our research and teaching around a core strategy of linking business and society.

As CBS continues to gain global prominence, we remain deeply committed to engaging with local and regional partners, such as the Global Alliance in Management Education (aka CEMS). Through a variety of research and teaching initiatives, we also remain actively engaged with our neighbors in the Baltic Region.

## CBS and The Baltic Management Institute

BMI is a non-profit educational institution based in Vilnius, Lithuania. BMI's mission is to train business executives across the Baltic according to international standards of academic and professional excellence. BMI delivers the only International Executive MBA in the Baltic region to earn the prestigious EPAS accreditation from the European Foundation for Management Development. BMI also provides customized Executive Training programs for companies, and promotes dialogue on issues important to the Baltic business community through public lectures, seminars and articles in Baltic business journals featuring BMI professors.

CBS helped found BMI in 1999 together with four other partner schools: HEC Paris (France), NHH-Norwegian School of Economics (Norway), Louvain School of Management (Belgium), and Vytautas Magnus University (Lithuania). Along with these partners, CBS remains actively engaged in the daily operations and future strategic direction of BMI.

Two of our faculty sit on the BMI Board of Directors and teach regularly in the EMBA program: Dr. Lars Christian Ohnemus, director of the CBS Center for Corporate Governance, has served on the board since 2000; Dr. Eric Guthey, Associate Professor in the Department of Intercultural Communication and Management, joined the board in 2010. Other CBS faculty who have contributed to the advance of management education in the Baltics via BMI teaching include Dr. Jens Aaris Thisted, Dr. Niels Mygind, Dr. Robert Austin, and lecturer-practitioner Mark Payne.

## Board Leadership and Corporate Governance

In collaboration with Lars Ohnemus and Eric Guthey, BMI will contribute to the 2015 launch of the CBS Global Program in Board Leadership and Principled Corporate Governance. This innovative new executive program will partner with Danish companies and investment firms, especially those operating internationally, to develop and to disseminate new knowledge about corporate governance, best board practices, and board director competencies. Through our links with BMI, we intend for this program to strengthen board director leadership and economic competitiveness in the Baltic Rim economies as well.

## A History of Research and Collaboration

Our partnership with BMI builds on our long history of interest in the Baltic Region. Inspired by regional movements towards democratization and privatization, CBS established a Center for East European Studies (CEES) in 1996. During its nearly 14 years of activity, CEES initiated a variety of funded research projects, partnerships, and academic exchanges. These included a major project on Privatization and Financial Participation in the Baltic Countries; a four-year project on Governance and Enterprise Restructuring in Eastern Europe; and the Nordic Russian Leadership Executive Training Program, which inspired the founding of the Graduate School of Management in St. Petersburg. The CEES also helped establish exchange programs from which CBS continues to benefit with the Estonian Business School (Tallin); University of Latvia, Riga; ISM University of Management and Economics (Vilnius); Vilnius University; Plekhanov Russian Academy of Economics, Moscow; Graduate School of Management, St. Petersburg State University; Kozminski University (Warsaw) and Warsaw School of Economics.

## The CBS Maritime Business-in-Society Platform

The CEES merged into the CBS Center for International Business and Emerging Economies in 2009, but our interest in research relevant to the Baltics remains high. For example, the core strategy platform CBS Maritime currently hosts two such research projects: on competitiveness and regulation in the Baltic Sea, and on issues in Arctic shipping of central concern to Baltic Rim economies. For more on this research, see the article by CBS Associate Professor Carsten Ørts Hansen in this journal: "Shipping In The Baltic Sea - Stormy Weather Ahead," *Baltic Rim Economies* 3/2013:22ff. And visit the CBS webpages to join us in our efforts to link business and society through innovative research, teaching and engagement. ■

PER HOLTEN-ANDERSEN

President

Copenhagen Business School  
Denmark



KALMAN KALOTAY

# The Crimean crisis and the future of Russian outward foreign direct investment

Expert article • 1614

**A complex crisis in Ukraine/the Crimea**  
Regarding contemporary Russian foreign policy one has to disagree with Winston Churchill's aphorism that the country "is a riddle wrapped in a mystery inside an enigma". The main aim of Russian foreign policy is clear: the preservation and strengthening of Russian interests abroad. Such foreign policy attempts to juggle with a multiplicity of interests derived from the complexity of the country itself. Of those interests, following the spirit of our times, economic considerations play a major part, naturally in competition with other – mostly geo-political and military – priorities. Complexity in this case can easily lead to complications and imperfect results. This analysis argues that the fallout of the Ukrainian/Crimean crisis for foreign economic relations, including outward foreign direct investment (FDI) is a case point of sub-optimal results from the point of view of Russian interests.

Russian foreign policy uses a multiplicity of tools. For the sake of brevity, mention is given only to two which are relevant for the current analysis: protecting ethnic Russian communities in neighbouring countries, and fostering Russian business interests abroad. The former is very powerful tool but could easily clash with other goals, especially in the economic sphere where firms, both privately and state owned, have to protect their interest in territories spanning beyond Russian-speaking areas. Foreign expansion by Russian firms gets support from public authorities. This type of arrangement is not unique to Russia: a similar arrangement characterises for instance China. Even in less étatique countries such as the United States or France, the Government promotes business interests abroad.

Russian foreign economic policy pays close attention to regions with which it has the longest tradition to cooperate: the former Soviet Union, the European Union (EU) and other European member states of the North Atlantic Treaty Organization (NATO). It has to be stressed however that the Russia's interpretation of recent events in this Wider European space is very different from that of its Western partners. For the EU and NATO, former Comecon and Warsaw Pact members and the Baltic States switched to Euro-Atlantic integration because that was the will of local population, and their incorporation, rather than threatening Russia, promotes peace and stability. The Russian point of view is that EU and NATO acted unfairly by exploiting the temporary weakness of Russia in the 1990s and early 2000s to push its Eastern expansion unopposed. Moreover, Russian politicians feel a parallel with the mid-20th century when the West tried to isolate the Soviet Union through engaging countries of the neighbouring buffer zone (such as Poland and Romania) in a scheme called the cordon sanitaire.

The main aim of Russian foreign policy is clear: the preservation and strengthening of Russian interests abroad.

Against this backdrop, the EU's initiatives in 2012–2013 to sign Deep and Comprehensive Free Trade Agreements (DCFTA) with countries from the region that Russia calls immediate neighbourhood (Georgia, Moldova, and Ukraine) was opposed by Russia, which this time was promoting its counter-proposal in the form of the extension of the Belarus–Kazakhstan–Russia customs union. In this clash of interests, Ukraine, itself a very complex country, became the main ignition point for conflict. During this struggle for influence, a Ukrainian President who hesitated between the two trade blocs but finally (in 2013) opted for Russia, was removed by an uprising (in 2014) led by political forces who in international relations were in favour of Western orientation. The interpretation of this political change varied geometrically in West and East. For the West, this was the legitimate action of people against a corrupt regime; for Russian foreign policy, it was an illegal coup d'état involving worrisome political forces, including anti-ethnic-Russian far right.

In its response, Russian foreign policy used the protection of the sizeable ethnic Russian community in Ukraine as a justification for intervention. This was facilitated by the choice of the new political leadership in Kiev to opt for a centralized political structure, abolishing the previous Government's concessions to Russian speakers in terms of language rights. Pro-Russia sentiment was the strongest in the Autonomous Republic of Crimea, where ethnic Russians formed majority (59%) of population. Local authorities started a secessionist movement and, with the help of paramilitary groups coming from the Russia, removed Ukrainian authorities; then organized a referendum about (re)joining Russia, to which the peninsula used to belong up to 1954.

Russian and Western interpretations of the Crimean referendum diverge sharply. For Russia, it was an issue of self-determination for the majority population, undoing a Soviet-era transfer of the territory from Russia to Ukraine. For the Ukrainian authorities and for the West, the referendum was illegal and illegitimate, because of the presence of the pro-Russian paramilitary forces and the absence of international observers. Ukrainian press even raised doubts about the veracity of the officially published results, claiming that in reality only a small part of population participated in the vote, and barely half of them said yes; it was claimed that most of the ballots in favour of Russia were inserted in the voting boxes a fraudulent manner.

The secession of the Crimea, while apparently satisfying the aspirations of part of the Russian speaking community in the territory, and increasing the popularity of Russian Government at home, had mostly negative foreign policy consequences for Russia. International reaction was overwhelmingly

negative. United Nations General Assembly Resolution 68/262 of 2014 reconfirmed – by a large majority (100 for, 11 against, 58 abstained and 24 absent) – the international community's attachment to Ukraine's territorial integrity. The Russian Federation fell into isolation at the United Nations not seen for a long time, with the scanty list of votes for its side including mostly countries already under heavy criticism on the international scene, such as the People's Democratic Republic of Korea, the Syrian Arab Republic or Zimbabwe. Within the former Soviet Union, only Armenia and Belarus voted with Russia; the majority opted for abstention or absence.

The secession of Crimea strengthened the resolve of countries such as Georgia and Moldova to accelerate the signature and application of their DCFTA with the EU, reducing further Russia's influence. Most importantly, the Crimean separatism failed the change the policy course of the Government in Ukraine in favour of stronger links with the West. Rather it led to an escalation of the conflict to other Russian-majority areas in eastern Ukraine. These areas tried to follow the Crimean path but with practically no chances of joining Russia. Although the idea of creating a separate "country" from Eastern Ukraine has been floated, that "country" would stand no chances of being recognized by the international community, and its creation would only bolster the resolve of Ukraine and the international community to resist Russian territorial aspirations.

The Ukrainian crisis and the role of Russia and ethnic Russian minorities may have a particularly chilling effect on political and economic relations in the Baltic Sea region, in which various countries are direct neighbours of Russia (Finland, Norway, the Baltic States and Poland); and some of them (mostly the Baltic States) are also home to sizeable Russian minorities. For these countries, the Ukrainian-Crimean crisis is a major security concern.

#### **The economic fallout of the Ukrainian/Crimean crisis – for outward FDI**

Although the secession of the Crimea might have been a Russian military success, enshrining control over the port of Sebastopol for the Russian Navy, and contributing to revived Russian national pride, from the point of view of economic interests, the consequences are negative. First of all, the integration of the Crimea into Russia will be costly due to the need to construct hard and soft infrastructure (from roads through water supply to hospitals and banking), and to raise salaries, pensions and social benefits for the local population to Russian levels. On the cost side again, Russian business interests are hurt in Ukraine where authorities may consider the nationalization of Russian property. There are also a number of post-Soviet republics which have cooled off on the idea of joining the Belarus–Kazakhstan–Russia customs union. But probably the largest negative effect is to be expected on Russian outward FDI. It has to be stressed here that the chill will be felt even if the economic sanctions, initiated by the EU and the United States in July 2014 concern on paper only parts of the outward FDI universe: EU sanctions so far affect the international activities of Russian banks; US sanctions affect selected banks and two oil-related businesses: Novatek and Rosneft.

Outward FDI has been one of the surprising success stories of post-transition Russia. Rising from nowhere, its total stock exceeded the amounts of \$300 billion in 2009 and \$400 billion in 2012. With this, the country entered the club of leading investors around the world. Among emerging economies, its performance has only been surpassed by China.

In the 1990s the Government treated FDI as an unwelcome loss of resources. At a later stage however, it discovered its strategic value. Indeed, state-owned and privately owned firms alike participated in an outward push, which seems to fit into the style of Russian state capitalism, and ensures the control of Russian firms over the value chain of their goods, be it natural resources (metals, oil and gas), or services (such as telecommunications and banking). It is also logical that after the centres of transshipment (e.g. Cyprus) used heavily by Russian firms for various strategic reasons – accounting for almost three-fifths of the outward stock –, the second most important destination of such outward FDI is the Wider Europe – accounting for over one-quarter of the total. This is the area with which Russia maintains close trade, business and logistical links, where the per capita incomes are the highest, and where the battle for control over value chains is the fiercest. These are key reasons for targeting these countries. Beside these two groups, the only massive target of outward FDI is the United States. The share of other large emerging economies (such as Brazil, China and India) is low, and so is the share of developing regions, despite reports of Russian interest, for instance, in Africa.

From the point of view of the fallout of the Ukrainian/Crimean crisis, we have to use an alternative classification: separating those countries and territories whose Governments voted for General Assembly Resolution 68/262, implicitly condemning Russia's action, from those that either voted against, or abstained, or were absent. In this counting, we have to consider the vote of those countries that exercise foreign policy sovereignty over their dependent territories obliges the policy stance of the latter. For instance, if the United Kingdom voted for the resolution, we have to consider it binding for the British Virgin Islands, too; and if China abstained, it binds also the authorities in Hong Kong. If we categorize the year 2012 outward FDI stock of Russia (the latest year for which complete statistics are available), 95% is located in countries and territories that directly or indirectly voted against Russia, starting with Cyprus, followed by the Netherlands, the British Virgin Islands, Switzerland, the United States and the United Kingdom. All major offshore financial centres that Russian firms use for transshipping fell into this "unfriendly" category. Only minor financial centres, such as St. Kitts and Nevis, Belize and St. Vincent and Grenadines remained neutral. And although the large emerging countries of Brazil, China and India also abstained, these economies are hosts of very small volumes of Russian outward FDI.

It is not expected to see an overall stop to Russian capital in "hostile" countries though. With the exceptions of Russian banks and State-owned Rosneft and "State-friendly" Novatek mentioned above, most Russian multinationals are apparently free to expand abroad.

Nevertheless, in three areas, the action of host countries can hurt the interests of all Russian firms. One of them is merger control. All countries use that instrument to block firms, especially state-owned ones, from countries deemed to be unfriendly, from acquiring "strategic" assets. Right now most Russian firms face mainstream merger control in host economies. However, should these countries transform their General Assembly vote into less friendly stance towards Russian firms, they could deprive the latter from a key conduit of their foreign expansion. Another measure that could hurt the foreign expansion of Russian firms is related to the financing of international business dealings. The amounts involved in large international transactions require the active participation of banks and other financial institutions. Needless to say that, in this respect, Russian companies already started facing difficulties with the onset of the current financial crisis. These financial problems can be seriously exacerbated if countries unhappy with Russian policy start implementing restrictive measures in their financial sector, following the footsteps of the EU and US embargoes. The third area is anti-corruption measures. Non-transparency of Russian firms has traditionally raised suspicion in the West about illicit activities such as money laundering. While so far general economic interests tended to override the calls for closer scrutiny, in a more hostile environment anti-corruption investigations could get a new impetus.

### Conclusion

The saddest fallout of the ongoing Ukrainian crisis is its ever rising human toll, including victims from third countries (especially since the downing of a Malaysian Airlines flight in July 2014). Even more serious harm to Russia can come on the economic front, and not only due to the cost of "integrating" the Crimea or to the destruction of economic links with Ukraine, but mostly as a consequence of the damage caused to economic relations with the world at large, including via outward FDI. It seems that Russian authorities attempt to mitigate the impact by diversifying economic links with new partners such as China; however it is doubtful that a major switch would be possible, and if it had taken place, it would be possible without major interruption to the traditional transactions of Russian business. The flag of BRIC may be important for political purposes but can have a moderate impact on the economic realities of Russian outward FDI. ■

The views expressed in this article are those of the author and do not necessarily reflect the opinion of the United Nations.



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ANDRII CHUBYK

# European gas rebus

Expert article • 1615

Europe still believes in gas interdependence with Russia, considering it from business as usual point of view. At the same time Kremlin builds up its own plans in terms of total confrontation with the West, where victory should be achieved by any means and economic losses are of minor importance. European leaders are elected to provide conditions for growing wealth of voters in peace and accord. Large-scale conflicts, not to say military actions, make them weak and unable for quick and strong resistance. Kremlin counts on this and tries to return Europe into violence and lawlessness of darkest days in recent centuries.

Kremlin's successful restoration of "soviet space" was prevented by Ukraine's Revolution of Dignity. Diverting much of Kremlin's efforts and attention, Ukraine contributed enormous to keep possible Association Agreements (AA) with Georgia and Moldova. Kremlin appeared to be unable for active destabilizing actions against more than one country. Failed "Blitzkrieg" in Crimea made possible for three EaP members to sign AA and to start ratification and implementation processes. Failed "Novorissia" project and large-scale war in East Ukraine tied up further Kremlin's efforts to destabilize Georgia and Moldova in similar way and completely destroy EU Eastern policy. It is not excluded however, that these countries and even several EU member states will not face military threats in coming years.

Kremlin considers very rational hostilities against the EU. Avoiding direct military operations, it prepares "gas weapon" to be launch widely during coming heating season. In Normandy V. Putin threatened to use it for political reasons to punish for reverse flows to Ukraine. In September several EU companies announced declining supply amounts. At the same time Kremlin postponed trilateral gas talks, showing its regular strategy to negotiate under worthiest period for partners. It is one of clearest signals that Kremlin is dealing in terms of war, while the EU still believes in common peace in Europe.

Kremlin is ready to suffer some financial and image losses in exchange for own goals being achieved. Large-scale gas war in Europe during coming winter will have immediate non-lethal effect on overwhelming majority in EU countries with opportunity for Gazprom to divide and rule by redirecting gas flows through already existing bypass network. It will keep possibility to justify itself by technical, economical, political or any other reasons, while waiting as long as necessary for solution, preferred preliminary by Kremlin.

To politically threaten Europe, Kremlin signed a very questionable gas agreement with China and demonstrated start of "Sila Sibiri" pipeline from the Eastern Siberia. On September 1, Gazprom promised to accelerate preparation of new contract on gas supply from Western Siberia (Altai pipeline).

Simultaneously Kremlin tries to divide the EU by carrots for some counties and sticks for others. Germany is ensured to be supplied via Nord stream even in case of full cut off through Ukraine. It could also provide surplus to neighbouring countries, if OPAL would be excepted from Third energy package. Austrian OMV is here surely among most important clients, emerging in recent time as the biggest supporter of Gazprom's plans in the EU.

Kremlin has selected Bulgaria to train sabotage of European Commission requirements on staying within European legislation, while implementing energy projects. By cutting off transit via Ukraine Kremlin seems to have intention both to create critical situation in Bulgarian economics and heating system during winter time and to set up control over elected in October politicians in parliament and government.

Italy is also likely to become a target for Kremlin. If during cold months gas supply will significantly go down because of gas transit cut off via Ukraine, Kremlin considers to find friendlier attitude both from Italian national politicians and new High Representative of the Union for Foreign Affairs and Security Policy with regard to own gas projects and control over Eastern Europe.

Romania may also face gas supply reduction, thus being eventually forced to eliminate deliveries to Moldova, which will stay without Russian gas in case of transit cut off via Ukraine.

Poland may also face full Russian gas cut off via Jamal-Europe pipeline, if some unexpected technical problems suddenly arise to put pressure on D. Tusk, acting President of the European Council to solve to conflict on V. Putin's terms and conditions.

Contrary to Europe, Russian citizens will not suffer from low temperatures without gas supply and worsening social conditions are already explained by hostilities of the West. Kremlin will rather burn gas surplus, not used domestically, than restore supply to Europe without own demands to be fulfilled.

Being ready to maximum conflict with Europe in gas sphere during coming winter time, Kremlin will certainly bring forward highest requirements:

- 1) Bilateral refusal on claims similar to outcomes of gas crisis in 2009;
- 2) Exception for OPAL and South stream from Third energy package;
- 3) Transfer of control over Ukraine's GTS and UGSF to Gazprom for ensuring gas transit to the EU;
- 4) Freezing ratification of AA with EaP countries (Georgia, Moldova, Ukraine);
- 5) Immediate ceasefire in East Ukraine with following negotiations under Kremlin's requirements;
- 6) Refusal on increase of NATO forces in Eastern and Central Europe.

## What could be a counter measures for such Kremlin's intentions?

The first and most important issue is common understanding, that Kremlin wages war not against Ukraine, but entire Europe. Citizens should be informed and instructed about possible threats, including reduction of gas supply, corresponding problems on local or national levels and even emergency state. Trainings and checks should be made in order to avoid massive panic and vulnerabilities at least in most threatened countries. Strong preventive measures against Kremlin may still hinder realization of its plans. Therefore launch of financial (SWIFT) and gas sanctions and investigations against Russian top-officials and businessmen in the EU and its partner countries, request to Kremlin to ensure access to Asia gas and its transit via Russian gas infrastructure may become instruments to prevent further conflict escalation in Europe.

Europeans and the entire world should understand that only removal of acting leader in Kremlin will prevent large-scale war, including a nuclear one, as threatened already by V. Putin. His isolation should become a prime goal for politicians and diplomats around the world to return stability of international order.

Expert article • 1615

Ukraine is an advance post in combating Putin's regime, but needs international support of political, diplomatic and military nature. Peaceful resistance it not enough to protect European values in fight with "Russian world" with evidences of Maidan and Crimea. Aggressor is afraid only if it faces strong military resistance, the only it considers as strength. Frozen conflict will only postpone for some time next aggression. Only victory of democratic Ukraine will contribute to further democratization of Russia. And upcoming gas conflict should become the defeat not of Europe but V. Putin. ■

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# EU-Russian energy relations and Ukraine crisis

Expert article • 1616

**T**he Ukraine crisis may have a long lasting negative impact on the EU-Russian energy relations. Even if the situation in the Eastern Ukraine calmed down, it is hard to believe in a quick solution of the Crimean issue.

## Russia's weaknesses

The benchmarking of Russia's oil and gas sectors against other important producers such as the Middle East and Africa reveals that in oil production Russia's weaknesses are small proved reserves and low growth of oil reserves and production. In the gas sector, Russia's weaknesses are also low growth of reserves and production. Compared to the leading western oil companies, the weaknesses of Russian companies are high indebtedness, modest profitability and low relative stock value. Russia's strengths are great proved gas reserves, geologically possible oil and gas resources and great export potential.

The weaknesses stem from too small investments in new production and the risks that threaten Russia's energy production. The most serious risks are: depletion of the low-cost oil fields, high taxation of oil sector, low domestic gas prices, competition and changes in international oil and gas prices, ruble inflation and exchange rate movements and problems with transit countries. Also, Russia is highly dependent on oil and gas export revenues. For example, the shares of crude oil, oil products and natural gas exports to the EU were approximately 26%, 7% and 10%, respectively, of Russia's export revenues in 2013. The EU's shares of Russia's total exports and imports were 54% and 42%, respectively.

## EU's weaknesses

The high dependence on Russia's oil and gas supplies poses a risk to the EU's energy security. The Russian state has a tight grip on oil and gas companies and a tendency to use oil and gas supplies as a political tool. Russia's share was 25% of the EU's oil and oil products and 26% of EU's gas imports in 2012. However, Russian oil and oil products accounted only for 13% and gas 6% of the EU's total energy consumption in 2012. Measured in euros the share of Russian oil and oil products was 3% and gas 1% of the EU's total imports. Russia's shares of the EU's total exports and imports were 3% and 5%, respectively.

The above average percentages tell only part of the truth. The EU countries' relative dependence on imported Russian oil and gas vary significantly between countries. However, dependence also does not tell the whole truth. A more useful measure is vulnerability, i.e., the oil and gas supplies that cannot be replaced from other sources. The general view is that the EU countries can relatively easily replace Russia's oil deliveries from safety stocks and by ship and rail from several other suppliers. It is more difficult to replace gas transported through pipelines. Liquefied natural gas (LNG) which is transported by ship is an alternative to pipeline and also Russian gas. Many EU countries have constructed and are constructing LNG import terminals and additional pipelines to decrease gas vulnerability. Part of the Russian gas can also be replaced by other fuels. Consequently, the EU's gas vulnerability originating from Russia is lower than the above 6%.

## Ukraine crisis

Russia's economic growth slowed down already before the Ukraine crisis because of cyclical reasons and the structural weaknesses of Russia's economy. The sanctions imposed by the EU and the US also affect Russian oil and gas companies. Sanctions reduce their access to western financing and ban exports of western technology necessary for deep-water, arctic and unconventional oil production in Russia. Uncertainty has increased capital flight and inflation and weakened the ruble and Russia's economic growth. The stock prices of Russian oil and gas companies have performed worse than those of their western counterparts. Standard & Poor's downgraded Russia's credit rating. The Bulgarian government suspended work on the South Stream gas pipeline on the recommendation of the EU.

The views on the efficacy of the sanctions vary. In the short term, it is likely that gas flows from Russia through Ukraine or related to Ukraine will be interrupted or reduced. The sanctions imposed by Russia will cut the export revenues of certain EU countries. It is logical to deduce that in the medium term, uncertainty and sanctions will exacerbate the weaknesses of Russia and Russian companies. Investments in new production will decrease, reserves and production growth will still slow down, profitability and stock prices will go down, and interest expenses will increase. Presumably, the Ukraine crisis will speed up technical and geographical diversification of the EU's energy sources. As the above percentages show, the EU is for Russia much more important trading partner than Russia is for the EU. Also, the EU's possibilities to diversify its energy procurement are better than Russia's possibilities to diversify its energy exports. ■



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# Russia sanctions – the need for new EU solidarity mechanisms

Expert article • 1617

**R**ecent events show that the Russian Federation has (re-) developed a full spectrum of instruments of aggression. Ukraine has been the victim of a broad-spectrum campaign which has included economic warfare, hostile propaganda, state-sponsored hooliganism, “deniable” military attacks, and a credible threat of full-scale military invasion. EU and NATO countries need to enhance their capabilities in order to deter possible future attacks in all of these areas.

One important area for further development is economic coercion. The Baltic States in particular have been subjected to multiple provocations and acts of coercion – both recently and in years past. EU Member States have a duty to protect not only themselves but also each other in a spirit of solidarity and mutual assistance, and the European Commission and Parliament have a duty to shape and facilitate such solidarity.

## An EU sanctions solidarity fund

Sanctions have significantly different effects depending on the Member State. An EU Solidarity Fund could help to share the cost of EU sanctions (or of third party sanctions against the EU), thus increasing the ability of EU governments to support strong collective measures when necessary.

Building on a first proposal by CEPS Director Daniel Gros (1), the eligibility criteria should not only be what minimum proportion of business volume is affected, but also how fast and to what extent a re-orientation towards new markets can occur. Compensation payments should be time-limited in order to provide clear incentives for EU companies to re-orient their sales or purchasing patterns. Precautions should be built in to avoid abusive claims for compensation.

One further idea could be to generate solidarity funds by imposing unilateral import tariffs (and possibly export taxes) on EU-Russia trade. This would not shut down EU-Russia trade but would give a signal that one is ready to ‘grow apart’ from a country that has chosen the path of aggression. Such price-based sanctions could also be applied to energy products – a ‘diversification tax’, see (2) – whose proceeds could also be used to co-finance a more rapid diversification of source countries.

## Understanding vulnerabilities

Exports to Russia are close to negligible for large Western European countries such as the UK, France, or Spain. Contrary to popular perception even Germany is not especially exposed, with just 3.4% of its total goods exports going to Russia. For the EU as a whole the share of exports to Russia is 6.8% (excluding intra-EU trade), representing a value of just 1.2% of EU GDP. This figure is higher than any plausible worst-case scenario: to experience that level as an actual GDP loss one would have to have a full shut-down of all exports to Russia while also assuming zero re-direction of trade. In sum, the impact of comprehensive trade sanctions – let alone of those sanctions already in place – should not be exaggerated.

The four sectors most exposed to the Russian market are not high-technology manufacturing sectors but fruits and nuts (32.4% of EU exports in 2013), edible vegetables (25.3%), trees and plants (22.8%), and meat (19.8%). This explains why the Kremlin chose to impose sanctions on food and food products: it was looking to cause maximum relative damage, as it is high relative damage that has the best chances of causing firm bankruptcies and political pressure.

The most exposed EU countries are Lithuania (19.8% of total goods exports in 2013), Latvia (16.2%), Estonia (11.4%), and Finland (9.6%). The next most exposed country is Poland with 5.3%. In sum, the EU’s vulnerability is concentrated on just a few countries – interestingly not those that complained the loudest against the EU’s sanctions policy. The distribution of vulnerabilities as compared to the overall EU vulnerability suggests that an EU solidarity mechanism would be both very effective and of limited total cost for the Union.

The case of energy import dependence is of course quite specific. Here there are promising ideas in the direction of an ‘Energy Union’ – namely attempts to consolidate bargaining power while also developing mechanisms for rapid diversification of source countries, should the need arise.

What both general trade and energy trade have in common in the EU-Russia context is the insight that the EU can be a considerably stronger and more resilient actor if it creates solidarity mechanisms. This is an area where we need more Europe, not less. ■

Data sources:  
Eurostat, UN COMTRADE

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# Will economic sanctions work?

Expert article • 1618

Several Western initiatives aim to change Russia's policy and involvement in Ukraine. These include economic sanctions. Russia has responded with a ban on the import of Western goods. The combined sanctions involve less free trade and economic losses for both Russia and the West, albeit asymmetric in Russian disadvantage.

Last time the West imposed an economic boycott of Russia was when the Soviet Union still existed. The American grain embargo in the 1970s was an effort during the Cold War to damage the Soviet economy. The ban on exports of equipment for the construction of the Siberian gas pipeline in 1982 was introduced in the interests of Western security. The Soviet Union was poorer than Russia is now and was at the time about to build itself up as a major exporter of natural gas to Western Europe, in addition to its oil exports. Energy exports' share of earnings of Soviet hard currency was about 80 percent. Sanctions aimed at the food and energy sectors were logical if the goal was to weaken the country's economy and political stability.

However, the Soviet Union did not change much because of the sanctions. The gerontocratic system and the Cold War remained. Under the grain embargo, Argentina greatly replaced the U.S. as exporter, against strong protests from American farmers. Under the gas embargo it was a political divergence between Western Europe and the United States about how much problems gas import dependency actually created, and several European countries wanted to have Soviet energy to diversify from other unsafe energy sources. The companies that lost contracts were not compensated, which created conflict within the West.

The lesson was that the success of economic sanctions mainly depends on three issues:

- Competing countries representing alternative sources should join the sanctions to make them work.
- Individuals, businesses and others who have to take the burden of an economic boycott should be willing to do it, and preferably be compensated.
- It is not always easy to predict the response to countries that are vulnerable to economic pressures. The reaction may be that they are softer, but also harder. An external enemy usually also creates stronger domestic cohesion.

The economic sanctions worked poorly at the time as instruments for economic warfare of one or more of these reasons. In the longer term only a strategic embargo of technological exports for military use was agreed upon (the COCOM rules).

The elements of economic warfare in current sanctions appears to be a degree of a lose-lose game for the same reasons. In addition, Russia is much more than the Soviet Union was, involved in international trade. The export ban is met with imports ban in boycotting circles. Hence, a fourth criterion for success may now be added:

- Sanctioning countries should not be too dependent on the country that is the target of sanctions.

Thus, it is uncertain to what degree economic sanctions are leading to positive changes in Russian policy, as seen from the West. It seems unlikely that Russia will withdraw from the Crimea or end their support for the rebels in Eastern Ukraine as a result thereof. There is also a question of how useful it is to irritate an angry bear, and strengthen anti-Western sentiments in Russia.

It is a hope that sanctions can provide incentives for continued and genuine negotiations. There are not many policy tools to use between sanctions and military action. If negotiations under pressure, however, do not work, we are left with the question about how to react to the unacceptable behavior of an opponent who is partially economic integrated with the rest of the world, and this world is gradually becoming more multipolar. The Russian–Chinese axis is strengthened further.

Back to Soviet times the most important economic element to its final resolution was not sanctions, but the fall in oil prices in 1986. National budgets and the current account went with large deficits and in 1991 the entire system unraveled. Perestrojka and reforms came too late to save the Union.

Oil and gas exports still dominate Russian foreign trade. It financed more than half of the Russian state budget in 2013, oil revenues reached 191 billion dollars and gas revenues 28 billion dollar (RT.COM 17/04/2014). The main single economical element that can change the Russian economic situation is now again a significant fall in oil prices, now as before outside the direct influence of either party. ■



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# Russia's innovation economy and impact of Western sanctions

Expert article • 1619

Russia's innovation development is still uneven and highly dependent on governmental support as well as Kremlin's willingness to keep liberal character of post-Soviet economy of the country. Innovations' development is threatened by a low level of economic diversification, weak demand for innovation from large state-owned companies, and bureaucratized and inefficient public administration in terms of ease of doing business, tax burden, market openness, protection of property rights, administrative barriers, and corruption.

The main source of capital for innovation development in Russia has always been and still is public spending, defence industry and procurement. The structural dynamics of Russian exports have been unfavorable since 2000, when energy prices on the world market experienced rapid growth. During the period 2000-2013, the share of machinery and equipment in exports (including military equipment) fell from 9 percent to 4 percent. This unstable and rather fragile nature of national economy is now facing tremendous test due to economic and personal sanctions, imposed on Russia in retaliation for its policy towards crisis in Ukraine.

U.S. and EU sanctions on high-tech industries to a large extent affect many Russian companies that have nothing to do with Ukraine and ongoing crisis in this Eastern European country. This primarily relates to the field of military exports, which have increased in volume over the last 13 years by 4.2 times (from \$3.7 billion in 2001 to \$15.7 billion in 2013). Russia's share of the global arms market now exceeds 28 percent, but that could fall as a result of sanctions and closing several national markets for Russian weapons. Russia's main competitors in the market (the U.S., France, Britain, and Sweden) would be the primary beneficiaries if Russia faces slumping demand for its military exports. It is likely that Russia will see a drop in demand for its weapons and military equipment in the coming years.

Sanctions on investments in infrastructure, transport, telecommunications, and energy, as well as oil, gas, and minerals, will cause a slowdown and raise the costs for many ongoing projects. Disruptions are expected in the supply of equipment for oil production on Russia's Arctic shelf, because it is currently made only by a number of EU countries, Norway, and the U.S. The long-term consequences will be a slowdown in Russia's economic growth, severed negotiations on further cooperation, and Russia's reorientation towards the other BRICS countries, Asia, and Latin America.

The third wave of sanctions, introduced at the end of July and continued in mid-September of 2014, targeted Russian banks with government ownership of more than 50 percent. The European Union's sanctions list (as well as U.S. list since September 12th, 2014) included OJSC Sberbank, the largest and most important institution in the country's banking system. It owns a third of the total banking assets in Russia, and its services are used by 70 percent of the population. Going forward, it and other Russian state banks will encounter difficulties in securing loans for more than 30 days. Although it can be assumed that Russia will face a higher cost of borrowing, the country will focus on increased financial

cooperation with the countries of Asia, as well as the transfer of huge foreign reserves from dollars and euros to other currencies (Swiss francs, Hong Kong dollars, Japanese yen, Chinese yuan).

The notion that Western sanctions are unfair and potentially driven by broader foreign policy as well as purely economic considerations is gaining momentum in Russian business circles. Russia's business leaders were generally supportive of the Russian government's response to Western sanctions, which were unveiled on August 7, 2014. Observing the widening scope of sanctions over a period of six months, Russian business, which mostly backs the government's actions in relation to Ukraine and Crimea, continually puzzled over why Russia did not retaliate against the West. Kremlin had to follow this demand. Russia's August 2014 sanctions for exporters of food, vegetables and fruits into Russia from the EU, North America and Australia should be considered as reaction to growing dissatisfaction of domestic public opinion.

For business leaders, President Putin's willingness to respond to Western sanctions serves as confirmation that the Russian government is sure of its actions and ready to defend national interests, including economic ones. Furthermore, the transition from cooperation to confrontation with the West opens up possibilities for restricting foreign producers' access to the domestic market, which will lead in the medium term to higher production rates in the country and fewer imports.

There is also hope that the crisis-induced hike in the Bank of Russia's key interest rate will lead to the mothballing of unproductive projects. As a result, only successful innovative ones will remain. Thus will the foundation of healthy economic growth based on innovation be laid.

In recognizing the merits of the Russian government in developing and implementing an innovative development strategy for the national economy, one must not ignore the presence of certain flaws hindering development in this sector. Key among them is the practice of investing public money in a limited number of projects handpicked by officials. In most cases, the practice is doomed to failure because bureaucrats are not best positioned to set the priorities in the selection process, and may apply non-optimal financing schemes or appoint as subcontractors and partners companies that are unable to see projects through to completion.

If the Russian government does indeed want to increase the effectiveness of its national innovation system (NIS), it should focus squarely (and urgently) on political, legal, social, and economic reform, which Russia has not seen since 2003. The strategic goal thereof is to transform Russia from a resource-based postindustrial economy into one driven by innovation and knowledge. As for financing, the government should make wider use of the market development model employed by institutions such as Russian Venture Company (RVC), established in June 2006. The company has demonstrated its ability to efficiently allocate government resources on a competitive basis, inviting leading experts to take part in the pre-qualification procedure, building partner networks for projects, and delegating responsibility for implementing them. In devising its own operational strategy, RVC tries to respond in real time to market fluctuations and make key business decisions as transparently as possible.

### How Western sanctions might push Russia to modernize its economy

Ceteris paribus, Western sanctions over Ukraine, which have been growing progressively stronger since March 2014, will hinder the development of Russia's NIS. The cost of each stage of the innovation process inevitably rises, from obtaining visas and making contact with foreign partners to raising debt financing and increasing country exposure to Russia.

But sanctions can still speed up the process of modernization in Russia, due to the fact that the government will be forced to act under growing external pressure. It cannot put off the reforms any longer. In the early 2000s, the massive inflow of petrodollars meant that reforms could be postponed. Today, with the U.S. determined to contain Russian economic and technological development with a perspective of regime-change in Kremlin, the policy of stimulating innovation is not just a matter of industry and foreign trade, but national security. That is one issue that no modern state should treat lightly.

No country can increase production and exports of high-tech products simply by government decree, and Russia is no exception. Such a result can only be achieved through concerted efforts, including the creation of NIS institutions and new R&D facilities, and integration with leading companies abroad in possession of advanced technologies and standards. It must be recognized that most of these companies are under the jurisdiction of countries that have declared sanctions against Russia over Ukraine. Does that mean that Russia's innovation economy is facing an uncertain future?

No, it does not. The West's centuries-long monopoly on new technologies is no more. In the new climate, the Russian government will need to establish partnerships with other countries that possess such technologies. The most likely alternative will be Russia's BRICS partners.

Russia's innovation system is not yet the sum of its parts. This is partially because the innovation process is non-linear and weakly formalized. The key to any country's NIS is the interplay of elements, as popularly described under the Triple Helix concept, which argues that government, science, and business, as the main actors in the innovation system, should not only interact with each other horizontally (and not just by the dictates of the state), but also adopt each other's functions to make the NIS more efficient.

Consequently, under the current sanctions, the Russian government will be forced to listen more closely to the opinion of domestic business with regard to improving the environment in which they operate, as well as to actively liaise with foreign partners that are prepared to ignore U.S. and EU efforts to isolate Russia from the global economy. The sanctions will force Russian business into markets where it previously had no presence or was subordinate to the overriding priority of developing relations with transatlantic partners. The center of the world economy is ever more clearly shifting towards the Asia-Pacific region, of which Russia should take full account and reduce its economic and technological dependence on the U.S. and its closest allies. ■

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# Thinking beyond Putin

Expert article • 1620

Since his Munich Speech in February 2007 President Putin has been complaining about Russia not being treated on equal footing internationally. This has much to do with his own policies. Russia can only isolate itself. That is what the Kremlin is doing with its present course: revisionism, destabilization of neighbors and their military infiltration, distraction from internal problems through confrontation with the outer world. This is the opposite of Gorbachev's "New Thinking".

That, however, is exactly what Russia needs: "new thinking" in foreign and security policy, as part of its much-evoked modernization. Conversely, the West, and particularly NATO, should make that easier by self-critically recognizing its share of the responsibility for the continuous worsening of the relationship over the last 15 years.

New thinking on the Russian side would comprise the following: NATO clichés and stereotypes from the Cold War period should be overcome as well as their instrumentalization for domestic purposes. Since its London Declaration in July 1990, the Alliance has sincerely extended to former adversaries the hand for cooperation, and in their "Founding Act" of 1997 NATO and Russia declared no longer to regard each other as enemies. Russia must realize that dangers to its security loom in the South and possibly in the East, but not from the West. At the same time the Kremlin must realize which worries arise in neighboring countries from its insistence on a privileged sphere of influence, its proclaimed "obligation" to "protect Russians wherever they live" and from Russia's "history policy".

Sovereignty, integrity and independence of the post-Soviet states have to be recognized, and Moscow should actively contribute to their reassurance instead of undermining it. Respect for the obligations, rules and institutions according to the 1990 Paris Charter is the basis of cooperative security in Europe. Here just as in global affairs Russia should constructively contribute to problem-solving instead of mainly acting through "nuisance power" and "prevention policy". This includes the requirement to actively promote solutions for so-called "frozen conflicts" (such as Transnistria, Nagorny-Karabakh and Georgia) instead of keeping them simmering for the sake of destabilization and influence. Nineteenth-century geopolitical categories should be laid aside, and what is urgent in general is to overcome the concept of security as a "zero-sum game", where allegedly one side can only gain at the expense of the other.

On NATO's side the following should be self-critically acknowledged (without being regarded as justification for President Putin's aggressive revisionism and violation of international law in Ukraine): First of all, Russian "political psychology" was insufficiently understood as well as what was aptly called "imperial phantom pain". After the end of the Cold War, too little attention was given to the question of Russia's place in the European security order. Also, for example, Russian proposals for the adaptation or the CFE Treaty on conventional forces in Europe were ostentatiously disregarded.

The NATO accession ambitions of Ukraine and Georgia were not handled constructively. When at the 2008 Bucharest Summit meeting mainly the US pushed for offering them the Membership Action Plan, both countries were for different reasons not in a position for that step. More importantly, no understanding was sought with Russia, whilst previous enlargement rounds had been "cushioned" through the crea-

tion resp. upgrading of the NATO-Russia Council. And the now so controversial missile defense plan, which should be in the interest of both sides, was offered as a cooperative project much too late. The West underestimated the significance for Moscow of Kosovo's recognition (although the analogy with the annexation of Crimea construed by Putin is flawed).

The NATO-Russia Council was insufficiently used and developed, and NATO put it on ice during the Georgia war in 2008 - just like Russia did during the Alliance's 1999 Kosovo air campaign, strongly criticized for this by the West. Finally, the zero-sum thinking condemned above is not quite unfamiliar to the Western side either. It is one of the greatest evils in today's world.

The West must be firm and demonstrate the limits of what is acceptable in international behavior. But at the same time it should hold out the longer-term prospect of better relations, of cooperation, of "modernization partnership". NATO should preserve the NATO-Russia Council for better times. The Alliance is right in not entirely deactivating it in the present crisis.

Concrete offers for a "better future" in the relations between Russia and the West, particularly NATO, could include for the NATO-Russia Council a new quality and determined broadening of the areas of conform interests and joint action, NATO readiness for a structured dialogue with the CSTO (the Russia-led Collective Security Treaty Organization), and with regard to further NATO enlargement frank discussion of Russia's sensitivities. Such discussions are also necessary regarding NATO's and Russia's contrasting concepts for the Euro-Atlantic area and Russia's place therein, as well as a new departure for conventional arms control.

Farsighted Western policy should promote and encourage the "new thinking" sketched out above. One day it will come, albeit possibly not as long as President Putin is at the helm. But his rule may end more quickly than he and the enthusiastic listeners to his Crimea speech in mid-March think. In any event, long-term offers for cooperation including the seriously renewed encouragement for cooperative as opposed to confrontational security should be developed - taking into account legitimate interests of both the West and Russia. It must be hoped that the Ukraine crisis will not escalate to an extent that such prospects become even more remote! ■

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# Atlantism versus gaullism? The sale of French Mistral-class ships to Russia in the context of French foreign policy

Expert article • 1621

It should have been a foregone conclusion. In the context of mounting Western outrage towards Russia, the sale to the Russian Navy of two Mistral-class amphibious assault vessels, christened *Vladivostok* and (ironically enough...) *Sebastopol*, would obviously be cancelled by France in the spring of 2014. But the French decision was late in coming, with president François Hollande unwilling to explicitly cancel the sale. A new charge was thus added to the long roster of France's faults commonly developed by the Anglo-Saxon and German press: already unable to 'reform their economy', the French were now also cynical arms dealers supporting Putin's Russia.

From a French point of view, the Mistral sale had moved from one of the greatest trade-political successes of Nicolas Sarkozy's presidency into a disaster his successor had to deal with. The early 2000s had seen a strong commercial rapprochement between France and Russia, especially through France's modern military-industrial sector and with the guarantee and help of the French state. For Sarkozy the Mistral sale was a success, wrapped into a general atmosphere congenial to new and better relations with Putin's Russia after the thaw in bilateral relations linked to the war in Chechnya: the signature of the contract was hailed by the rightist daily *Le Figaro*, while significant parts of the French intellectual, academic and political scene advocated better relations with Russia essentially for commercial reasons. Meanwhile, in a dichotomy reminding one of the late 1800s French debates about tsarist Russia, some voices presented Putin as a semi-dictator crushing human rights: the leftist daily *Libération* titled on the day of Putin's 2009 visit to Paris « Corruption, murders...: the Putin routine » (27.11.2009). But despite *Libération's* protests, Vladimir Putin was well received in Paris, where several important contracts and economic agreements were signed between 2009 and 2011. Besides the Mistral deal, deals on raw materials, financial cooperation, and even infrastructure (a project of train connection between Nice and Moscow) were finalized or contemplated. Sarkozy's France was obviously eager to catch up on Germany in contacts with the potentially formidable Russian market.

Only 4 years later, the events of 2013-2014 unfolded like a slow-motion train crash. From the beginning, nobody in France denied that Putin's actions in Crimea, then in Ukraine, were unacceptable. The Mistral-class ships are state-of-the-art warships, and their delivery on top of the training of 400 Russian sailors in Saint-Nazaire seemed difficult to justify after the Crimean events. But Hollande stuck to his guns for an unexpectedly long time: it is only after a September 3rd meeting of the president's Defense Council that he announced, three days before a NATO meeting in Wales, that the conditions were not met for the ships' delivery. Hollande's reputation for slow decisions and procrastination can explain part of this delay, but there are other reasons.

To start with, the domestic costs of a cancellation are heavy for a French naval industry always on the brink of disaster and in times of high unemployment: the Mistral contract meant work for tens of thousands of naval workers and sub-contractors, and the contract itself is a 1.2 billion euros arrangement meant as the first of a string of trade deals. Furthermore, the French are bound to pay if the sale

doesn't realize, potentially a paltry 1.5 billion euros that the head of Putin's administration Sergei Ivanov has already announced will be dedicated to buff up Russian naval industry. The reputation costs for France of a Mistral cancellation are no less grave. France has a military industry that is modern and performant, but constantly in need of foreign markets. What would potential buyers think of the French military industry and its capacity to deliver the goods once it would be shown that France's head can be easily turned by US pressures? The Russian authorities have known how to exert pressure on that spot, the vice-Prime Minister Dimitri Rogozin declaring for instance that the decision would « damage France's reputation as a provider of security material ».

Another aspect is at play, however, less concrete but no less important: behind the scenes and in the depths of French society, the debates on the Mistral deal are a repetition of the fight between an atlantist and a 'gaullist' vision of French foreign policy. For most of the political right for example, defense of the Mistral sale came as much from the desire to damage Hollande's standing as from reminiscences of Charles de Gaulle's grand-standing in front of NATO and the US. For advocates of 'national independence', bowing to NATO pressures is not only a mistake, it is a fault, contrary to what France's foreign policy should be. On the other hand, the current government (and generally large parts of the French moderate Left) has a strong atlantist streak, emphasizing relations with the US and NATO.

So one can understand why Hollande's decision was late in coming - and why it remains conditional: the final decision should be taken in November, and as of late September the first Mistral warship, the *Vladivostok*, is training at sea with Russian sailors on board. Generally the Mistral conundrum can be seen as an example of the way high hopes regarding a 'reasonable' Russia have been bitterly dissipated in France and elsewhere. If the situation in Ukraine hasn't significantly stabilized in November, and if the US continue to make the matter a point of principle, the French will have to cancel the deal and go for whatever compensations Hollande will manage to negotiate with the US, NATO, and the EU. ■

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# Regulating the Baltic Sea

Expert article • 1622

**T**he uniqueness of the Baltic Sea region, from several scientific perspectives, is well documented and understood by now. The legal/regulatory landscape of the region has received less scholarly attention, but is, it is submitted, similarly unique and worthy of academic study.

The cornerstone of this regulatory landscape has been, and continues to be, the national legal systems of the region's (sovereign) states. National laws reflect national policies and priorities, but implementation and enforcement, too, largely depend on the priorities, resources and governance capacity of the state concerned. It is well known that these priorities and capacities at times vary considerably between the different states in the region. The quest for joint and collaborative action among the littoral states has generated a series of international conventions and other policy instruments over time, at global and regional level, to complement and support states' national legal frameworks. More recently, European Union legislation has gained increased influence in the region. This follows from EU's geographical enlargement, now covering eight out of the nine Baltic Sea coastal states, but also from its increasing mandate and activities in several matters of key concern to the region. In addition, within the coastal states, law-making and enforcement authority is increasingly delegated to regions or even local communities, who have also increased their presence and impact on the international scene, through organisations such as the Union of Baltic Cities or the B7 Baltic Islands network.

As a result, the Baltic Sea has arguably come to be the world's most regulated sea area, with five or more layers of regulation acting in parallel. Yet these layers do not always interact well. The norms of different regulatory layers display both overlaps and gaps and are inter-related through a complex and constantly evolving relationship which needs to be assessed case by case. The relationship and hierarchy depends on, among other things, the subject matter, the EU's internal and external competence in the matter and, of course, the national laws of the state(s) concerned.

Another remarkable feature about the Baltic Sea is the number of transnational bodies and organisations involved in its well-being. In particular, the end of the cold war period brought along a variety of new institutions and formal and informal frameworks for addressing matters of common concern in the region. However, the legal basis of these bodies tends to be quite 'soft', which reduces their capacity to contribute to solutions with a normative impact, such as the adoption of new rules and the effective enforcement of existing ones. Out of the multitude of governmental co-operation bodies and platforms that operate specifically in and for the Baltic Sea region, only one, the Helsinki Commission (Helcom), is a clear-cut intergovernmental organization based on a classical founding treaty (Helsinki Convention), which at least in theory provides a solid platform for further regulatory developments. Other key organisations, such as the Council of the Baltic Sea States, is not established by treaty and has no legislative or regulatory powers in a formal sense.

A multi-layered regulatory setting does not necessarily guarantee regulatory strength. For example, despite the broad agreement on the main environmental challenge facing the Baltic Sea (eutrophication) and on the solution to it (a sizeable reduction of phosphorus and nitrogen loads to the sea), very few legal obligations have been introduced for states to reduce the total emission levels. As European sea areas raise very differing environmental concerns and eutrophication is not a major threat in any other of its regional seas, the EU has generally satisfied itself with rules that leave a significant discretion for states to set the targets and means to achieve them. To concretize this in a Baltic Sea context, Helcom has adopted more specific, and quite ambitious, nutrient reduction targets in its 2007 Baltic Sea Action Plan which, however, only exist in the form of (non-binding) recommendations. The absence of binding international rules is reflected in the national legislation of the littoral states which, in turn, means that the

whole array of legal tools that is normally available to promote compliance and to discourage violations, such as administrative and penal sanctions and liability instruments, are equally unavailable for this purpose. Informal and flexible framework rules, which have become the norm in environmental regulation, hence risk to weaken effective law enforcement.

Another risk with multiple regulatory layers is that the responsibility for ensuring compliance may be confused. This is also highlighted in environmental law, where international and EU legislation tends to leave increasing discretion for states to decide on how to achieve the broader – and more abstract – regulatory

objectives. The new generation of rules for protecting the marine environment in the EU has moved away from a specific regulation of individual sources of pollution towards an integrated approach focusing on broader environmental objectives to be achieved in the longer term.<sup>1</sup> The Marine Strategy Framework Directive, for example, provides that the environmental status of the EU marine waters shall be 'good' by 2020, but offers limited guidance as to how the objective is to be achieved, or even defined, and how the responsibilities for achieving it should be shared among various players. In reality, states may not be familiar with implementing such prescriptive flexibility and may only have forwarded the normative uncertainty further down the

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<sup>1</sup> The key instruments are the 'water framework directive' (Directive 2000/60), the 'marine strategy framework directive' (Directive 2008/56) and, most recently, in the directive on marine spatial planning, adopted on 23 July 2014. The flexibility for member states was also noted by the European Court of Justice in Case C-335/07 (Commission v. Finland) where Finland was acquitted from allegations that it had violated the 'urban waste water directive' (Directive 91/271/EEC).

administrative line, to regions and local/municipal authorities.<sup>2</sup> Moreover, it does not seem that the regulatory flexibility – to date at least – has stimulated innovative approaches of legislation for the protection of the marine environment, such as incentive- or market-based emission reduction schemes or other mechanisms aimed at making environmental friendliness 'pay' for the individual operators.

Such a multi-layered and multi-institutional regulatory setting provides fertile ground for researchers interested in multi-level governance and regulation and the hierarchy and conflict of different kinds of norms. The two universities in Turku, Åbo Akademi (Department of Law) and Turun Yliopisto (Faculty of Law), have recently joined forces to establish an internationally leading legal research and teaching environment, BALEX, to help to fill the void in academic research in this area. More information on this initiative is available at [www.abo.fi/institution/balex](http://www.abo.fi/institution/balex). ■

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<sup>2</sup> See e.g. COM(2014) 97 final. 'Report from the Commission to the Council and the European Parliament: The first phase of implementation of the Marine Strategy Framework Directive'

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# BALTIC RIM ECONOMIES

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ÜLLAS EHRLICH

# Current challenges of environmental economics in Estonia

Expert article • 1623

**L**ow density of population (ca 30/km<sup>2</sup>) and the political past when economic utilisation of the coast as the Soviet Union border area was restricted, have enabled a large part of Estonian territory to remain in a good natural condition. It may be said that Estonia like Scandinavian countries and Finland has vast wilderness resources which in the European Union context can be regarded as deficient environmental good for which there is considerable demand.

In connection with economic development and especially as a result of European directives demanding priority development of renewable energy, the pressure from developers on Estonian nature and especially on coastal areas has increased in the last decade. Wind generators built in the natural coastline as well as major waterfalls and rapids left waterless due to electricity generation are competitive or exclusive ways of using resources for use and non-use values created by wilderness. Estonia has established higher buying-in prices for renewable energy compared to energy produced from fossil fuels. This has given rise to a boost in capital investments into renewable energy production and led to a situation where Estonia has already fulfilled the EU target of 2020 for the renewable energy proportion. At the same time, developers' pressure for building wind parks in the coast as well as in coastal waters as scanty hydro energy resource, continues. Developers apply for building permits for nearly all locations where the energy resource allows it. Often these places have also the biggest natural, aesthetic and recreational value which exclude the resource utilisation for energy production purpose.

Allowing of one or other exclusive resource utilisation should be based on cost-benefit analysis (in particular social cost-benefit analysis). This is a challenge for environmental economics since while income from energy production is market value which can be easily used as an input to cost-benefit analysis, then values of the nature (biological regulation value, aesthetic value, recreational value, psycho-social value, etc.) that compete with energy production are intrinsically non-market. Non-market values made unidimensional with market values are a precondition for using them equally with market values in social cost-benefit analysis. For that the market values should be quantified and a monetary equivalent should be calculated for them, which is the task of environmental economics. Another important task of environmental economics is monetary quantification of externalities of wind and hydro energy. According to the currently widely spread practice, the externalities of wind and hydro energy generation are often ignored, which gives from these methods of energy production a distorted, more environment friendly picture. Only when the monetary equivalent of both non-use values of the nature and electricity production externalities are available and incorporated into social cost-benefit analysis one can decide which of the exclusive ways of using resources is more beneficial for society.

Several research projects have been carried out in Estonia for monetary quantification of the values of the nature that compete with energy production where demand for coasts in their natural condition (e.g. Mürsepp, Ehrlich, 2012) as well as for waterfalls with natural flow of water (Ehrlich, Reimann, 2010) has been identified. The meth-

od of contingent valuation has been used and the results show that Estonian population has a considerable willingness to pay both for a coastline in the natural condition (wind turbines free) and for waterfalls with the natural flow of water. The demand for a coastline in its natural condition without wind farms of the Estonian working-age population is 23.4 million euro annually. The research findings allow concluding that a coastline in its natural condition as non-market resource of the nature is also economically more valuable than electricity produced from wind at the cost of destroying this resource.

A sharp resource utilisation conflict also occurs in the use of hydro energy for electricity generation. Mostly two types of damage occur here. First, the construction of dams rules out spawning of salmon fishes in the Estonian rivers with the biggest spawning potential (e.g. Sindi dam on River Pärnu, Kotka dam on Valgejõgi river and dams on Kunda river). The national policy has been clearly ineffective in liquidating these dams which are currently not used for producing electricity. The second problem is that as a consequence of the activity of hydro power plants built on major waterfalls in North Estonia (Jägala Waterfall, Keila Waterfall) the waterfalls as tourist objects will lose their recreational and aesthetic value, the measurement of what is a severe challenge for environmental economics.

The non-market value of the Jägala Waterfall with a natural flow of water has been estimated in Estonia (Ehrlich, Reimann, 2010). The research identified that the annual willingness to pay of the Estonian working-age population for a natural flow of water in the Jägala Waterfall is approximately 10 million euro, which is 35 times more than the annual income from electricity production.

When environmental economics has provided input to social cost-benefit analysis, the next step should be to ensure that the results were used for making political resource use decisions. By all accounts, the results so far question whether the wind and water energy produced in Estonia are green at all. ■

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# Russian minority in Estonia – social co-existence, educational transformation and the labour market

Expert article • 1624

**T**he role and influence of significant Russian minorities in Europe came to the fore since the occurrence of several commotions in Ukraine that led to the current crisis. Russian minorities and their discontent initially played a major role during the uprisings. For this reason, the topic is also vital for the domestic affairs of Estonia – a state that has to deal with a major minority population share for years and is now reconsidering their options.

Since the re-establishment of Estonian independence in 1991, with the Russian Federation have never been easy but stressful and encumbered by sharp political rhetoric and recent developments in the fields of security, trade agreements and minority policies. Until today, the situation of the large Russian minorities in Estonia has invoked dozens of international reports, resolutions and recommendations over the years. The consistent fear of seeing the pursuit for national unity, autonomy and confession having their own cultural heritage overturned by Russian influences is a familiar one. But so are the arguments of the Russian side.

Looking back in history, there was a significant group of ethnic Russians even before the emergence of the Soviet Union and after the annexation in 1940. Russians always valued the region as a stepping stone towards the prosperous countries of Northern Europe. Due to militarization, industrialization and Soviet policies of Russification, the number of ethnic Russians was growing significantly with the Russian language becoming official language.

In the aftermath of the USSR's implosion, the situation of the Russian minority changed dramatically with the renewed awakening of national consciousness as well as with a societal urge to come to terms with the oppression of the past. The Estonians faced the question: How can the country integrate the Russian minority in terms of citizenship, education, labour market access and social inclusion while avoiding the danger of excessive Russian influence and without coming into conflict with fundamental minority rights?

In the Estonian society participation and public visibility are useful indicators to measure the intended level of integration. Regarding the previous development, the key question is all about the extent in which societal minority participation may actually happen when "contemporary social context (stays) sporadically overshadowed by the historical context". This extent seems to be limited for various reasons. Mainly due to the citizenship policy, the degree of political participation is relatively low. And even the russophone population with Estonian citizen status shows a rather reserved behaviour towards political or other commitment. Almost 80% of the Russian-speakers do not hold membership or participate in organizations.

The field of citizenship is probably the most critical topic as well as the one where the unequal position of significant minority groups is the most obvious and visible. Many ethnic Russians felt humiliated by demanding knowledge of the local language and the passing of a history test in order to obtain citizen status, others simply had in the early years no sufficient command of Estonian or no willingness to learn it

because the surrounding they live in is predominantly inhabited by other Russian speaking. As a result, the number of completed naturalization procedures is comparatively small and also on the decline for years.

Furthermore, demographic changes and an aging society are nourishing the enmity against ethnic minorities. The fertility rate is low and many native citizens settle down anywhere else in the EU. Between 1989 and 2010, the Estonian population decreased by 0.23 Million. The Russian-speaking minority without citizen status itself feels often excluded – from access to higher positions within society or from the full benefits of the general welfare system. But there is still a strong core of (often older) minority member that will resist any state efforts to deepen their integration level. They often show difficulties and a lack of enthusiasm when it comes to language skills and the willingness to learn the official language. Moreover, the required fees for completing the naturalization process can play a role as well as the ability to avoid the otherwise compulsory military service or a kind of Slavic Pride that opposes an Estonian identity. Acquiring local citizenship would also be accompanied by the loss of several visa and registration privileges for Russia and the other CIS states. But even though those points remain obstacles for a perspicacious and long-term oriented minority policy, there are other categories that define the integration process as well.

The labour market is such a category and until today one of the main areas of social discrimination, repulsion and disparity. It is the backbone of economic security, a key factor for social relations and exchange, important for individual aspects of psychological wellbeing and self-respect and a major influence for the future opportunities in life. The Estonian labour market is competitive and the situation is very difficult for members of the Russian-speaking minority, regardless of citizenship status. They earn less, are often excluded from public offices and they have a significant higher risk of facing rejection by potential employers than other citizens.

The employment rate among Estonians is slightly higher than among non-Estonians. The unemployment rate confirms this impression with a difference of 8% (non-Estonians 19% and Estonians 11%).

The roots for this phenomenon and for other obvious disadvantages lie deeper and its main component is primarily an educational one. The official language has an almost "sacred" status and is widely regarded as a central part of national identity and culture; a consensus that even reflects the way the state constitutions handle this topic. According to official statistics, the Russian-speaking population makes up roughly a third of the Estonian population. However, many children today grow up in households with both languages. Nonetheless, in Estonia only the titular language has an official character while Russian is only recognized as a foreign language. After the declaration of independence, the Russian language was quickly removed from all official functions and limited in usage.

After some educational reforms in which most public high schools were abolished due to the mismatch of their curriculum with Estonia's educational plans, the language debate has gained momentum in politics as a front topic of minority affairs. In 2007, Estonia has implemented a law that obligates schools to teach a minimum of 60% of the offered subjects exclusively in Estonian; even in cases in which the overwhelming majority of the students has a Russian-only language background. The goal is to strengthen and standardize the national education, especially with the eastern region in mind, where the ethnic differences are most severe. In the border town of Narva which is the third biggest city in Estonia. The Russian-speaking minority accounts for about 97% of the population. Many minorities tend to recognize the pressure of the reform as an unjust imposition and when asked after the outcome, more than 50% claimed that the perspectives of Russian youth and their education quality will not improve but rather worsen.<sup>1</sup> The same rigorous language policy has also infected the higher branches of education. Public universities offer their degree programs in most cases solely in Estonian, fragmenting the education system and impairing the emergence of parallel societies even more. In 2007, 55% of all students wishing to study in Russian had to enrol in a private university, while only 7% of students studying in Estonian did so.

Despite some efforts by the Council of Europe and the European Union to help solving the problem with its Russian speakers, the international community recognized the struggle of the minority and the fear of the majority first and foremost as a problem of national, or at the very most, regional relevance. This perception has changed with the emergence of the Ukrainian crisis and the ethnic fracture that goes along with the breach of latent linguistic, cultural and habitual borders. It graphically revealed the sizeable influence of ethnic heterogeneity and the power of minorities to cause severe political unrest when feeling oppressed and underprivileged. It also revealed how minorities can be influenced from outside sources and used as an instrument for political purpose. And - maybe most notably - it finally revealed how seemingly stable political structures and constellations can cease to exist quickly and unexpectedly.

The Estonians are aware that the Russian role during the crisis does not only affect their foreign and military policy plans but also raises the question of the probability for violent turmoil's on their own ground. What would happen if the Crimean referendum on independence would have been held in Narva? Of course, there are plenty of Russians who are satisfied with the post-soviet circumstances, enjoying the improving living conditions and the benefits of an EU citizen, the rule of law and most of all freedom, without invoking any sort of nostalgia. But others feel isolated and disappointed with the state of affairs while they like to cultivate their minority role through glorification of being Russian natives.

<sup>1</sup> Twelve percent (12%) agreed to the full extent, stating "Exactly true" while thirty-eight percent (38%) chose "Moderately true" and only nine percent (9%) opposed strongly with "Not true at all". [www.ties-project.eu/component/option,com\\_docman/task%2cdoc\\_download/gid%2c351/Itemid%2c142/index.html.pdf](http://www.ties-project.eu/component/option,com_docman/task%2cdoc_download/gid%2c351/Itemid%2c142/index.html.pdf)

Russia gladly accepts this reception and is flexing its muscles. Since the 1990s, Moscow has emphatically proclaimed itself as the protector of Russians living in diaspora. It has developed a variety of instruments in order to influence the domestic affairs, spanning from trade limitations and price increases for oil and gas to the utilization of Soft Power. This includes but is not limited to the support of Kremlin-friendly groups and networks in the cultural sector with financial contributions, legal and organizational assistance as well as media strategies.

It is hardly possible to make clear distinctions between the different spheres of Russian influence since the usage of power on the political field is highly dependent on flexible business and energy networks. Estonia even has an organized form of political representation for the Russian minority: the "Russian Party in Estonia" (VEE) merged fully into the Estonian Social Democrats (SDE) in 2012 after a disappointing election results.

Estonia faces a problem that not only affects a wide variety of themes but also contains a historical dimension. Especially Estonia had to handle a major minority population share for now more than twenty years and did well. Nevertheless there are still issues they need to overcome. Maybe the most important one concerns the language. Estonia still considers the Russian language as a tool for spreading Russian influence, preventing the nation of finally growing together. It is not so much about the language itself but about the Russian broadcast media, which is a well-known fact.<sup>2</sup> The language policy itself is a double-edged sword. On the one hand, it is a clear sign that the society is willing to foster integration. It will also most certainly help Russian-speaking youth when applying for employment inside the country. On the other hand, some arrangements appear to not only look strict, incompliant and exaggerated but also seem to be contradictory to international law.<sup>3</sup> Feelings of discrimination that therefore occur lead to low level interethnic contact, isolation and

<sup>2</sup> This includes Television channels such as First Baltic, RTR Planeta, NTV Mir and radio stations. C. f. Agnia Grigas in Legacies, Coercion and Soft Power: Russian Influence in the Baltic States (2012), a Chatham House Paper [www.chathamhouse.org/sites/files/chathamhouse/public/Research/Russia%20and%20Eurasia/0812bp\\_grigas.pdf](http://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Russia%20and%20Eurasia/0812bp_grigas.pdf)

<sup>3</sup> The Framework Convention for the Protection of National Minorities (1995), signed and ratified by all Baltic States underlines this in Article 10 (2) as follows: "In areas inhabited by persons belonging to national minorities traditionally or in substantial numbers, if those persons so request and where such a request corresponds to a real need, the Parties shall endeavour to ensure, as far as possible, the conditions which would make it possible to use the minority language in relations between those persons and the administrative authorities."

Expert article • 1624

open animosity towards the majority. Events like the 2007 riot over the relocation of a Soviet-era war statue in Tallinn is good example for the societal tensions that may erupt at any time. Estonia should continue to promote a strong and durable integration while carrying on encouraging Russian-speakers to be more active in the local social and political life especially regarding the youth. They grew up in a comparatively prosperous state without the encumbrance of a Soviet past. The citizenship laws have been criticized as counterproductive and in addition inappropriate for the purpose of integration. The identity of young people and their self-conception as European citizen may help to develop a less demanding and more respectful dialogue between the members of the different ethnic groups. There are also other fields in which future generations sow the seeds of cooperation, exchange and partnership. The universities in Estonia could be a convenient tool to open up the European education market for Russian speakers in general. That would certainly strengthen the ties between all nations as well as conveying European values and a proper mode of thought to young Russians' mind-sets. In addition, it could serve the system of higher education as well. A stronger positioning on the education market towards Russia could satisfy all parties and become an important step on the road towards surmounting the past. The success of socialization and integration procedures as a whole will be in any case highly dependent on these educational developments but will also be affected by the general satisfaction with life and economic perspectives which society can ultimately provide.

Due to the European debt crisis and its surroundings, Estonia had to fight with rising unemployment and a recession-induced, shrinking GDP. But it quickly recovered.

Minority members have always been recognized as scapegoats and unreliable second-class-citizens but not many have identified them as ideal bridge-builders who can connect the titular identities and values. It is difficult, as long as the relationship between Estonia and Russia remains frosty but in the long run their capability to transcend linguistic and cultural borders can prove itself valuable for further societal developments in 21st century Europe.

The task is to make this positive change happen without trapping itself into a rigid and inflexible position or neglecting fear, sorrows and interests of the autochthonous population that already experienced marginalization and foreign cultural dominance. Regarding the fact that any policy approach to this day was primarily motivated by the necessity to handle the situation in the short run, the situation of minorities in Estonia still has the potential to experience a quick and unexpected change when the Ukraine crisis begins to fade away. ■

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# BALTIC RIM ECONOMIES

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EVGENY GONTMAKHER

# The Russian labor market – European tendencies and national features

Expert article • 1625

**D**emographic development of Russia in its main trends differs a little from the pan-European situation. The main coincidence - the process of population ageing. In 1989 the people over 65 years was 10% of the population, in 2012 this figure rose to 13%. In addition, the natural growth of the population in Russia, despite a slight decrease in the last years, has a strong negative rate, as in many European countries (e.g. Germany, Italy, Lithuania, Hungary). This leads to the fact that to the labour market come less people of working age. At the same time increases, as in most European countries, the flow of temporary labour migrants, mainly from former Soviet republics of Central Asia and South Caucasus, Ukraine and Moldova.

However, after this statement begins the Russian specificity. First of all it is necessary to note the relatively high compared to Europe, the share of those employed informally, without registration of labour relations. According to estimates, this share is not less than 20% and it has a tendency to growth. We are talking about people employed mainly in small business and agrarian sector of the Russian economy. The reasons lie in overly burdensome tax system, as well as in the global mistrust of the state as the manager of budgetary funds which collected through this system.

It is difficult to adequately assess the Russian unemployment rate. According to the ILO methodology its level is less than 6%, which would be the envy of many European countries. However, this prosperous figure conceals a huge number of inefficient jobs with low productivity and low wages. The closure prevents the policy of the state, which fear a surge in unemployment and related social unrest. Therefore, the employers have to ensure at least a minimal profitability to reduce the already low wages. Worker generally agrees with it, for fear of dismissal and further uncertainty with his employment. According to sociological surveys, the loss of a job is one of the biggest fears of the Russian.

This fear defines low interregional mobility of the Russian labour force. People don't dare to move, even for the sake of better-paid work. More significant are the risks of losing the usual circle of communication, reduction of access to social infrastructure (health care and culture, education for children). An important obstacle for a more active movement of labour force in Russia is the weakness of national housing market, the acute shortage of cheap rent apartments.

Existing labour mobility is determined by the long-term tendencies of outflow of population from Siberia and the Far East to the European part of Russia, and also gradual steady move of the rural population of working age in the cities. This creates great difficulties with the implementation of investment projects in the Asian part of Russia, where are the main reserves of export's raw materials.

One of the important problem of the Russian labour market is the disparity between its needs and the system of vocational education. There is a clear bias in favor of preparation of specialists with higher education - economists, lawyers, managers. The result is acute shortage of engineers and specialists of similar professions. Practically stopped functioning system of training skilled technicians and workers.

And finally, the main problem of the Russian labour market: a very large number of so-called "bad" jobs. These jobs are in non-competitive sectors of the Russian economy - manufacturing industry, agriculture, and this consequently leads to low productivity and wages of the majority of the economically active population. "Good" jobs are concentrated in export-oriented industries related to production of natural raw materials, as well as in public administration. This backward structure of employment aggravates the imbalance between the real needs of the labour market and the quality of vocational training. The situation can change only by large-scale reforms aimed at radically reducing the role of the state in the economy, guaranteeing the inviolability of private property and independent court, the formation of a truly competitive political system. The aim of these reforms should be the return of Russia in the European institutional space. ■



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# Kaliningrad's paradoxes

Expert article • 1626

Many things are 'upside down' in Kaliningrad. Its location, that would be an asset in a democratic model, is the region's bad headache. What is a stimulus for growth in market economies, doesn't work with the exclave. Coastal regions usually outdistance the inland ones (as well as the national average) in their economic parameters, but, as a renowned economist Vladislav Inozemtsev points out, Kaliningrad's gross regional product is 36% lower than Russia's average. Within BRICS, the coastal regions' GRP significantly exceeds the national average: by 47-78% in case of Chinese coastal provinces and by 19-37% in case of Brazil.

Sandwiched between other states, Kaliningrad oblast successfully attracted foreign investments (Polish, Lithuanian, German and other) in the 1990s, under the Special Economic Zone established in 1996. However, the amended regulations in force since 2006 have only fostered large investors. As a result, foreign investors (most of them being medium and small) moved away, their number decreasing fourfold. Moreover, the federal government in Moscow has been undermining the Zone's conditions by removing successive products from the duty-free import list. For instance, the banning of duty-free imports of cocoa fat in 2012 seriously affected local chocolate producers.

Another paradox – applicable to entire Russia – is the fact that Moscow's recent counter-sanctions hit the economy much harder than the actual EU sanctions. This particularly concerns highly import-dependent Kaliningrad, which has already been called the main victim of the counter-sanctions (34% of the region's imports were food products from the EU). One of the sectors that suffered most is Kaliningrad's fishing industry, which is almost fully dependent on fish imports – which is yet another paradox of this Baltic coast region. Its own fishing industry plunged into crisis in the 1990s and never recovered, and fish processing plants use almost exclusively imported raw fish, mostly from Norway. Following Russian embargo on Norwegian fish, the price of fish in Kaliningrad increased more than twofold, and local processing plants were forced to suspend their activity and start laying people off.

Things can be upside down in a positive way, too. Kaliningrad is probably the only region in Putin's Russia, where the governor was dismissed following social protests. In 2010, in the aftermath of massive street protests, that were discreetly supported by local elites, a Moscow-born, 'bossy' and unpopular Georgy Boos was replaced with a local politician Nikolai Tsukanov.

Kaliningraders also stand out when it comes to mobility and directions of travel. 60% of them are passport holders (Russia's national average being 20-25%, according to different data), of whom 25% have Schengen visas and as many – local border traffic cards, entitling to visa-free travels to several Poland's regions. The region's residents frequent the neighboring (or other) EU states: it is close, cheap and cost-effective: grocery prices in a better-off Poland are lower than in Kaliningrad. The younger generation of Kaliningraders is used to weekend trips to Poland, Lithuania or Germany; most of them have never been to the Russia proper, Kaliningrad mayor Alexandr Yaroshuk admits. This "mental distance" is reflected in sayings like "I'm going to Russia" or "Them, in Russia". People, especially the young

ones, refer to their capital by its Prussian name, Koenigsberg, abbreviated to a tender "Koenig", and their region – an "Amber Land". Their identity, being undeniably Russian, nevertheless contains a portion of European identity, and their stance on many crucial issues may be different than the national average. The support for Crimea's annexation, for instance, is much lower than in other Russian regions – a survey, cited by Kaliningrad MP Salomon Ginzburg, places this support at a mere 15% level.

These are not signs of Kaliningrad's desire for sovereignty or separatism, despite recurring media speculations. What Kaliningrad residents and decision-makers expect is genuine federalization and consideration of their specificity. A consistent advocate of Kaliningrad's "reasonable" autonomy, Salomon Ginzburg, has for years sought the adoption of a special law for the region, that would offer it a degree of autonomy sufficient for dealing with many of its issues locally.

The problem for Kaliningrad and other Russian regions (especially those with major economic potential and resources) is that Moscow's priority has been control and security rather than the regions' development. It is yet another paradox: in recent years the Kremlin started to perceive the citizens' wellbeing as a challenge. Its experience shows that "excessive" increase of living standards gives rise to political aspirations that the Kremlin does not intend to fulfill, as happened with Russian urban middle class 2 years ago. Instead, a "tighten-the-belts" strategy is being employing in the face of Western sanctions, enhanced by Russian embargo on many imported products and numerous isolationist initiatives (e.g. the notification of dual citizenship has been made compulsory). In this context, Moscow may be anxious that a prosperous, Europe-integrated Kaliningrad will demonstrate greater ambitions and drift away from the Russia proper. Therefore, today's post-Crimean realities pose a question of Kaliningrad's future. Will the regulations fostering Kaliningraders' mobility and wellbeing (such as local border traffic with Poland) be maintained? Or will Moscow instead try to isolate the exclave, further strengthening its military potential and turn Kaliningrad back into a half-isolated military zone it was in the Soviet times? One may incline to the latter version, considering the large-scale strategic maneuvers, that stretched from Russian Far East via the Arctic to Kaliningrad oblast in September (in Kaliningrad oblast, the Baltic Fleet's land component exercised on 16-22 September) and were Russia's demonstration of power in response to its deteriorating relations with the West. ■



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# Kaliningrad region establishes favourable conditions for international business

Expert article • 1627

**T**he Kaliningrad Region is the westernmost part of Russia, located on the south-eastern shore of the Baltic Sea. The Region does not have a land border with the rest of Russia, only the borders with the countries of European Union – Poland and Lithuania.

Warsaw, Vilnius, and Riga are within a 500 kilometer radius of Kaliningrad. Stockholm, Copenhagen and Berlin are within 800 kilometers. Distance from Kaliningrad to St. Petersburg is 1000 kilometers and to Moscow is 1250 kilometers. Such points open wide logistic opportunities for business.

Kaliningrad region is the westernmost point, where you can establish an enterprise with Russian price level for energy supplies and electric energy. 22 border crossings enable to import and export goods, to enter the territory of Kaliningrad region by different modes of transport. One of the most important factors for the residents of the Kaliningrad region was simplifying the visa regime with the Republic of Poland.

The Region operates as a special economic zone which allows both Russian and foreign investors to obtain significant tax privileges. Kaliningrad has become an assembly platform for automotive giants like General Motors, BMW, and Kia. General Satellite, another resident of the special economic zone, implements its Technopolis GS project, one of the largest radio-electronic industrial clusters in Europe. RosAtom, GazProm, and LukOil carry on operations in the region.

The region's infrastructure is well developed: there is a sufficient number of hotels, restaurants, cultural sites and places for leisure. Health care system has modern perinatal and cardiology centers. In general, the Kaliningrad region is ready to provide guests with comfortable conditions in all aspects.

At 2013 the "Forbes" magazine published the rating of Russian cities, analyzing the terms of business development. The city of Kaliningrad took the first place in the rating: it turned out to be the most comfortable place for running a business. According to the experts of the edition, the features of the city allow to consider it as the one "with an affordable skilled labor force, loyal tax system and the minimal administrative pressure".

Kaliningrad has high rates on three parameters: availability of human resources, availability of finance and the tax authorities operating efficiency. As for the human resources, in spite of the average results in the number of graduates per 1000 population, the «Headhunter» and «Superjob» agencies state that there are five CV per one job opening in Kaliningrad, while the national average is three CV. So, the employer has a choice, both of skilled and unskilled labor force.

At present, there are plans to implement seven industrial parks in the region. Five of them are assigned to Kaliningrad Region Development Corporation. The fundamental tasks of the Corporation are: to work on investment projects, providing personal managers for the project assistance; to construct industrial and technology parks, implementing high-tech solutions; to assist the investors in selection and registration of land plots and to execute marketing activities of investment opportunities in the region. Distribution of the industrial parks in the whole region ensures sustainable development of advanced production throughout the area.

All these measures will enable to raise the financial attractiveness of the region and allow the residents of industrial parks to get a full range of privileges, necessary for the competitiveness improvement of their business and for entering the new markets in the nearest future.

Moreover, according to the decision of FIFA's executive committee, Kaliningrad is selected as one of the host cities during the World Cup 2018 in Russia. This decision will give a powerful new stimulus to the development of the region's economy and infrastructure, including tourism and hospitality sectors.

At the threshold of the third millennium, the Kaliningrad region is making a break-through in the united economic area of Europe. Many socio-economic indicators of our region are among the leaders of Russia's northwest. The Government of the Russian Federation gives preferences to the development of the Kaliningrad region, initiating the launch of new and prospective economic projects. ■

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KRISTIINA TÖNNISSON

# Where did we lose the students while teaching EU?

Expert article • 1628

**A**round the world there is increasing fuzz about the content and approaches to teaching in primary, secondary and higher education. There is almost no higher education institution that does not go through constant curricula development process. On the one hand it is a very positive trend and on the other hand there are so many various and often also conflicting ways how to proceed.

Very often schools and universities are mainly concentrating on improving and updating the content. More and more evidence show that as important as the content/knowledge is also the form/methods of teaching/studying. Looking at the literature on development of expertise, students' approaches to learning, and the role of motivation in learning, it is hard to underestimate the importance of the whole study process as such. Learning means much more **interactive and social process** than we usually think.

European College at University of Tartu in Estonia has invested a lot of time and energy in order to bring back the students to the center of studying and teaching. We would like to stimulate simultaneously inquiry and interest while students acquire knowledge and skills. There are no better students than motivated students.

What knowledge and experiences do the students expect to get during the studies? How well do they/we predict what the future graduates need in the twenty-first century? What are the cornerstones of the term "European Union" in the changing world? What are the core experiences and competencies in order to work effectively for, within or due to European Union? All these questions lead to the central one - **how should we teach** European Union Studies?

Looking at various experience about teaching reforms around the world, we started our reform with the following standpoints: 1) the methods of teaching is as important as the content of the subject 2) EU is so multidimensional we need to move away from political science centered approach and include much more aspects from medicine, environment, economy, etc. Our aim is to increase students' competence in the analysis of complex systems, integrating societal, environmental and economic perspectives. We ask them to **reflect systems thinking** in a deepening understanding of complexity, holistic approaches, and how the parts relate to the whole.

We set to the whole institution certain goals: 1) to offer the students the best possible environment for studies and development 2) in addition to professional development there is a need to focus also on personal development of the students 3) to aim for graduates that would be able to **make better/more conscious choices** based on understanding, analyzing and reflecting information available. We want the graduates to reflect critically their own values and examine different paradigms and perspectives, seeing beyond objective data to understand how values shape commerce, policy and actions. After graduation we hope our graduates to work to make a difference in the civic life of their communities and countries through both political and non-political processes. If our graduates consider social problems to be at least partly their own, and they would feel an urge to take actions when appropriate, we are on the right track.

For the academicians and administration we had three simple goals: 1) to have constant open communication among us in order to be with the whole group "in the same boat" 2) to great a group feeling among all levels of the involved parties: students, professors and administration 3) to share the feeling of **common responsibility** among all involved persons.

One of the easiest responses has been the incorporation of more team-based, project-driven activities. Our active learning strategies refer to a variety of collaborative classroom activities, ranging from long-term simulations to five-minutes cooperative problem solving exercises. Students work to collectively design and implement interventions, anticipating future scenarios and adaptively managing information, human and natural resources for maximum impact. EU education should encompass a set of learning experiences that allow students to construct deep conceptual knowledge.

Our most appreciated professors are student-centered, they maximize participation while being motivational and they give life and immediacy to their subject matter by encouraging students to move beyond a fact-based linear approach to the material. In order to facilitate the teaching process, European College is currently also testing peer review teaching feedback systems among all our professors.

This is our way to seek deeper understanding of teaching and learning processes. We took notice from Chinese proverb "Tell me and I will forget. Show me and I will remember. Involve me and I will understand. Step back and I will act." Now it is time to step back and act. This way we will hopefully rediscover the students again. ■



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# The EU Centre in the Barents Euro-Arctic region

Expert article • 1629

Cooperation between northern regions of Russia and the EU is crucial for their development and strengthening as well as for reinforcement of regional integration. The Barents EU Centre covers all territorial entities of the RF composing the Barents Region and thus it is the link, "bridge" between Russia and the EU.

The Barents EU Centre was established in December 2011 based on the EU Information Centre of Petrozavodsk State University and unites 5 leading universities of the region: Petrozavodsk State University, Murmansk State Technical University, International Institute of Business Education, Syktyvkar State University, Northern (Arctic) Federal University.

Its activity is dedicated not only to scientific and educational sphere but also directed to the satisfaction of interests and needs of different social groups and organizations. It is confirmed by diversified arrangements implemented by the Centre.

The Barents EU Centre pays special attention to work with wide public as this region is marked by the high interest in the knowledge related to the EU and participation in the events devoted to the EU. Each year the "EU Days" are conducted, they have information and educating form. One more arrangement is exhibition "The EU Today". The "Open Days" are also of great interest to the audience. Along with presentation of the Centre activity there are meetings related to the EU, European scholarships foundations and programs as well as lectures and information seminars.

For the representatives of authorities and civil society institutions training programs are designed. One of them was conducted in 2012-2013. The program consisted of 3 components: two training courses ("Integrated Course on the EU", "Principles and Basis of International Cooperation") and practical information on-line seminar "European Donor Organizations and Programs". As a result the participants of the training program submitted three project applications to the Nordic Council of Ministers. One project application for the program "Horizon 2020" was created and presented in Brussels.

Undoubtedly, the Centre also fulfills research and educational functions. Sequence and continuity of all levels of academic sphere are the peculiarity of the Centre's activity.

Various contests for pupils are conducted each year in Petrozavodsk, Syktyvkar and Archangelsk. More than 600 pupils took part in arrangements. Each year students participate in the international summer schools in Karelia.

One more significant direction of activity for the academic target group is inviting experts from the European universities for lecturing in English, for exchange of experience with Russian lecturers in the sphere of applying modern pedagogical technologies and educational process organization.

The logic continuation of the previous direction is the training program related to elaboration of educational courses on the EU issues. It had 3 stages. On the first stage the lecturers from partner universities of the Centre had English language course and then the course related to the modern pedagogical technologies and psychology. On the final stage lecturers had internship in Central European University (Hungary).

After the training program the lecturers implemented research in their spheres and elaborated educational courses on EU-related issues in English. The new courses meet the European educational standards and increase of educational quality in the Barents region. Therefore the universities of the Barents region of Russia made one more step to the European educational space. In 2013/2014 academic year the courses were approved and included into curricula of 2014/2015 academic year in each partner university. In the course of the working meetings representatives of the Centre and lecturers discussed the possibility of establishing the interuniversity Master's degree program related to the EU based on these courses.

Each year the EU Centre arranges the contest for post-graduate students. No doubt, it promotes development of the EU research in the region. The Centre concentrates its attention not only on humanitarian research as the applied part and practical applying of scientific achievements play the great role in the modern world.

Research component in the activity of the Barents EU Centre can be traced in the work of the EU Research Club. The Club provides opportunity to receive consultations from lecturers and experts, discuss scientific issues, urgent news and questions related to EU development, as well as to communicate with each other.

The Barents EU Centre fulfils irreplaceable function. It is link between the Russian North and the European Union. It connects geographical territories, social groups, different organizations and it will continue to make efforts for development, strengthening and extension of cooperation in this region. ■



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# Considering the stake of science in politics

Expert article • 1630

**E**stonian writer J. Smuul (1922-1971) wrote a story „The Colonel's Widow" where he gave a grotesque picture of the human hubris which sometimes ensues from an elevated social position. The heroine of the story made herself notorious by her catch-phrase – “doctors do not know anything"! This odious character is occasionally reminded if one happens to notice the posture of political practitioners or even political analysts towards political scientist. Perhaps out of modesty or decency they do not rush to declare outright that political scientist does not know anything (about politics) but that is often their practical attitude. A prominent Estonian politician has once explicitly expressed that truth—those who really know their trade are members of the diet; those who only believe to know what politics is about are chatterboxes in politics. Accidentally the author of the dictum himself came from the academic community and held the highest academic degree in social, but not in political science. A political scientist hardly earns any professional respect in the eyes of a political practitioner or even an analyst let alone being taken seriously in the matters calling for practical decisions. Not many political scientists of international stature have won prominence as politicians or statesmen. That sort of career is usually reserved for the laymen in political science, i.e. journalists, lawyers, economists, sportsmen etc. In the list of successful politicians and statesmen political scientists usually occupy a modest position, if any at all, and are occasionally referred to in derisory terms. To give examples it is appropriate to make reference to some representatives, one even dare to say the classics, of political science from the past. Max Weber unquestionably ranks the most prominent among them. He unsuccessfully balloted for the German Reichstag and later on was engaged in practical politics in a modest position of an advisor to the committee that drafted the Weimar constitution. Karl Kautsky, one of the leading Marxist theoretician in the late nineteenth and early twentieth century is another example is. His practical political career in the civil service after the revolution which brought German social-democracy to power, culminated for a short period in the service of the Foreign Ministry in the capacity of under-secretary. Hans Morgenthau is probably the best known representative of realist theory of international relations who was engaged as an adviser for the US State Department for shorter periods after the World War II but was fired from the service when he started to publish articles which were at variance with the officially stated policy aims in Vietnam. Thus the point of the foregoing is trivial. Famous German proverb - wer kein Geld hat, hat auch keine Bedeutung can be applied hier. Geld in current context, of course, denotes political power. Political power in a democracy is granted by the voters. It does not have much to do with intellectual disposition that motivates and is characteristic of a scientist.

Politics for a practitioner is, after all, a practical activity which strives for palpable results (often including a personal benefit) and is to be judged on these results. The same stance is typical of a political analyst. However, analysts differ from the practitioners in their intellectual propensity, by the attempts to understand motivation, logic, far-flung consequences of political decisions etc. One may say that for both of them politics is pragmatic business by nature which has to be dealt with in relatively short-term perspective. In long-term perspective we shall be dead and need not worry about politics any more.

Still, politics is perennial. A scientist deals with the essentials and specific features of that phenomenon which are of more or less permanent nature. The problems, such as who will win the next election and form the government, how long a coalition is going to exist or whether a certain policy should be applied or not are not of scientific nature but practical, and hence of objectives for a political analysis. Despite the superciliousness towards the political science political practitioners and analysts themselves are hardly conspicuously apt in their profession. Out of multitude of example, the best testimony of the questionable quality of their professional competence in politics was their inability to predict the collapse and disintegration of the Soviet Union even in the nick of time. In short-term perspective a political scientist has, perhaps, no better chances in this respect, but, at least in long-term perspective, their bet is probably more accurate. Take Andrei Amalrik as an example: in 1970, i.e. at the summit of the Soviet might, he published a book under a provocative title “Will the Soviet Union Survive until 1984”? In historical perspective his prediction narrowly missed the point. ■



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# Shadow economies in the Baltic countries – recent trends

Expert article • 1631

**S**hadow economies are important to understand because they can have detrimental effects on tax and social security systems, economic growth, inequality, and the ability to accurately measure economic activity. Policymakers' ability to influence shadow economic activity is often limited by a lack of information about the shadow economy. To help policymakers understand the Baltic shadow economies and thus manage them more effectively, the Stockholm School of Economics in Riga (SSE-R) annually analyses the size, structure and determinants of the shadow economies in Estonia, Latvia and Lithuania. Researchers at SSE-R have developed a novel approach to measuring the Baltic shadow economies, making use of annual surveys of entrepreneurs and company managers.<sup>1</sup> The method combines estimates of misreported business income, unregistered or hidden employees, as well as unreported "envelope" wages to estimate the shadow economies as a proportion of GDP. This article describes recent trends in the Baltic shadow economies, based on the analysis by SSE-R.

During 2013, Estonia and Lithuania continued their long-term trend of gradually reducing the size of their shadow economies, which in 2013 are estimated to have contracted by approximately 2.9%-3.5% of GDP to 15.7% and 15.3% of GDP, respectively. In contrast, the Latvian shadow economy has ended two consecutive years of contractions with an increase of 2.7% of GDP to 23.8% of GDP in 2013. These changes have halted convergence in the size of the Baltic shadow economies; the Latvian shadow economy is currently 8-9% of GDP larger than in neighbouring Baltic countries. The main contributor to the recent increase in the shadow economy in Latvia is corporate tax evasion. A particularly large increase in 2013 occurred in medium-sized construction companies.

The macroeconomic and institutional environment is likely to have contributed to the increase in the size of the Latvian shadow economy. As the Latvian economy continues to recover from the crisis, real estate prices have risen from their post-crisis lows and the construction sector has regained activity after having almost ground to a halt. In all three Baltic countries, the construction sector has the highest level of shadow activity of all sectors, and this tendency is particularly pronounced in Latvia, where 45% of construction sector activity is estimated to occur 'in the shadows'. The recovery of the construction sector is likely to have contributed to the increase in the size of the Latvian shadow economy in 2013.

Latvian companies are also less satisfied with tax policy and the government's support for entrepreneurs than companies in Estonia and Lithuania. Our analysis finds that dissatisfaction is a key driver of a company's involvement in the shadow economy, and therefore it is likely that part of the difference between Latvia and neighbouring countries is due to differences in companies' satisfaction with the fiscal and institutional environment. This issue could be addressed

with actions such as making tax policy more stable, making taxes more "fair" from the perspective of businesses and employees, and increasing the transparency with which taxes are spent. We also find that companies that perceive the probability of being caught for tax evasion tend to engage in less shadow activity.

Despite the recent increase in size, over the past five years the Latvian shadow economy has experienced the largest contraction of all three countries (from 36.6% in 2009 to 23.8% in 2013). Much of this contraction is attributable to two main factors: (i) improving macroeconomic conditions from the post-crisis lows (the crisis and recovery in Latvia was the most extreme of the three countries); and (ii) a package of 66 government policy actions aimed at combatting the Latvian shadow economy. The policy actions in Latvia, the most important of which took effect in 2010 and 2011, were the most extensive of the three countries. The regulatory/policy efforts targeting the Latvian shadow economy have recently subdued, in particular since the completion of the EU-IMF assistance program, and this is likely to have contributed to the recent reversal of the medium-term contractionary trend in the Latvian shadow economy. Combatting the shadow economy requires continued effort from policymakers and enforcement agencies such as the State Revenue Service. This is particularly important to avoid undoing the significant progress made to date. ■

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<sup>1</sup> Details of the methodology can be found in the article "Measuring the shadow economy using company managers" by Tālis Putniņš and Arnis Sauka, which is forthcoming in the Journal of Comparative Economics. Annual reports on the Baltic shadow economies are available at <http://www.sseriga.edu/en/centres/csb/shadow-economy-index-for-baltics/>



VICTOR VORONOV

# Systemic difficulties in Latvia – causes and possible solutions

Expert article • 1632

Latvia has implemented an economic model based on the redistribution of wealth and other economic resources to corporate interests, not the production of material goods for the benefit of society. Its economy is growing since 2004 at the expense of the service sector, debt resources, but with a low level of savings of the population, with a strong dependence on foreign capital inflows, from the "infusion" of structural funds of the European Union. The structure of the Latvian GDP in 1990 was 79% of the product of precision engineering, instrumentation, microelectronics, forest, light, fishing and agricultural industries. At present the structure of the economy of Latvia is about 75% of the service sector (traditional and various mediation), while the share of the manufacturing sector declined to less than 15% of GDP. Why such a transformation has occurred in the country, a former member of the industrial and intellectual development?

Socio-economic difficulties of Latvia have a systemic character; look at them in more detail.

For *economic* reasons, systemic difficulties in Latvia include the construction of neo-liberal economics, where the main role played by financial institutions rather than the actual production. The industrial sector is characterized by low level of technology: now almost 70% of value added in industry done in its low-tech industries.

The share of the production of high and medium-tech production accounts for only 2% and 29%, respectively, of total production. Fiscal policy is carried out in the interests of oligarchs and bureaucrats (in Latvia reached one of the highest levels in the EU budgetary burden on the economy - about 44% of GDP). A high level of fiscal burden, as well as the growth of the tax burden, makes it difficult to now development of the real sector of the economy.

Monetary policy of the country is carried out in the interests of foreign finance capital (the high proportion of assets held by non-residents, especially in the banking sector - more than 80%).

For *political* reasons include complete dominance of pro-Western political forces represented by the national-radical and liberal parties, the low level of public confidence in political institutions because of their policy of discrimination considerable part of society (only 25% of the population trusts them), the weakness of civil society institutions especially associations of employers and employees. Also of note is the discriminatory exclusion of a large part of the Russian-speaking population of Latvia to participate in government, as well as the unfriendly policy towards Russia.

*Socio-cultural* reasons can be attributed unbalanced social structure (no middle class), the non-market mindset and values much of the population, making it difficult to actively adapt to modern people hard realities of the market, the underestimation of science and research for innovation (the costs are - 0.35% of GDP in the EU at a rate 10 times greater). At the same time Latvia has the intellectual and investment opportunities to participate in this process. One can also note the lack of government programs to combat poverty and create jobs in all regions of the country. Therefore, the main efforts are aimed at the population passive adaptation to social change and the search for ways to survive (at risk of poverty are subject to 26% of the population).

There are some internal and external conditions to address the systemic problems of the Latvian society.

The necessary transition to a new economic model focused on the development of production, and not on redistribution and the acquisition of wealth in the interests of specific groups. The current ruling elite go for a radical change of the system is not capable of managing and limited currently regrouping of forces within the government coalition. Therefore, the EU should take a more principled stand against the US-led Latvian neo-liberal economic policies that recognize and begin to assert their own interests in the country of its membership.

It is necessary to develop real production in Latvia on the basis of modern innovative development strategy of the country and its regions.

Now the world is actively formed VI technological way, the process will be finished by 2018-2020 years, and its driving force is likely to become biotechnology, nanotechnology, robotics, high humanitarian technologies, new medicine, new nature. Still remaining scientific potential of Latvia is able to solve some problems of this technological system (biotechnology, nanotechnology) and applied practice in this area (enterprise "Madara" and others) confirms this ability. ■



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# Live and let die?! Corporate social responsibility as a sustainable business concept

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**”**I am an exceptionally pure capitalist. Nobody takes care of me, so why should I take care of anybody else? [...] There is nothing like human rights in business: either you are a shark or a fish.” Statements like this one given in a research interview on Corporate Social Responsibility by a South Baltic project reveal the urge of establishing responsible leadership in businesses. Live and let die – is this how we define our business culture while pursuing prosperous economy and sustainable development? Moral reservations against this predatorily concept manifest themselves in people’s behaviour: consumers increasingly do not accept unethical business practices or organisations that act irresponsibly, and would consequently neither buy products nor like to use the services provided through these enterprises. A new era is rising: especially young people are not willing to be a part of a disposable society but are interested in socially responsible behaviour.

Corporate Social Responsibility (CSR) is a concept devised to channel businesses towards an ethical interaction with their stakeholder environment: respecting human and labour rights, facing the environmental challenges and fighting corruption. Even though big enterprises such as Microsoft, Google and IKEA apply and popularise this concept in their global business interactions, there is also a need for implementing the concept to small and medium sized enterprises considering their growing importance for the global economy in terms of productivity and employment.

This need has been recognised by the South Baltic project Responsible Entrepreneurship – a way of increasing SMEs’ competitiveness in economical crisis (RespEN), which seeks to promote the CSR concept among SMEs from German, Danish, Lithuanian, Polish and Swedish regions surrounding the southern Baltic Sea, in order to ensure their commitment to fairness, tolerance and human right principles.

Findings from RespEN studies suggest, however, that there is still a long way to go: The majority of respondents to interviews conducted within the framework of the project had neither heard about Corporate Social Responsibility nor could they define this term, even less apply the concept within their businesses.

RespEN brings evidence that there is a lack of well-developed CSR culture in the South Baltic area and that socially responsible behaviour is not perceived as common sense. Having recognised the need for concrete action, the RespEN project established a South Baltic CSR network and successfully trialled the penetrability of the CSR concept counting several success stories of companies which introduced the CSR principles.

The advantages of responsible business are clearly visible in the long-distance view: Satisfied employees being proud of working for their company, satisfied customers who continue buying the company’s products and the positive PR implications are major advantages of the CSR practice in enterprises. But also costs can be reduced with more efficient staff acquisition and retention strategies or through the implementation of energy saving schemes. Moreover, satisfied employees are more likely to vigorously contribute to the development

of their company. Of course, these benefits are to be considered as long-term ramifications which lend weight to the business sustainability.

RespEN’s actions include trailblazing follow-ups like the Polish company Polix which is now one of the CSR pioneers in Poland’s SME habitat. The company applied strategies for environmental protection, customer retention and employees’ satisfaction. Polix achieves excellent market results by taking up consistent sustainable actions in key areas of the social corporate responsibility strategy. The company states that it “is not only about machines and technology, it is mostly about the people and their skills that have been gained over the years.” The PVC producing enterprise also applies ISO standards for quality management (ISO 9000) and environmental management (ISO 14000). While seeking to remain competitive, and guarantee high quality products, Polix cares about its environmental footprint. The manufactured PVC products are 100% recyclable and spare lead and cadmium, both having serious negative impact on humans, animals and the nature. With Polix, the RespEN project verifies the link between CSR and the reduction of hazardous substances outlets.

The engagement in the CSR practice can pay off for every company which follows in Polix’ footsteps with promising outlooks for growth and good reputation overleaping the shark tank of business attitude.

RespEn has a pivotal role in the South Baltic SME environment sparking a live-and-help-live corporate policy through the good practice exchange across borders. ■

RespEN was co-funded by the South Baltic Cross-border Co-operation Programme, which covers Danish, German, Lithuanian, Polish and Swedish coastal regions surrounding the Southern Baltic Sea. The South Baltic Programme 2014-2020 will continue to support joint efforts enhancing the competitiveness of SMEs. More information at: [www.southbaltic.eu](http://www.southbaltic.eu)



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# BALTIC RIM ECONOMIES

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