



**LENITA TOIVAKKA**

The benefits and doubts  
of TTIP



**LINAS LINKEVIČIUS**

Road from Vilnius  
to Riga – mounting  
challenges for the EU  
Eastern Partnership

**SIRPA PIETIKÄINEN**

Baltic Sea area as  
the key player in  
blue growth





# BALTIC RIM ECONOMIES

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LENITA TOIVAKKA

# The benefits and doubts of TTIP

Expert article • 1654

Liberalising trade increases growth, reduces poverty and strengthens employment. For a small, export-oriented country like Finland opening new markets is vital.

Trade liberalization has been done mostly through the GATT and WTO trade rounds. As the conclusion of the Doha Development Round remains still unclear, regional and bilateral trade agreements are needed to sustain economic growth. The European Union and the United States have tied several free trade agreements with third countries. Also other countries and regional organizations are currently negotiating trade and investment arrangements.

Consequently, a trade agreement between two of the world's largest economies is a natural development of this global trend.

The Transatlantic Trade and Investment Partnership (TTIP) is one of the most important agreements in defining the future landscape of global trade. The EU is the largest economy in the world with over 500 million citizens and the United States the second largest with over 300 million. Together these two account for around half the world GDP and for nearly a third of global trade flows. The agreement is not only about trade. It will also enhance the strategic partnership of the EU and the United States.

For Finland the United States is an important trading partner and source of foreign direct investments. The USA is our third largest export destination in goods, and the largest in services trade outside the EU.

The European Commission has raised TTIP as one of its priorities. At the end of September the seventh round of negotiations was concluded. Our goal is to speed up the negotiations after elections on both sides of the Atlantic in order to finalize the agreement by the end of 2015.

It is essential that special attention is paid to openness and transparency in the negotiations. The Ministry for Foreign Affairs (MFA) of Finland has arranged regular public hearings on TTIP. In addition the MFA's and the Commission's websites provide essential information and updates on the topic. Our experts regularly engage in the public debate to provide most updated information.

The Commission ordered an independent report from the Centre for Economic Policy Research (CEPR). The study found that an ambitious deal would increase the European exports to United States by 28 % and add an annual economic gain of 119 billion euros to whole EU. Naturally, at this stage these are rough estimations but the direction of the impact is revealing.

TTIP offers a much needed boost to economy in many EU Member States where growth is very modest or nonexistent. Similarly, European and American consumers would enjoy lower prices with broader selection of goods. For example the EU-South Korea free Trade Agreement concluded in 2011 increased the European exports to South-Korea by 32 %. Finnish exports to South Korea increased by 31 %.

TTIP is an ample opportunity for the EU and the United States to set high rules and standards in global trade for other countries to follow in order to gain benefits in return.

While, there are many benefits on TTIP, it is clear that many doubts still remain. Unfortunately those are often based on misleading information. Usually we come across three concerns.

Firstly, TTIP and especially ISDS will narrow the national right to regulate and compromise democracy.

It is worth noting that the right to regulate will remain solely in democratic hands after TTIP. The European Parliament, the national parliaments and stakeholders are very much involved in the whole process.

ISDS has been raised often as a source of worry. However, Finland already has over sixty bilateral investment treaties, and all of these have an investment settlement dispute mechanism. Finnish companies have profited from these treaties greatly over 35 years. The commission is currently analyzing the results of a public hearing on TTIP. The results will define the possible need to revise it.

Secondly, TTIP will only benefit large multinational companies.

Trade barriers place a comparatively heavier burden on small firms, as those have less resource to comply with regulations.

With TTIP we can help SMEs by reducing regulatory burden. Closer regulatory cooperation between the USA and the EU has the potential to generate significant cost savings.

This makes sense; in the EU and the USA, over 99 % of all businesses are SMEs. In the EU, two thirds of all jobs are in SMEs. In the USA, the figure is over 50 %.

Thirdly, the high European standards in environmental protection, employer rights, or consumer safety will be lowered.

Gladly, the agreement will not lower the current levels of protection for the environment, health, labor neither for the consumers. This can be clearly read from the public negotiation mandate itself. By completing TTIP high and sophisticated transatlantic standards will raise the level of environmental, health and safety standards around the world. ■

## The Transatlantic Trade and Investment Partnership (TTIP) is one of the most important agreements in defining the future landscape of global trade.



**LENITA TOIVAKKA**  
Minister for European Affairs  
and Foreign Trade  
Finland

LINAS LINKEVIČIUS

# Road from Vilnius to Riga – mounting challenges for the EU Eastern Partnership

Expert article • 1655

**C**ountdown – 6 months left to the Eastern Partnership Riga Summit. Under normal circumstances, today we would be just reviewing expected deliverables and taking the remaining steps towards them. However, the current circumstances are not normal anymore. Russia is challenging the fundamentals of Eastern Partnership policy. It is questioning the right of Eastern European states to freely choose their foreign policy orientation, as well as the level of ambition and the final goals they wish to achieve in their relations with the EU. A variety of tools is being used to achieve that – from political and economic pressure to using leverage of energy, massive propaganda and even military intervention. We have found ourselves in the different security environment, first of all.

Moscow is trying to show to the international community that it has a legitimate right to decide on everything that is happening or should (not) happen in the neighbouring countries and beyond, treating these countries simply as a territory that used to belong and still belongs to Russia. As a territory, where no European values, no democracy nor rule of law, no reforms, and no market economy is welcome. Because the ultimate goal is not just to reestablish the geopolitical empire, encircling Russia with loyal semi-sovereign authoritarian countries. The ultimate goal is to challenge the world order, its rules and the international security system, established after the end of the 2nd World War.

The means to achieve that is to consolidate and promote the alternative system of conservative authoritarian and protectionist norms, rules and standards, where openness, trade and integration into the global system are perceived as a threat, bringing damage, and where fundamental principles of international law are treated as a non-necessary rudiment. The main tactics with regard to the West is to weaken the Western institutions and their policies, and ultimately make the West acknowledge the existence of the spheres of influence as well as the logic behind. Because might (power) and determination are the only characteristics that matter in the mythical Eurasian world Russia is aiming to create. This is precisely why impact of conflict in Eastern Ukraine goes far beyond Ukraine, or even far beyond the region of Central and Eastern Europe - Ukraine today is the frontline of liberal democracy and market economy. The challenge is a global one; the way we will deal with it or fail to deal with it today will shape Europe, and the world, tomorrow.

Even if main targets of Russia's current actions are our neighbours and especially our associated partners, their main target audience is in the West. Russia wants us to drop our joint (agreed upon by the EU and six partner countries) Eastern partnership policy, as well as to stop supporting our partners in their ambition to undertake serious reforms and modernize their countries. Russia challenges values and principles behind our policy of political association and economic integration; the same values and principles upon which the very project of the European integration is based. Giving Russia a say in the EU internal policies might be perceived by some as a way to accommodate it by giving recognition it wants. But history shows, that this would only provide them with a new platform to push the line of compromise even further.

This strategy is not without success – we do hear different voices in our own societies, admiring strong willed Putin and stating that it is the West that is to be blamed for what's going on in Ukraine; or those whispering that Eastern Partnership as a policy has failed, it only irritates Russia and damages our strategic relationship with it, and therefore needs to be seriously revamped if not dropped at all. Such thinking is exactly what Russia wants to achieve. But such a scenario would dramatically weaken our regional - and global - influence. It will also mean the end to any ambition of having a Common Foreign and Security Policy of the EU.

Let me be clear – it's not our Eastern Partnership policy, but our Russia policy, which has failed. Engagement strategies have not brought any tangible result.

Persistence, unity and solidarity is the only way "out". We need to stick to our policies, principles, norms and standards. Riga summit is of crucial importance in terms of re-confirming our joint commitment to the Eastern Partnership policy and its objectives. These should not be just words - we should be ready and well equipped for standing by our Eastern partners on their uneasy road of pursuing a major transformation against the backdrop of heavy external pressure. The three Association agreements, negotiated, signed and under implementation now, are the most ambitious agreements the EU has ever concluded with the third countries. Our forces should now be united – more than ever – in order to help partners implement these agreements fully and effectively. What we need, is an elaborated toolbox to help partners deal with these enormous twin challenges (covering financial, trade, technical assistance, strategic communication tracks).

After Vilnius summit stated for the first time that our partners have a sovereign right to choose their policy ambition, an elaborated toolbox to help them exercise this right should become a legacy of Riga. These countries have already paid a huge price for their European choice, - we now need to enable fulfillment of their aspirations. We need a smart revision of the policy, enabling achievement of a goal to transform and modernize the region, its states and economies. Most importantly, we have to clearly demonstrate benefits of the European choice to the people of our Eastern partners. So that the vision of 'Europe whole and free' will finally come into reality. ■



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SIRPA PIETIKÄINEN

# Baltic Sea area as the key player in blue growth

Expert article • 1656

**T**hroughout the history, the seas have played an important role in the success of the European continent. Instead of dividing areas, they have connected peoples and cultures surrounding the seas. This significant role of the seas was recognised officially at the European Union level through Marine Strategy Framework Directive that was adopted in 2008.

The main target of the Directive is to achieve Good Environmental Status (GES) by 2020 for four European marine regions: the Baltic Sea, the North-east Atlantic Ocean, the Mediterranean Sea and the Black Sea. Based on their differing characteristics, each of these marine areas also got a specific policy area they focus on. Neighbourhood policy and conflict prevention for the Black Sea, migration policies for the Mediterranean and environmental protection for the marine area that was most polluted - the Baltic Sea.

Already before this milestone, the state of the Baltic Sea raised worries among the Members of the European Parliament. Baltic Sea Intergroup was established in the European Parliament in 2004 to advocate for the launch of the Baltic Sea Strategy and later to monitor its enforcement. This group of MEPs is still active in the Parliament, having diverse pool of topics around which the co-operation takes place.

The environmental concern however remains the most prominent one. Due to its nature being small and land-locked, the Baltic Sea is susceptible to environmental impacts. Maritime transport, agricultural and industrial emissions, other environmental waste and overfishing keep burdening the marine area at a pace that exceeds sustainable limits.

Achieving Good Environmental Status for the Baltic Sea is not about missing scientific evidence. HELCOM - Helsinki Commission for Baltic Marine Environment Protection - has gathered scientific information on the state of the sea and set recommendations for policy makers already from the 1980s.

For example in the area of transport alternative fuels and technological development of the machinery and equipment should be deployed. In the area of aquaculture, the commission has recommended sustainable measure to be taken on board in fish cultivation.

In addition to scientific knowledge, there is also a diverse group of actors to work towards more sustainable Baltic Sea area. Baltic Sea foundations, municipalities and other actors at the local level do extremely valuable work that needs to be secured also in the future.

To my opinion, no new strategies or plans are needed for the Baltic Sea area. Neither further fragmentation of activities contributes to the protection measures.

Targets are met by more effective actions and implementation. Special focus needs to be on the reduction of the nutrient emissions from the intensive farming of all coastal countries. Additional measures need to be taken towards the reduction of industrial and domestic waste waters by Poland. The protection of the Baltic Sea needs also firmer commitments from Russia. Notwithstanding the current political situation, the EU and the local actors need to actively involve our eastern neighbour in protection measures.

Earlier this year, the Commission concluded in its report on the implementation of the Marine Strategy Framework Directive that the Baltic Sea area is lagging behind from its GES-targets and thus the Member States should step up their efforts to deliver. In addition to the recommendations to the Member States - and something that I directly asked from the Commission earlier this spring- the EU should include the recommendations of HELCOM in its legislation that affect the state of the Baltic Sea, such as the Urban Waste Water Treatment Directive, the Water Framework Directive and the Nitrates Directive.

Money always helps. The funding base from the EU and the Member States needs to be solid also in the future. For the financial period of 2014-2020, a large pool of funding is available for activities around the Baltic Sea from the European Regional Development Fund and from the research fund. In view of budgetary constraints at all levels of administrations, more attention needs be paid on coordination of activities.

Environmental protection of the Baltic Sea goes hand in hand with the economic development of the area. Already now, the countries around the sea champion the development of new, cleaner transport methods with, inter alia, LNG-solutions and more efficient ship designs. The prospects for cleantech innovations are bright not only in Europe but also globally. Developing economies, China in the forefront, begin to face massive environmental problems which will force them to green their economies in the future.

Forward looking innovations will ensure the vitality of the area. After all, it is only a sustainably healthy sea that can connect us around it. ■



SIRPA PIETIKÄINEN

Member of the European Parliament  
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IN ESE VAIDERE

# EU sanctions against Russia – the high price of indecisiveness

Expert article • 1657

**T**wenty five years after the fall of the Berlin Wall, the European security order was shattered when Russia forcefully annexed Crimea. This was a breach of numerous international treaties Russia had signed to and the provisions of the 1994 Budapest Memorandum by which Russia, the United Kingdom and the United States were supposed to guarantee Ukraine's security. The EU reacted by applying sanctions against Russia hoping that Moscow would renounce from its aggressive policy. Unfortunately, Russia's belligerence has not diminished, so the sanctions must remain in place.

In the meantime, we should not be complacent about EU's reaction to the Russian aggression. If the 28 Member States would have acted faster and more strictly, the escalation of the conflict and the economic sanctions could have been avoided. The key was to target the Russian elite, fond of going to Europe for holidays, shopping and studying. Immediately after Russian annexation of Crimea, I initiated a letter to Herman Van Rompuy and Catherine Ashton co-signed by Members of the European Parliament from several member states where we demanded that EU's sanctions should include Russian president's administration, members of Russian Duma and, which is particularly important, their families. Besides the asset freeze and travel ban that would affect the ruling elite, we also asked for an arms embargo. Unfortunately, the Member States opted for a much more gradual approach which had next to non-existent impact on Russia's policy. The first set of restrictive measures in March 2014 was largely symbolic - a "mosquito bite", as described by the Ukrainian ambassador at that time.

It took 298 lives of innocent travellers on Malaysia Airlines flight on 17 July 2014 to convince the EU leaders to take a more decisive step towards economic sanctions. Russia, on its turn, has not only implemented counter-sanctions, but also taken the EU Council to the European Court of Justice. The EU sanctions, together with the measures adopted by the US, are felt hard by Russian companies and banks which, excluded from the western capital markets, have to refinance more than 130 bn USD of foreign debt by the end of 2015. Besides a massive exodus of foreign capital, the Russian Central Bank has spent more than 30 billion USD in October alone in order to save the rouble from collapsing. With the currency reserves estimated around 450 billion USD, Russia has limited manoeuvring space. The state of Russian economy is in such a dire state that President Putin might even deliberately provoke the West in order to blame the EU and the US for all the afflictions Russian people are forced to endure.

While the economic pain inflicted by the sanctions is felt also in the EU, it is much less affected than Russia. For the EU as a whole the share of exports to Russia is only 6,8%, which corresponds to 1,2% of EU GDP. Contrary to the popular belief, even Germany exports just 3,4% of its goods to Russia. The total amount of economic impact

will not reach these numbers, because such a worst-case scenario would require a total shutdown of our trade relations with Russia and no redirection towards other markets. The most exposed in terms of exports to Russia is not the high-tech manufacturing sector but food products (fruits and nuts made 32% of EU exports to Russia in 2013; vegetables - 25,3%; meat - 19,8%). The EU has been able to help the affected industries with a financial support (125 million EUR) and by offering to provide help with surplus storage.

While the impact on the EU as a whole might not be dramatic, the situation is worrisome in the countries bordering Russia. Latvia, Estonia and Finland remain fully dependent on Russia as the only source of gas supply. The new LNG terminal in Lithuania will allow some diversification of its gas supplies, yet its capacity will be limited in the beginning. All three Baltic countries are affected by the trade restrictions (19,8% of Lithuanian exports, 16,2% of Latvian and 11,4% of Estonian exports went to Russia in 2013). In the case of Finland, 9,6% of exports were destined to Russia. To remedy the disproportionate consequences, a strong and sustained action is needed at the EU level to share the cost through the EU Solidarity Fund.

With the momentum lost in the beginning of the conflict, the EU now finds itself with limited options. The sanctions must be maintained to force the aggressor to renounce from its destructive actions. They should be even strengthened and applied to families of Russian president and members of Duma. A strict arms embargo should be applied to end the Mistral helicopter carrier deal and other arms contracts. In the meantime, the EU should coordinate its own policies in order to mitigate the impact of the sanctions on Member States' economies. The most important is to reduce the dependency on energy imports from Russia and to help the EU companies reorient their business towards new markets. ■



IN ESE VAIDERE

Professor  
Member of the European Parliament  
Latvia



TIBOR SZANYI

# Possible effects of the Russian embargo on food taxes

Expert article • 1658

The immediate effects of the Russian embargo on the EU's agricultural sector are obvious. On the short run the European producers have been partly compensated by the quick response of the European Commission. The disturbance is understandable, as Russia represents an important export market for the EU's fruit and vegetables production, buying about one third of our fresh fruit exports (EUR 1225 million in 2013). Similar proportions can be seen with regard to other products as well: one thirds of the cheese- and the beef-exports, while a quarter of the butter-exports go to Russia. Besides these, the ban has been affecting a wide range of products this year, while there is no guarantee that this situation will ever be over completely. Whatever future brings, one thing is certain: such interactions have a long-term impact on the markets in terms of mutual confidence. This situation – inflicted by a foreign policy decision and not by market disturbances – results in large scale surpluses on the market. Finding new markets is a difficult and complex issue, and alternatives can also be found in the internal market.

Meanwhile, in the European Union more than 120 million people – among whom more than 25 million younger than 18 – live in poverty, or around the minimum living standard. These people are deprived of sufficient food at a reasonable and affordable price. The EU spends billions of euros on supporting agriculture; nevertheless, there is no sufficient food available at a reasonable price fulfilling certain quality requirements. This means in fact that the Common Agricultural Policy fails one of its most important objectives, with malnutrition continuing to deteriorate, even in some EU member countries. In addition, governments of certain Member States are overtaxing food products. Various VAT rates apply to food in different Member States, varying from 0 to 27%. In certain countries we see VAT-exemption, or levying 0% VAT on certain categories of food articles. As we have been able to lessen the tax burdens on medicines (the VAT on medicines is below 10% in most of the EU Member States), would it not be fair to act similarly with regard to articles which represent a sheer necessity to ensure human dignity and a fair standard of life?

There is a simple solution to solve this conflict, which could consequently address several problems at the same time: the EU should introduce minimum taxes as a result of a 'No Tax on Food' initiative in each of the Member States.

There are already known evidences showing that lower VAT on certain categories will have positive effects on social welfare and on the market positions of the producers and farmers, while offering an EU-wide solution to widespread VAT fraud. Fraud groups sought to avoid VAT charges by making articles travel through borders and importing non-European countries, moreover there are also governmental officials in certain cases who are allegedly involved in the fraud scheme. In Hungary only there is an estimated central budget loss of 1 billion euros a year as a result of food VAT fraud. The fraud schemes

with the VAT all over the EU inflict damages to the countries' financial balances and economic health, including their farming industries and their food sectors. The main solution recommended by different experts is to reduce the lucrativeness of VAT fraud by reducing VAT to less than 10%.

I would go even further. Elimination of VAT and other fiscal burdens on food would result in a drop of food prices, which could develop to the capability to absorb surpluses caused by the embargo. It could address certain fiscal sources of poverty related malnutrition, particularly among children, sadly present in most of the EU Member States. Criticism may arise, saying this is not conform with current EU VAT regulation. If so, the European Parliament is just the right place for such initiatives aiming to change outdated legislation! This initiative requires of course thorough preparation, involving academic research, political and social reconciliation, targeting a fair tax system to enable us to provide food at reasonable prices.

Therefore I shall remain determined to keep the issue, in one way or another, on the EU's political, social and legislative agenda, and to facilitate the future dialogue. ■



TIBOR SZANYI

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CHRISTOFER FJELLNER

# EU's perpetual dance with Belarus

Expert article • 1659

In a tense geopolitical environment, many issues are at stake, also in our own neighbourhood. Russia is increasing the pressure on the former Soviet buffer zone. The most recent expression of the new expansionist impulse is the Russian annexation of Crimea and the military violation of Ukraine's territorial integrity. In this setting, it would be unfortunate if the situation in Belarus is forgotten. As Putin appears to want to reassemble the Soviet Union, turning Belarus towards the West is perhaps more important now than ever.

Belarus has for a long time tried to perform a balancing act between East and West, ignoring the two sides' declarations that it cannot have it both ways. Where Europe demands democratic reforms, market economy and respect for human rights as conditions for support, Russia portrays itself to have less demands, but more to offer. Russia demands loyalty, and offers a steady and cheap supply of energy, preferential access to the Russian market and favourable loan conditions, which keeps the Belarusian economy afloat.

Unfortunately, the EU's lack of strategic policy goals has caused a stagnation in the relations between the two parties. To a great extent, the strategy of the EU has been to balance the carrot and the stick: to tighten the sanctions when needed, and to ease them when the regime attempts to make progress as regards reforms and human rights. In diplomatic terms, the EU is committed to a policy of critical engagement.

As an unintended consequence, the pursued policy gave Putin the opportunity to take a closer look at what countries he could count as allies and those he could not. For Russia, the strategic value of the relations with Belarus has increased after other Eastern European states have turned towards the West. Preservation of the Russian sphere of interest is clearly the main driving force for the Kremlin. The realisation that the European strategy is not delivering is even more worrying in a time when Russia is on an expansive path.

Our relations with Belarus must be based on long term strategic considerations. The long term objective must be to get Belarus to subscribe to the core European Neighbourhood principles. To this end, the EU must continue to send clear messages to those feeding the current regimes, and continue reviewing and amending the visa blacklists for supporters of the regime, and for individuals who violate fundamental human rights. However, whether or not the list is extended is irrelevant. What matters most is that the blacklist is not seen as a relic of the past, but as an ongoing process that is constantly on the agenda to monitor its enforcement. When the EU restricts nationals from doing business in the EU, but allows the same individuals to go on vacation in the Alps, the sanctions lose credibility.

The people of Belarus will have a hard time turning towards Europe as long as Russia controls its energy supply. Due to the geopolitical importance of energy security, Belarus and other countries stuck between the EU and Russia should to a larger extent be subject to the European energy security strategy.

But as the people of Belarus are the first victims of the isolation imposed by its authorities, they will also be the first to reap the benefits of a democratic Belarus. Thus, we have to engage with those that can bring an organic change from within Belarusian society. A first step of such an approach is to liberalise movement for ordinary

citizens in order to facilitate the exchange of ideas and democratic values. Today, travelling into the Schengen area is easier for Russian nationals than for Belarusians.

Business also has an important role to play. Improving trade relations with the country can help improve economic growth and job creation. Isolation will only benefit the regime. However, we have to be aware of the fact that Belarus is not a democratic country, and we should not do business with companies tied to the regime.

In the same spirit, European universities have an important role to play in spreading ideas and democratic values. Institutions around the EU could accept students from Belarus. Such an initiative could easily be administered by the current EU student exchange programmes, such as Tempus and Erasmus, but could be combined with scholarships designed for Belarusian students.

Europe was very slow to recognise and respond to the seriousness of the Russian threat to Ukraine. Still today, there is a lack of common strategy towards the increasing tensions in the region. But change will come, also in Belarus, in one way or another. Historians have been acutely incapable of predicting the greatest changes in history. The EU has to be aware of what it knows, but also what it does not know. Sooner or later, change will come to Belarus. A divided Europe will accomplish nothing but legitimise Russia's actions. When the time comes, the EU must make the most of this opportunity, and must prepare a common foreign policy in order to embrace Belarus, if the country chooses deeper relations with the EU. ■



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HEIKKI AUTTO

# The European bio-economy grows from the North

Expert article • 1660

**T**he decline of European markets since 2008 has been a massive issue to tackle to Finland and other small countries that are economically deeply dependent on their exports. As Europe's weak economic growth has stretched to last longer than expected it has directly affected and caused troubles to provincial businesses all over the continent.

In the North the so called forest-economy is also in a turning point. For many decades printing paper exports have been in great importance for Finland's economy. Unfortunately, the current narrative in the age of digitalization has been more about the decline of numerous paper producing factories and loss of relevant jobs. But there is still hope.

Despite the rough ride that the paper industry has gone through during the last decade the utilization of Finland's forests has stayed on a high volume. And thanks to the good forest management the sustainable logging volume could actually be significantly higher although the high volume has kept on. And for example the common European goal for the use of renewable energy sources does in its own part open new possibilities for a new growing bio-economic sector.

I am very happy that the EU member states have finally decided to take the cost efficiency into account in the future share of climate action burden between the states along with the GDP-criteria. It makes more sense to apply more emission reductions where it is more cost effective. This also indirectly gives more leeway and market dynamics for the important potential growth of the clean tech sector in the areas where the conditions are met best. This in turn makes great sense considering the European and Nordic economic growth. These decisions can truly be argued to gaze to the future.

The EU's aim for the use of renewables has a noble cause and any environment-aware person can easily support it. But the danger is not in the aim, but in the execution, which if badly managed can cause the member states to miss the goal altogether and lose important factors for bio-economic growth. In essence, the EU is in danger of stumbling on its own feet if it either accidentally or purposely thwarts the livelihood of areas in its peripheries.

The chain of value for bio-economy starts from the provinces and notably the wood industry is a vital part of this chain. If there is no lucrative forestry industry there will not be a thriving bio-economy. That's why EU must keep the emphasis to underpin and strengthen the livelihood of provinces.

Arctic regions thrive from their nature and as a parliamentary representative of Finnish Lapland I know of the vast history, economic successes and more importantly of the large potential that is absorbed in to our woods and nature. The arctic bio-economy that extends itself to education and high tech research is potentially one of the key factors in pulling Europe back on its innovative feet.

For Finland it has always been an important principle that sustainable and profitable forestry can be practiced in all parts of the country. But it seems that EU policies can cause unpredictable problems as there is a plan to terminate the subsidies for the forest renewal. This is an actual part of the plans for the reformation of the Finnish law for the "financing of sustainable forestry", which follows the guidelines given by the EU commission. Forest renewal is an important part of the lifespan of arctic forest and an important tool in the sustainable forestry management. So sometimes it feels that the EU should better observe the differences in the climate and natural conditions of its vastly diverse areas.

The future role of the forestry sector as a dynamo for low emission products, materials, services and energy is essential. The industry that is based on high value know-how is in the brink of forming all new businesses based on nature's intangible value and ecosystem services, along with nature tourism which works hand in hand with the rest of the sector. The new bio-industry grows not only from the big scale investments but also from the small and middle sized businesses.

The advanced liquid biofuels are already compatible with the current European auto base and fuel distribution network and therefore the usage and continuing development of them is the most viable and cost efficient way to reduce transport emissions. The best news for both the Europe and the North is that the know-how of the development and production of sustainable biofuels already exist in Finland. Now it is only matter of will that we start to utilize all the possibilities.

I know that Finland has the expertise and the will to take the bio-industry to new heights. One could also claim that Finland is already many considerably ahead of other EU-countries when it comes to the business in question. There should not be a single viable reason to put shackles on the innovations that are about to grow from the North. ■

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ESKO LOTVONEN

# Rovaniemi – the Arctic capital of Finland

Expert article • 1661

The city of Rovaniemi is crossed by the Arctic Circle, so that most part of surface area is above it. Today the city is a dynamic, growing city by population and business. The number of inhabitants is about 61,600. Rovaniemi is fifth biggest arctic city globally. The science and applied sciences Universities of Lapland are major educational institutes with almost 10,000 students. The city is also home to the units of the main national research institutes of natural resources. These form strong base for research and development activities in many issues related to knowhow of arctic conditions. So it is not only the location on Arctic Circle that makes the status of Arctic Capital.

Rovaniemi is most probably best known globally as the Official Hometown of Santa Claus, which is recognized by EU, USA, Russia, China and Japan among other countries. Nowadays Rovaniemi is often highly ranked as one of the top winter tourism destinations worldwide in the lists of CNN, Lonely Planet, Huffington Post and many others. We have been steadily growing to attractive international tourism destination with large scale of services trough out the year. Most of the tourists come from abroad.

Rovaniemi attracts not only tourists but also important politicians and heads of states. During recent decades the City of Rovaniemi has hosted the visits of many kings, presidents, prime and other ministers. Their agendas have varied somewhat but usually they have taken time to meet Santa Claus. During recent years the agenda has been strongly focused on arctic development and the ongoing work to enhance it. Strong interest is seen from Asian countries. In this decade, we have had visits from three of today's five top ranked Chinese politicians, starting with the President Xi Jinping. The most recent visit was by a delegation of the President of India. Delegations are benchmarking arctic information and competence, cultural heritage, clean technology, tourist attractions and arctic policy related to changing logistical perspectives created by climate change and the opening of North East Passage.

The city of Rovaniemi feels an obligation to be active partner in arctic development. Today's existing arctic cooperation under the Arctic Council started in Rovaniemi in 1991 with the signing of the Arctic Environment Protection Strategy. The commencement of the cooperation, the Rovaniemi Process, led to the establishment of Arctic Council in 1996 in Ottawa. To continue the tradition, every second year we arrange an arctic conference in the Spirit of Rovaniemi Process. Next one will be in November 2015 and hopefully the Arctic Summit by head of states will take place in 2017, when Finland will be chairing Arctic Council and celebrating 100 years of independence. Rovaniemi is member of World Winter Cities Association of Mayors and through this network shares experiences between cities in order to create better living conditions for residents.

Arctic Center research institute was opened in 1992. It plays a major role in arctic research network globally. According to plans, it will be the host institute of EU's Arctic Information Center, to be established in next year. The University of Lapland also hosts the Secretariat of the University of the Arctic. UArctic covers a wide network of educational and research units worldwide.

Located in arctic area Rovaniemi is a good natural laboratory for the development of cold climate know-how and products. Mainly for tourism purposes made ice and snow constructions are attractive and practical service solutions. In Rovaniemi, we have also four sites serving different kind of testing. The majority of clients are car manufacturers or tire, snow scooter and all-terrain vehicle producers. With the cleanest and freshest air quality, the area offers good and aromatic wild natural products such as berries, herbs, mushrooms, fish and reindeer meat. Arctic business is a growing and, with the goal of supporting this development, the Lapland Chamber of Commerce arranges annual Arctic Business Forum in Rovaniemi. The sixth Forum will take place in March 2015.

One of the new sectors of innovation is Arctic Design. Since 2009 the city of Rovaniemi and University of Lapland have organized annual Arctic Design Week. The week has grown to an important international event with participants from 32 countries. Arctic Design is a natural step for Rovaniemi due to the presence of the faculty of Art and Design in the university. It is not just about industrial design but also service design and city planning. Designers form a good national network with Aalto University and Lahti Design Institute. Arctic Design is a new and exciting concept that can play an important international role for Finland in the future.

Global interest to Arctic has raised the role of Rovaniemi in national and international context. With good accessibility, infrastructure and capability with regard to arctic and cold climate issues, Rovaniemi is open to cooperation with national and international partners. Let's keep in touch! ■



**ESKO LOTVONEN**  
Mayor  
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FELIX H. TSCHUDI

# The Arctic Corridor – Arctic infrastructure as catalyst for Nordic resource development

Expert article • 1662

**V**isions are important not only for people, but also for countries and regions. The Arctic Corridor ([www.arcticcorridor.fi](http://www.arcticcorridor.fi)) initiative's call for an Arctic railway connecting the Baltic and the Barents Sea could create a vision of vital importance for the Nordic and even Baltic countries.

It is difficult to measure the indirect impact of large-scale industrial investments before they happen. Tschudi Shipping's experiences in the northern Norwegian town of Kirkenes is an example of this. In 2006, before the decision to reopen the iron ore mine Sydvaranger, many of Kirkenes' inhabitants felt left behind in the offshore development of the Barents Sea. The main local debate was about the proposed closure of the local hospital which described the town's prior decline. Today, seven years later, a new hospital is under construction, the population of the municipality is increasing, and the optimism has returned to the region. What brought about this change?

The completion of the NOK 2.5 billion mining project meant activity. Activity creates more activity and expertise. After extensive work during the reconstruction phase of the mine, local Kirkenes subcontractors are now prepared to serve the expected oil and gas developments in the Eastern Barents Sea. Due to the common Nordic labour market in a region where the language and cultural barriers are low, the reconstruction of the Sydvaranger mine was able to draw on experienced workers and management from Norway's northern neighbours. Kirkenes now has the port expansion plans, skills and capacity required to succeed. In sum, Kirkenes' outlook radically changed over the course of eight years due to the Sydvaranger industrial investment. The development of the North must start with an attitude change within and towards the region. Real results need to be realised for negative trends to be broken – Kirkenes is a good example of such a transformation.

"Where gas meets ore" could be the motto of the Barents Region. The Fennoscandian geological shield covers the Kola peninsula, northern Sweden and Finland. It is one of the largest and richest mineral provinces in the world. Its deposits are similar to the world-class ore deposits in the Canadian, Western Australian and Southern American shields. At the same time, large oil and gas fields have been discovered in the Barents Sea. Clearly, the combination of large deposits of both minerals and natural gas are opening up for unprecedented industrial and technological developments. Natural gas can be used as feedstock for the processing of the minerals and metals of the region. The resulting semi-processed materials are environmentally beneficial due to reduced transportation needs and industrial emissions. By combining the metallurgical, natural gas and offshore know-how of Finland, Sweden and Norway, the Nordic countries could develop a new technological frontier together. This joint project has the potential for large regional and environmental benefits – a real vision for the future.

The Barents Sea South East is a new oil and gas province close to the newly defined sea border between Russia and Norway in the Barents Sea. Since 2011 seismic surveying has been ongoing in this area. The 23rd round of offshore licensing, which covers parts of this seabed, has gathered the interest of more than 40 oil companies. Although the offshore developments were initially hugely popular, the sentiment has lately turned negative as the local population do not believe they will benefit as much as expected without landing the oil and gas ashore. These issues could be overcome through creating onshore value with offshore gas. Applications for oil exploration licenses should be given preferential treatment if they include plans for onshore gas and mineral processing. Such preferential treatment would spur the oil and gas companies to become catalysts for new industrial thinking in cooperation with the mineral and metal processing industry. Due to the scale of investments required, only very large gas fields will be developed independently. Every oil field, however, contains associated gas that is normally reinjected into the field. If such stranded gas could form the feedstock for industrial projects, all parties would have incentives to find joint solutions. In the future requirements for CO<sub>2</sub> capture onshore should be included. For example, returning captured CO<sub>2</sub> as pressure support to the oil fields could become the norm. It could be technically feasible to use the same shuttle gas carriers for transporting the CO<sub>2</sub> back offshore which are transporting the compressed natural gas ashore.

Such a development would require a holistic approach, which creates incentives for trans-national collaboration. Such initiatives are already starting. In the Ironman project in Norway, Statoil, LKAB and Høganäs of Sweden jointly investigated the possibility of a Direct Reduced Iron (DRI) plant at Tjeldbergodden, a gas-receiving terminal on the Norwegian coast close to Trondheim. A key challenge for such projects to be realised, however, is the volatility of gas prices which is a key challenge for any large scale industrial projects employing natural gas. A number of studies have already been made by Norwegian research institutions into the use of natural gas for industrial purposes. Examples are the Gasmat – gas to materials – and Geonor projects undertaken by SINTEF, Trondheim and several studies (Gas-smaks, Geogass and others) by NORUT (the Northern Research Institute, Narvik) into building industrial clusters around gas-mineral processes.

This kind of collaboration will not happen by itself. It will have to be nudged into realisation through political will. The coming 24th licensing round could be the first opportunity to include such new criteria for licensing.

The Arctic Railway initiative connecting Rovaniemi with Kirkenes is stretching the imagination. It will be the single most important factor for realising the long-term vision of the Arctic Corridor. It will require enormous investments, long debates about environmental impact

and cost/benefit analysis. Ultimately though, it could create a unified economic North with its own industrial logic and momentum. The Arctic Railway would transport raw materials and goods to the North for shipment either via the Northern Sea Route to the Far East during the ice-free season, or to the Atlantic. For example, the ice free deep water port of Kirkenes can today load vessels up to 100 000 dead weight tons (dwt), and there are plans to increase this to 170 000 dwt vessels. This would offer considerable economies of scale for shippers of bulk cargoes. Like the previous Petsamo corridor it would connect Finland to the Barents Sea and be a gateway for exports and imports that could provide Finnish industry with an opportunity to serve the growing offshore activity in the Barents Sea. Importing LNG by specialised tankrail cars could also be important for Finland and the Baltic countries seeking to diversify their energy supplies. This “rolling LNG pipeline” could be run on LNG itself and would enable energy generation and processing at remote mine sites in northern Finland and Sweden. This would make industrial developments possible almost anywhere, and at the same time be environmentally friendly, save transportation cost and create jobs and value locally.

The main supply of LNG to Europe via the Arctic Corridor to Finland, Sweden and the Baltic countries will come from new LNG plants envisioned in Finnmark on the Norwegian Barents Sea coast. In the future when Russia again will become a natural partner in these developments, the LNG from the Yamal LNG project could also be sold and transported along this route. The Arctic Corridor would add flexibility, save cost as well as create a new supply route for Norwegian and possibly Russian LNG to a gas hungry Europe.

As mentioned earlier, historically large infrastructure projects are difficult to evaluate. Bergensbanen, between Oslo and Bergen, and Malmbanan, from Kiruna to Narvik, at the beginning of the 20th century are examples of large infrastructure investments which were controversial at the time due to the enormous capital required, but which have benefited society greatly in the long run. The positive impact of these projects would be impossible to justify with today's stringent financial NPV calculations based on relatively short project lives. For example, a direct consequence of Malmbanan's existence was the prospecting, discovery and subsequent development of further ore deposits which would not have been economically justifiable without the existing railway. The Arctic Railway is likely to have similar effects. If such indirect long-term effects are not taken into the decision-making process, then the value of infrastructure as a transformational tool is lost.

The industrial development involving natural gas as feedstock will probably first develop along the northern coast of Norway, possibly involving the expertise of Finnish or Swedish companies and scientific institutions. In parallel with these industrial initiatives the time consuming preparations for planning, approving and financing the Arctic Railway should be started. The end destination of this journey should not be the Arctic Corridor alone but a new Arctic Industrial Corridor of sustainable developments benefiting the people and the region!

In his book “The New North – the world in 2050” professor Laurence Smith of UCLA describes a demographic and economic shift northwards caused by rising temperatures, melting ice covers and rapidly increasing populations in low-lying or drought affected areas. Resources such as space and water will become scarce, and these are resources of which the North has plenty. Maybe the possible development described in this article could be the forerunner for that trend.

The Arctic Corridor is a grand vision - a bridge to the future for the Nordic countries. It is environmentally friendly and economically beneficial, but it requires our political leaders' understanding, determination and courage to be realised! ■



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ERJA TIKKA

# EU Strategy for the Baltic Sea Region, more commitment and focus for better results

Expert article • 1663

**D**uring the first 6 months of this year I had the honor of chairing the National Contact Points (NCP) of the EU Strategy for the Baltic Sea Region. The adoption of a rotating chair of the NCPs reflected the discussion on more ownership of the macro regional strategies by the Member States. Estonia, as present CBSS Presidency, took over as NCP-chair after Finland and will be followed by Latvia and Poland in 2015.

The main topics during my chair were the discussion on governance, leadership and better implementation of the EUSBSR, embedding it into the ESIF- and other financing programs and the needs for updating the EUSBSR Action Plan.

A Commission report on the added value of macro regional strategies in June 2013 noted that they are an important innovation in territorial cooperation and cohesion, but this approach has to be judged by results. The implementation is challenging. Stronger leadership, reinforcing ownership in the regions concerned, clear decision-making and greater visibility are needed. On this basis the EU Council asked the Commission to prepare a report on better governance of the macro regional strategies.

The report was published in May 2014 and the Council conclusions were adopted on October 21. The Council recalled that the delivery of results of macro-regional strategies relies on an effective governance model and efficient procedures for the implementation, stressing though that governance is not a "one size fits all" model. The Council did not endorse the Commission's proposal of a rotating presidency on ministerial level and called to refrain from setting up additional EU formal structures. Instead, better exploitation of the existing ones was encouraged. This was the view of most BSR Member States, as there already are so many cooperation formats in the Baltic Sea region.

The Member States are invited to reinforce the political leadership and ownership of the macro-regional strategies and maintain their political commitment in the long term. The conclusions also underline the role of relevant ministries in implementing the macro-regional strategies and their responsibility for driving progress in their thematic areas. Although the EUSBSR 5 years ago was a forerunner of EU macro regional strategies, we still have a lot to do in our countries in this respect. The sectorial ministries should work much closer together in answering the common regional challenges, shaping policies, planning tangible projects and utilizing the financial instruments.

According to the Council conclusions, priority should be given to issues of coherence and strategic relevance for the macro-regions concerned, providing genuine value-added in relation to horizontal community policies, in particular to the Europe 2020 Strategy and to result-orientation. The need to focus on a limited number of challenges and opportunities is also pointed out.

The Action Plan of the EU Strategy for the Baltic Sea Region will be updated by the beginning of 2015. The main goals of the Strategy, *Save the Sea*, *Connect the Region* and *Increase Prosperity*, will remain. But as these goals are now implemented in as many as 17 priority areas and 5 horizontal actions, the need to focus is vi-

tal. The Commission interviewed the Priority Area Coordinators and Horizontal Action Leaders last winter. The following report concluded that most priority areas under *Save the Sea* are delivering results, the *Prosperity* priorities do relatively well but need attention and the priorities under *Connect the Region* need improvement and proper focus. We should also concentrate on issues that bring real value-added to the region.

*Save the Sea* is certainly the goal, were we need to deliver – or the Strategy will lose its credibility in people's eyes. Reducing nutrients, working for sustainable agriculture and ensuring maritime safety are the main priorities of the Finnish Government in this respect. And the necessary cooperation with neighboring non-EU countries must not be interrupted in spite of the tensed political situation.

*Connecting the Region* is likewise crucial. The priority areas Transport and Energy need a new approach and more attention and ideas from the Member States. Business representatives attending the 5th Annual Forum in Turku last June wanted the Strategy work to concentrate more on promoting transport connections and growth corridors.

Under the goal *Increase Prosperity* there are 7 priority areas, e.g. separately for SMEs, innovations and internal market. They could well be clustered or merged. In this field we should also define a focus that would bring more regional value-added, such as "going green" were the Baltic Sea region has promising prospects for growth.

The review of the EUSBSR Action Plan is timely and should be finalized quickly. The goals of the Strategy have now been embedded in the main EU financial instruments for the region and the first calls for projects will open soon. This program period will prove our capability to deliver. ■



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HELENA LINDBERG

# Meeting the challenges of trans-boundary flows through macro-regional cooperation

Expert article • 1664

In 2009, during the Swedish EU Presidency, the European Union launched its Strategy for the Baltic Sea Region (EUSBSR). The strategy and its action plans have provided a common direction and purpose to the cooperation in the region. The EUSBSR is currently composed of a number of thematic Priority Areas (PA:s), where concrete expert level cooperation is carried out. As of February 2013, the Council of the Baltic Sea States (CBSS) Secretariat and the Swedish Civil Contingencies Agency (MSB) serve as Coordinators of PA Secure – Protection from emergencies and accidents on land.

The PA Secure is aimed at coordinating and enhancing macro-regional efforts in the protection from emergencies and accidents on land. It was a natural outgrowth of the Swedish government mandate for MSB to accept to coordinate the activities of PA Secure. MSB has broad responsibilities in the area of societal security. The work covers a wide spectrum of risks and threats – ranging from IT-incidents to health threats, extreme weather events and CBRN security. The agency is also active in all phases of contingency management – before, during and after – and operates both nationally and internationally. MSB is also the national point of contact for the European civil protection mechanism and for the European cooperation in the area of critical infrastructure protection (EPCIP).

Today most major risk scenarios involve critical flows of different kinds - flows that reach both across sectors and across national borders - flows of energy, essential goods, finances, information and people - "good flows" that we want to protect and develop. But we also find undesirables flowing across our borders, like viruses – both human and digital – extreme weather conditions, illegal and hazardous substances, criminality and conflicts.

One of the important objectives for our work within PA Secure will be to explore these flows and to see how we can strengthen the interoperability of civil protection authorities in the region. This is a multidimensional task with a foundation in technology but with even greater obstacles in organizational rigidities, professional prisons legacies and human mind-sets.

We want to establish a better understanding of existing and needed arrangements, continue to map and assess macro-regional risk scenarios, identify shared vulnerabilities and close gaps in common capacities.

In order to advance our work within PA Secure we will need to work closely with other EUSBSR priority areas, such as "Safe", "Crime", "Agri" and "Health".

We have much in common in the region, but there are also differences to address openly. Our perceptions of risks and threats are not the same, our national systems are organized differently and we use

different approaches, terminologies and skill-sets. This variation can give rise to some "healthy friction" in our deliberations about the work ahead.

An important tool to overcome some of these deeply engrained obstacles and to find common platforms for action is joint training - at many different levels.

One flagship initiative for priority area "Secure" is the launch in 2014 of a "Baltic Leadership Programme", focused on societal security.<sup>1</sup>

This programme - which is funded by the Swedish Institute - will target future leaders in civil protection and address "intercultural aspects" of cross-border cooperation. I am convinced that this joint training initiative can serve as a model for other Priority Areas and for

emerging macro-regions in Europe.

The purpose is to equip the next generation of high level policy makers with the tools and perspectives needed to manage cross-border collaborations among diverse organizations in an intercultural context. The leaders of tomorrow need to be better connected and will gain new and lasting networks that can strengthen regional cooperation in civil protection.

Carefully selected individuals with high promise for the future will work for four days with colleagues in their profession. The focus is on challenges with clear implications for policy makers at the strategic level and not on operational or tactical concerns. Other courses cover those important topics.

Issues to be addressed in an interactive format include: How can we put safety and security issues at the top of the regional political agenda? What are the risks and the vulnerabilities? What capacities are needed to improve trans-boundary co-operation? How can we communicate about present and future risks and offer meaning to the public during crises? What can we learn from each other?

<sup>1</sup> The Leadership Programme for Societal Security builds on the experiences of other similar training initiatives focused on inter-cultural exchange between project leaders in the region.

The challenges related to the increased intensity of maritime traffic, and the potentially very serious impacts of large oil spills, provide concrete examples of areas where we need to mobilise regional efforts [...]



Expert article • 1664

Some issues will be taken further in a flagship EU-funded project “From Gaps to Caps”, which is led by the Fire and Rescue Department under the Lithuanian Ministry of the Interior. The project covers Risk Management Capability Assessment Methodology and Evaluations of Emergencies and Exercises. The aim is to increase cross-border preparedness for complex hazards and emergencies.

Another flagship project, underpinning the cooperation in PA Secure, is the BaltPrevResilience project. MSB is Lead Partner for this EU-funded project which started in 2014. The ambition is to establish a platform for sharing statistics, experiences and best lessons to enhance daily practices regarding accidents and emergencies.

The challenges related to the increased intensity of maritime traffic, and the potentially very serious impacts of large oil spills, provide concrete examples of areas where we need to mobilise regional efforts, based on the 1992 Helsinki Convention (HELCOM). The Baltic Sea is becoming cleaner and safer, but it is still a vulnerable sea, unable to cope with a significant rise in oil spillage and pollution. It is essential to maintain a standard of responsible shipping in the region. For PA Secure it is an important mission to support the current development within HELCOM towards a broadening cooperation, including also response on the shore.

Once again, we see the added value of macro-regional cooperation when the countries around the Baltic Sea are able to join efforts for a common goal – safety and security in critical flows at sea and on land. In order to meet the many challenges ahead, we should seek to exploit the tight web of mutually reinforcing, cross-border relationships, that provide a rather unique foundation for future resilience in the region. ■

#### HELENA LINDBERG

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# BALTIC RIM ECONOMIES

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ASTA MACKEVICIUTE

# Solidarity – a burden, privilege or natural state?

Expert article • 1665

As one of the overarching values on which the EU was built, solidarity has been at the core of its integration, both driving the Union forward and keeping it together. The principle of solidarity found its explicit place in the Lisbon Treaty under the obligation for the Union and its Member States to assist in case of a terrorist attack and a man-made or natural disaster. This is the area where we find many beautiful expressions of solidarity between our Member States as well as with third countries.

Solidarity does not come without responsibility. EU legislation requires Member States to assess their risks and to prepare at best of their capacity. States carry primary responsibility to respond to disasters and to protect their population and environment. However, the EU also recognises that disasters – even the more predictable ones – sometimes take unprecedented proportions and can overwhelm national response capabilities. In these cases we need to be able to reach out and help each other.

Much of this mutual assistance has developed spontaneously, and has sometimes led to closer and more structural co-operation among neighbouring countries or in entire regions. Regional sea conventions for co-operation against marine pollution, like the Helsinki Convention in the Baltics, are very good examples of such engagement for coordinated preparedness and assistance. For decades countries around the regional seas practice joint alert systems and emergency response arrangements, co-operate in surveillance, share good practice and exercise within impressive international fleets. As an extra layer of support the EU has also played an increasingly important role in assisting its Member States to respond to marine pollution. It started with an action programme against hydrocarbon pollution in 1978 and developed into the establishment of the European Maritime Safety Agency in 2002 with a network of stand-by oil spill response vessels along the entire European coastline, satellite based oil spill and vessel detection and monitoring, information service in case of chemical spills at sea and a lot more.

The EU's involvement in solidarity among Member States with additional services and funding has not been limited to marine pollution. In 2001, the Civil Protection Mechanism was established to facilitate coordination among national civil protection authorities for better prevention, preparedness and response to all types of natural and man-made disasters. It already brings together EU Member States, Iceland, Norway and the former Yugoslav Republic of Macedonia but remains open to all candidate and potential candidate countries and we expect to soon welcome Montenegro and Serbia. The operational heart of this Mechanism is the Emergency Response Coordination Centre in Brussels. Although primarily focused to support Member States, it has been designed to extend European solidarity on a global scale and to provide aid wherever it is requested. Since its creation the Mechanism has been activated over 300 times, swiftly pooling in-kind assistance, specialised equipment and expertise available throughout its Participating States and transporting them with the EU co-financing to alleviate human suffering or environmental damage. Those cases include major disasters that hit the world in the past decades, like the earthquake in Haiti (2010), cascading disaster in Japan (2011), typhoon Haiyan in the Philippines (2013) but also numerous forest fires and floods in Europe. The latest example of such Euro-

pean solidarity in the north of Europe was demonstrated in summer 2014 when four fire-fighting planes from Italy and France, supported by a French surveillance plane, performed 1500 water drops (equivalent of around 7500 tonnes) over the burning areas in Sweden. Assistance is usually provided free of charge except for marine pollution cases where the polluter bears the cost.

For such solidarity operations to be professional, timely, effective and blending smoothly into a national response, there is a need for specialised knowledge and preparation. The Mechanism provides the necessary framework to gain international training, to exercise among and within multinational teams and to have a secure real time communication system that connects all relevant authorities.

In times when we experience various natural phenomena that lead to catastrophic events, when unrest in its many forms comes ever closer to the Union's borders and when national economies are under strain, the EU is maintaining solidarity in disaster management in the forefront of its activities. The implementation of the recently revised civil protection legislation providing for more robust arrangements on disaster prevention, preparedness and response, and a strong focus on sharing and pooling of response capacities, is a common effort of the Member States and the European Commission to face the growing complexity of events and increasing expectations of citizens.

The future of solidarity will depend on the attitude that will prevail in our families and societies, in our countries, regions and in the EU as a whole. Now, when it is enshrined in the Lisbon Treaty and has developed into a sophisticated mechanism that demands engagement for assistance, will solidarity be perceived as a burden on individual Member States, will our countries race to be among the first to help those in need or will we simply find it natural to keep growing together in a spirit of genuine solidarity? This is not a mere moral question. As we are developing together, we are actually learning that solidarity and close cooperation in the area of disaster management is having a major impact not only on national resilience but even on growth and jobs across the EU. With more focus on prevention and preparedness, the industry is seeing opportunities and governments are creating a safer environment for people and for investment. Perhaps this prime example of how closer EU cooperation benefits us all could be more prominent in the current policy debates on the Union. ■

This text reflects the views only of the author, and the Commission cannot be held responsible for any use which may be made of the information contained therein.

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# Belarusian language and national identity – old challenges, new paradox

Expert article • 1666

Anyone wandering around the Belarusian capital of Minsk this autumn will soon notice the large posters featuring a happy, smiling young girl. This is not an advertisement. The text with the picture reads in Belarusian: My first word in my native language – love. And there is also a question aimed at the viewer: What will be your first word in your native language? The posters are part of a government campaign to promote the nation's titular language, Belarusian. This message is initially confusing, as it seems to imply that the population is only now going to start speaking its native language. However, in the Belarusian context, "native language" does not normally refer to the first language spoken by a particular individual, but instead to the official language of the nation in which they grew up. The native language mentioned in the campaign is thus not the language the audience actually learned during early childhood, but the language they are assumed to identify with.

Interest in learning and using the Belarusian language is increasing. Several civic initiatives are offering free language courses. Perhaps more remarkable is the fact that the Belarusian President, Alexander Lukashenka, has spoken in Belarusian at several public events in recent times, and has emphasized the importance of the language for the nation. This is a significant change in a president who had previously refrained from speaking Belarusian in public and had also spoken disparagingly of the language. After Lukashenka came to power 20 years ago, and in the wake of the referendum on language that followed, Belarus has had two official languages. Of these, Russian has been dominant. Those who consistently prefer to speak Belarusian have encountered major practical difficulties. In censuses, the majority of the population has indicated Belarusian as their native language, but sociological studies show that only a quarter of the population actually speaks the language, and only a few per cent use it on a daily basis. But even though the language is not used to a great extent, it is present in other ways. It has a prominent role in public events with an emphasis on Belarusian culture or when the intention is to express loyalty to the Belarusian nation.

Most political parties – and even the Francišak Skaryna Belarusian Language Society – have abandoned the demand for Belarusian to be the only official language. There is now an understanding that an altered linguistic situation requires both patience and an understanding of the needs of the population. However, efforts to promote the use of Belarusian must above all be seen in the context of the need to strengthen the national identity. This process involves finding symbols of national identity regarding which there is a broad consensus and which can be effective boundary markers against more powerful neighbors. The regional crisis and the perceived threat to the republic's very existence have reinforced these efforts. So is this new found linguistic interest demonstrated by the President and the political elite just opportunistic? And how has this interest been received by those who have long fought for a stronger national identity? Many feel that this is too little, too late. The role of language as an indicator of a position of opposition also makes it difficult for many to unite with the President on the issue. However, there is criticism of this attitude.

One example is the political analyst Artiom Shraibman, who recently argued in an article on tut.by, the leading Belarusian internet news portal, that it is not only an opportunity to exploit the regime's interest in what the opposition has been striving to achieve for 20 years, but also a necessity. The Ukraine has been at its most unstable in regions where Russian speakers are in the majority. To that extent, says Shraibman, the whole of Belarus is exposed, and the government's change in attitude should be exploited, regardless of whether this is primarily driven by self-interest.

For the political opposition, the language has long been a component in a political vision intended to constitute an alternative to the policies carried out by the current government. Quite unexpectedly, this component now appears to have become part of the current regime's survival strategy. The situation is thus both complex and, in some respects, hopeful. Opportunities to promote the Belarusian language – both as a means of communication and as an element in a clearer national identity – seem to be greater than they have been at any time since the early 1990s. However, with the forthcoming presidential election and the likely continued uncertainty in terms of the economy and regional security issues, priorities may quickly change. It therefore remains to be seen whether the increased interest by the population in the language becomes permanent and whether the President's promises regarding an altered language policy will actually become reality. ■



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# Nordregio in the Baltic Sea Region

Expert article • 1667

**E**stablished by the Nordic Council of Ministers in 1997, Nordregio is a research institute mainly within social sciences. We are working with international comparative research and are active in European scientific networks and programmes, including ESPON, Horizon 2020 and Territorial Cooperation Programmes such as the Baltic Sea Region programme. With a diverse setting, including researchers from 12 countries, Nordregio is well suited to consider a range of perspectives on the implications of post carbon cities in Nordic, European and global settings. Research at Nordregio follows the three broad categories of Territorial Development, Governance, and Society & the Environment.

Nordregio specializes in international comparative and collaborative research. Using leading-edge skills, quantitative and qualitative analyses is carried out on a range of geographic scales. Urban resource efficiency – from the building to regional scale – governance, regional development, spatial planning, innovation and entrepreneurship, green growth, global climate change and local adaptation are among our major areas of interest. Our research competencies include the production of high-quality maps and the development of state of the art statistical databases.

The Baltic Sea Region (BSR) has always been an interesting geographic space for Nordregio. Three Nordic countries, namely Sweden, Finland and Denmark as well as the autonomous region of Åland are part and member states of the BSR. Since its establishment Nordregio has done policy relevant research in the BSR that has especially been interesting in terms of spatial development due to the political changes and the enlargement of the European Union. Between 2007 and 2008 Nordregio was involved in the East-West Window project and produced the report “Exploring the Baltic Sea Region – On territorial capital and spatial integration”. In 2014 Nordregio finalized an ESPON project on territorial monitoring for the Baltic Sea Region (ESPO TeMo).

Furthermore Nordregio has a proven track record in projects funded by the Baltic Sea Region and Central Baltic programmes supporting regions in addressing challenges by integrating EU policy goals into spatial planning processes. To give some examples during the last programming period Nordregio worked with the concept of quality of life and rural urban interaction (NEW BRIDGES 2008-2011), adaptation to climate change (BaltCICA 2008-2011), labour mobility (Centralbaltic Job Ferry 2011-2013) and flexible working arrangements (FLEX 2010-2011). As a research partner Nordregio supported the analytical work as well as facilitated transnational learning among project partners. Project reports and policy recommendations are usually products produced and disseminated by Nordregio.

Focusing on spatial planning processes Nordregio has interestingly been observing the development of the Baltic Sea Region as EU's first macro-region since the European Strategy for the Baltic Sea Region (EUSBSR) was launched in 2009. The same year Nordregio produced a scoping study on EU macro-regions and macro-regional strategies as well as started analyzing the potential added value of developing a climate change adaptation strategy at macro-regional level from a territorial governance perspective.

Besides cooperating with e.g. regional planning authorities, research institutes and NGO's in projects, Nordregio also cooperates closely with pan-Baltic organizations such as the Union of the Baltic



Baltic Sea Region (BSR) with regional boundaries: Cooperation Area. Map layout: Linus Rispling, Nordregio

Cities (in the NEW BRIDGES project), VASAB: Vision and Strategies around the Baltic Sea 2010 (in the East-West Window project) and the Council of the Baltic Sea States (CBSS). Nordregio is a member in CBSS Expert Group on Sustainable Development – Baltic 21 and provided a background paper that is envisioned as a main source of input for the formulation of the Strategic Action Plan for 2010-to 2015 on climate change.

In different kinds of projects and initiatives Nordregio will continue providing policy relevant research results in the broad field of regional studies and supporting policy- and decision makers in cities and regions across the BSR to achieve regional, national and EU policy goals. The Europe 2020 Strategy and the EU Strategy for the Baltic Sea Region (EUSBSR) are two central policy documents influencing regional development and planning as well as the upcoming programming period 2014-2020. ■

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# Nordic branding

Expert article • 1668

**O**n the Seas of the World, Norway has always been large. In 1868 our national poet Bjørnstjerne Bjørnson wrote about how white sails had earned us our power and glory. Until then, and for a hundred years to come, this power and glory was associated with ocean hunting, fishing, shipping, marine research and polar expeditions.

A new era in Norway's maritime history was initiated in 1968, when hydrocarbons were found in the Cod field in the Norwegian North Sea. The discovery was made by United States Petroleum Company Phillips. Together with my colleague, Peter W. Smith, I stood some time later for a spectacular and successful marketing of engineering works for the Cod field development by Kvaerner Engineering. I was the project manager for the implementation of the same works, in collaboration with a number of Norwegian and foreign consultancy firms. Many Norwegian engineers debuted then in the offshore sector.

With this, and later discoveries, good Norwegian sailors and shipping companies, engineers, professionals and industries, and last, but not least, politicians and bureaucrats, had new sea-oriented disciplines to master, such as Offshore prospecting, production, and landing of petroleum in sustainable ways. Until then, it was a profession dominated by the US, French, Dutch and British.

The Norwegians took the challenge and opened the continental shelf for foreigners with hard, but predictable conditions which among other things contained strong rewards for technology transfer to the Norwegians. We did not need to be asked twice to take part in the challenge, and eventually to take over.

We concentrated on being able to crawl before getting on our feet. The initial fields were in areas with reasonable depths, good bottom conditions, moderate weather and climate conditions and solid and predictable reservoirs. On the road towards more difficult conditions in all these parameters the brave Norwegians used their continental shelf as a laboratory for further technology development. Ultimately, on this road, some of our process systems ended up on the bottom of the sea, as subsea installations. Now we have a hegemony to defend. Norwegian oil technology has a good market share on all continental shelves around the world.

At home we are facing a relocation of the centre of gravity of the petroleum industry towards the North, in Norway and Russia, with new challenges. Dark, poor visibility, snow, cold, unpredictable and rapid weather changes due to polar low pressures, ice and icing. On top of all this; extended communication, life-and health-related and social infrastructure, all in a very vulnerable ecosystem that needs to be protected and preserved. However, this is where the major resources are located, with the welfare of the world depending on their utilization, sooner or later, and we will handle the challenges.

Our society has a high level of welfare and a similarly high cost levels. Benefits that many of us, in line with our social democratic values, would like to share with the rest of the world. We believe that there are tasks and opportunities for all, but at the same time we want to be more proficient and lead the way in the development of products and services which we have so far concentrated on and have had special conditions for. We have put into use knowledge, skills, traditions and technology to help us in being competitive. We concentrate on doing things right the first time. We implement practical quality assurance, and we make extensive use of automation and robotics.

In the very recent past we have been threatened by the placement of big contracts in low-cost countries in far-away lands. It has not been successful. We are experiencing large cost and time overruns and quality failure. We want to take these tasks back home in order to make them more successful and more affordable but most of all because we want, and need, to be the players and not the audience. We do not get to keep our hegemony if we leave the implementation of complex tasks to others.

At the same time, we see that the needs for expertise, capacity and competitiveness can exceed what Norway can provide, at which point it is natural to see how we can work together with our good industrial neighbours.

We have in the first instance investigated carefully what we can find in Finland and we are impressed with their expertise, capacity and competitiveness. Finland's Arctic experience is highly needed in the North. Further, Finland's excellent educational system is known as well as their IT expertise. We also find advanced production technology and a number of companies with a broad technology spectrum.

Additionally we are confident that if we look to Sweden, Iceland and Denmark we will find more than we can use: Nordic cooperation, 25 million heads and twice as many hands to bet on. Unbeatable.

Various historic assumptions have led to the fact that the Nordic countries have chosen or have to choose different Associations relative to the rest of the world. However, I see nothing that stands in the way of an increased Nordic cooperation on many fronts. Let the maritime industrial sectors work together to be a rose in an ever more beautiful and larger Nordic collaboration bouquet. ■



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# Summer 2014 – a tale of two seas

Expert article • 1669

**L**ast summer broke records – both in a good and in a bad way. In the east, i.e. in the Gulf of Finland, waters were as clear as ever witnessed, whereas west of Hanko we had miles long blooms of blue-green algae. The main reasons for the water clarity in the Gulf of Finland were the effective measures taken in waste water treatment of St. Petersburg and mitigation of phosphorus discharges from the Phosphorit factory in Kingisepp. At the same time, the disaster in the Archipelago and Åland seas was caused by the great phosphorus reserve, collected over time in the deeps of the Baltic Proper some of which was released by strong winter storms and transported into the Finnish waters.

The exceptionally hot summer was a veritable acid test for the condition of the Gulf of Finland. Still, the waters remained clear. Two individual actions have had the greatest impact on the unprecedented clarity of the Gulf of Finland: improved nutrient removal from the wastewaters of St. Petersburg, and the cessation of phosphorus discharges from the Kingisepp gypsum pile. Together, they have decreased the annual phosphorus load of the Gulf of Finland by an amazing 60%. According to the Finnish Environment Institute (SYKE), in July – August average chlorophyll levels – which correspond to the volumes of algal blooms – were lower than at any other time in the 2000s at the eastern observation sites of the Gulf of Finland.

This proves that the recent water protection co-operation between Russian and Finnish public and private organisations – water utility of St. Petersburg; EuroChem, the owner of the Kingisepp fertilizer factory; John Nurminen Foundation; and the Finnish government – is bearing fruit, which both ordinary citizens and research institutes can witness in the form of clear waters. Despite this, we cannot become complacent as regards the Gulf of Finland, thinking that the good situation of this summer would be permanent. The oxygen status and phosphorus concentration of the Gulf are strongly influenced by the sporadic currents from the deep waters of the Baltic Sea's main basin far into the eastern areas of the Gulf of Finland. What will next winter bring?

Although we cannot influence sea currents and winter storms, a lot can be done to reduce external loading to the Baltic Proper. The fastest and most efficient way is to cut the discharges from the main point load sources in the catchment area.

As an example of effective means to reduce nutrient load to the Baltic Proper, the EU part-financed PRESTO project invested in improving the efficiency of nutrient removal in the three Belarusian cities of Grodno, Vitebsk, and Molodechno. The Foundation was responsible for technical plans and investments related to improved nutrient removal, which reduced the annual phosphorus load from these sources with hundreds of tonnes.

The Foundation is also working actively with Russian organizations in the Leningrad oblast to even further reduce discharges to the Gulf of Finland. After the project in St. Petersburg, completed in 2011, enhanced phosphorus removal will be started in the waste water treatment plants of Vyborg and Gatchina. In addition to municipal projects, the Foundation has a project dealing with manure leakages from the Udarnik poultry farm, situated in the village of Pobeda some 50 kilometres from Vyborg.

The Foundation is currently working on a number of new projects which aim at reducing the nutrient load of the Sea by improving wastewater treatment especially in Poland, the Baltic countries, Belarus, Kaliningrad and Leningrad regions in Russia.

One initiative under preparation is the EU-funded **BEST (Better Efficiency for Sewage Treatment)**, where the main partner is City of Helsinki Environment Centre. Other key partners include the City of Warsaw and a number of water utilities and authorities in Poland and the Baltic countries. The goal is to improve waste water treatment in the new EU member countries to match the HELCOM recommended treatment level and to improve co-treatment of municipal and industrial waste waters in the whole Baltic Sea region. The project has been nominated as a potential flagship project of the EU Baltic Sea Strategy.

Another new initiative of the Foundation, also a potential flagship project of the EU Baltic Sea Strategy, is the **NutriTrade** project. Nutrient trading has for long been considered as a promising way to cost-effectively reduce the nutrient load of the Baltic Sea. The goal is to launch the first nutrient trading scheme and marketplace across the Baltic Sea.

The battle against eutrophication continues. We will continue our efforts towards a cleaner Baltic Sea. There are no miracle cures, but this summer was enough to prove that with effective and fast measures focused on largest pollution sources, we can achieve a visible improvement in the condition of the sea already during our lifetime. ■



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# Maritime transport in the Baltic Sea from a global perspective

Expert article • 1670

All countries whether they are developed, developing, littoral, landlocked or small island developing states depend almost exclusively on maritime transport to carry their international trade. With 80% of international merchandise trade by volume and over two-thirds by value carried by sea, maritime transport has for millennia been the backbone of international trade. The volumes carried and the distance travelled by maritime transport continue to grow. In 2013, world seaborne trade volumes grew by 3.8% to reach nearly 9.6 billion tons and measured in distance this amounted to some 50,000 billion ton–miles.

The Baltic Sea region is important for trade in commodities such as oil, wood, minerals and grain, as well as in importing and exporting finished and semi-finished goods carried in containers. UNCTAD estimates that container port throughput for the Baltic Sea region in 2013 stood at around 10.1 million TEU up from 9.8 million TEU in the previous year. This equates to growth at 3.4% which is below the world average growth of 5.6% for the same period. The growth gap between the regional average and the world average means that the Baltic Sea region's share of world container throughput declined from 1.59% in 2012 to about 1.56% in 2013.

The significance of the Baltic Sea region in international trade with the rest of the world should however not be underestimated. UNCTAD's Liner Shipping Connectivity Index, a tool measuring how pairs of countries are connected by container liners services, shows that of the 10 countries in the Baltic Sea region half (Germany, Sweden, Denmark Poland and the Russian Federation) have significantly increased their connectivity to other countries within the last decade. The most notable gain is that of Poland which moved from being ranked the 90th most connected maritime country in 2004 to 24th position in 2014. Favourable geographical positioning close to a large prosperous population with access to emerging neighbouring markets as well as infrastructure developments such as the Deepwater Container Terminal in Gdańsk have all contributed to this meteoric rise.

Today the region has been offered an opportunity to engage in developing best practices and experiences in implementing new standards on ship's emissions. The latest IMO regulations (Reg. 14 - Annex VI - MARPOL) which is due to come into force on 1st January 2015 aims to improve air quality by limiting sulphur emissions from ships in Emission Control Areas (ECA) such as the Baltic Sea region to 0.10% m/m. To do this, Shipowners may have to retrofit existing vessels with scrubbers or order new fully compliant vessels from shipyards. This comes at a time when other areas outside the ECA are subject to the less stringent regulations where emissions are capped at 3.50% m/m until 2020. Yet, it is important to remember that within the ECA there will be a level playing-field and sooner or later that playing field is likely to be extended globally. Thus what is happening in the Baltic Sea region today could become a global standard tomorrow.

Looking at the bigger picture, the IMO regulations are part of general UN wide drive to push sustainability onto the global agenda. Indeed, in 2015 the United Nations is expected to adopt Sustainable Development Goals (SDGs) to build upon the Millennium Development Goals (MDGs). Having gone through a series of consultations

with numerous international experts at the Open Working Group, these SDGs are expected to be finalized for adoption at the United Nations General Assembly in New York in September 2015. The new goals will take into consideration the outcome of the Rio+20 conference in 2012 by addressing a multitude of issues on sustainable development, not least how to achieve continued development with the least impact upon the environment. Shipping emissions have lagged behind other transport modes emissions because the pollution occurred largely at sea and unseen. Ship emissions were until very recently 1400 times more polluting than the average diesel car and therefore it was only a matter of time before change was due.

The Baltic Sea region, along with other ECA has a role to play in shaping how the rest of the world handles the consequences of increase volumes of international trade and the corresponding impact upon the environment. The new IMO regulations should be seen in a positive light. By being amongst the first to adopt measures which will make shipping more efficient there could be first to market advantages. This may lead to new opportunities for market leaders to generate new revenue streams. However, sustainability in transport is not just about the environment but includes economic and social aspects such as the need to achieve economic efficiency and viability while providing safe and secure infrastructures and services. Importantly, improvements in one area are likely to lead to improvements in other areas which when combined can lead to a better safer and cleaner world for all. ■

Disclaimer: The views in this article are those of the author and not necessarily those of UNCTAD or its member states.



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# Baltic Sea – the sea of information?

Expert article • 1671

**D**uring the last decades it has been often stated that we are drowning in a rising sea of information. Not many of us would challenge this argument when thinking of the surge of e-mails, reports, analysis, news, etc. pouring in to our daily life. Never has it been so easy to obtain information on almost anything you can think of. At the same time a variety of information needed for e.g. ensuring safe and environmentally friendly sea transport system is still not available. We are in the process of understanding our present and future information needs but we are struggling with the means to achieve it. And while trying to make the most of the information available we note that the information is meaningless without a way to locate, filter, organize and summarize it.

Major trends shaping our world are globalization, digitalization and deregulation. Of these digitalization enables the further development of globalization and deregulation and is often seen, together with the possibilities created with deregulation, as the solutions to Finland's urgent need for economic revival.

Transport authorities are working to facilitate digitalization and deregulation. Realization of both requires readily available quality information. In search of the new, more effective and less manpower consuming modus operandi the fundamental role of information has been acknowledged and, to show it rightful status, information has now been recognized as the fifth transport mode. The aims of increased safety and efficiency for maritime or any other transport mode can no longer be achieved without comprehensive availability of relevant information.

One of the drivers for more information intensive authority work is the fact that traditional safety by rule compliance has not ensured desired level of safety. It is time to move towards safety performance thinking where preventive safety consciousness and risk informed approach is an integral part of each action taken onboard. To enable this more and more reliable information is needed. All this is needed to realize a new risk informed decision and rule making regime amongst authorities. It can be argued that all efforts to improve safety are based on information and analyses of it. It is, therefore, safe to say that information forms the foundation of the efforts to improve safety, carried out by all parties, including the shipping industry and the authorities. Unfortunately, obtaining comprehensive and reliable information still remains difficult, or impossible even. By international comparison, however, Finland is one of the leading countries in maritime data exchange between maritime safety authorities. Despite this, the majority of information required for safety work is only available at the production source, or is not stored for further use. On that note, in recent years information, storage, management and sharing have become one of the performance development targets in national, EU-wide and international forums.

On a European level the SafeSeaNet (SSN) system is an example of successful information sharing among the maritime transport sector. An important phase in the development of SSN will be reached when the national centralized single windows will be connected to SafeSeaNet in June 2015, enabling even wider collection and exchange of maritime transport related data. Another important

EU-driven initiative is the Common Information Sharing Environment (CISE) development. In Baltic Rim Economic 2014 issue no. 4 Minister of Defence Carl Haglund raised the importance of this initiative. The objective of CISE is to create situational awareness that supports effective decision making among authority functions related to maritime safety and security, coast guard services, marine environment, fisheries control, as well as law enforcement and national defence activities in general. The main difference compared to SSN is the more comprehensive approach entailing all maritime and marine authority functions. The authorities themselves have a significant role in this initiative but the development work should strongly strive to take into account the public sector objectives concerning the open access to and reusability of digital datasets. This objective has also been incorporated into the Maritime Transport Strategy for Finland, published in the spring of 2014, and into the background materials of the future outlook report by the Ministry of Transport and Communications. Information and digitalization are also useful ways of gaining a competitive edge. With this in mind, the future outlook report states that clear goals and timetables should be set for the opening up of public data resources and the related interfaces, as well as creating common management policies for information sharing and integration.

Decision and rule making should always be based on latest knowledge and state-of-the-art analysis combined with the societal facts and, to a certain degree, to political ambitions. Trafi has chosen the production of information and information-sharing environments as one of its strategic projects and is implementing the measures required for ensuring the availability of information described in the above-mentioned EU- and national initiatives and strategies. One step to this direction is the new maritime information storing and sharing environment 'PURKKI' built by Trafi since 2012. Another important project is the management of occurrence and hazardous situation reporting. With these projects and continuous data analysis Trafi wants to ensure that information is available through standardized interfaces 24/7 for all marine stakeholders according to their personalized rights by means of machine readable coding.

Information is a source of safety and new services. That being said, Trafi will continue its efforts to ensure the comprehensive availability and exploitation of data, information and knowledge. Though we are developing the safety and the efficiency of the transport system, information is not only an asset inside a system. Smart seas can do more, better and cheaper. ■



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KIMMO MÄKI

# Port of Helsinki on the move

Expert article • 1672

The Port of Helsinki enjoys its position as the capital port of the country. Especially in current times, as the Finnish and the world economy are stumbling, the Port of Helsinki is standing out. Goods still have to move but Finnish export and import traffic handlers seem to be reconsidering their routes. The Finnish economic situation is strongly expressed by the success of Finnish ports. They mirror the state of the country. One has to remember to look at total port traffic figures, not just the success of one port in order to get the big picture. Helsinki's figures are growing. It would be somewhat vainglorious to boast that those figures are always good, but luckily they often are. Throughout this year Helsinki's figures have been on the positive side. Traffic flow seems to have a tendency to concentrate when there is less to deliver.

Nevertheless, the present good situation does not give us reason for complacency. The competition is getting tougher and solutions to carry on business with customers need to be found. Flexibility is one of the keys. The Port of Helsinki is eager to find new ways to work with customers and also the surrounding areas' operators and stakeholders, such as residents. The location itself needs to be earned by the port in a quite outspoken way.

West harbour is the biggest and ultimately most important development area for the Port of Helsinki. The challenge is a demanding one as the harbour lies in the very heart of a housing and office area and the traffic cannot be moved away for the construction period. As the housing area is being built simultaneously the new residents are alert and the passengers' travelling comfort endangered. The aim is to develop the port activities, their efficiency and the smooth flow of traffic. All this is to be done with the residents' interests heard taken into account. This is a show case of how to integrate the surroundings in a development work. It also expresses the split role of a port to work for the good of a shipping company and at the same time that of the residents. They may coincide at times.

Being the number one port in Finland, Helsinki has the right and responsibility to lead the way in port business. This means that we also fight in the first line. New demands, challenges, hopefully also opportunities need our attention. The solutions have to meet the expectations and the standards we ourselves are setting. Come e.g. the ever tightening environmental regulations as the soon – as of Jan. 1 2015 – to be SECA regulation. One challenge is that there are many ways to reduce the amount of sulphur in the fuel. Shipping companies have different solutions, such as LNG, MGO, scrubbers, and ports need to have a way of handling all these if there is a serious will to remain in the business. Earth powers and its delivery are another issue.

It would be easy to say that the regulations limit the creativity of business, but they can also nourish it. As the price of the fuel is most likely changing, it will most probably affect the logistic structure of the Baltic Sea. Helsinki and Tallinn ports have started a cooperation to increase the smoothness of travelling and to enable the growing number of passenger and cargo to pass through the centrally located ports. The passenger number is nearly 8 M already and the figure is expected to grow, not just of holidaymakers but also of business travellers and commuters. West harbour is an important node for shuttling between Helsinki and Tallinn, enriching the economic life and commerce on both ends.

The EU originated law to privatize publicly owned organisations operating in the market economy has been passed in Finland. Due to this Port of Helsinki will become a limited company as of 1st January 2015. Port of Helsinki wants to use this opportunity to reconsider its brand at the same time when some of the duties related to city ownership are being redefined and there is a strong will to make the company even more market oriented. This has meant some inner activities in addition to the actual administrative effort the process demands. The aim and expectations are high.

Even though times are tough, some light is at the end of our tunnel. A letter of intent has been signed to take care of pulp export in the future for Metsä Fibre Oy. This will, as it becomes efficient, increase the Finnish economy and not the least our traffic by up to 10 % on a yearly basis. The final decision to make the investment will take place this coming spring. It also needs some adjustments in the infrastructure. But it does have an employing and definitely enlivening effect. This is a major development in a good direction. ■



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JOHANNA BOIJER-SVAHNSTRÖM

# Viking Line's commitment to environmental work

Expert article • 1673

**T**he first genuine Baltic Sea car ferry, the s/s Viking was placed in traffic between the Finnish mainland, the Åland islands and Sweden in 1959. Many people viewed these new ferry ventures with scepticism, but they later realized that this was the first phase of an almost revolutionary expansion in ferry communications.

Today, over 50 years later, ferry services provide a vital link between mainland and islands and play an essential role in transportation of goods and passengers. The services also include devoting great attention to environmentally friendly solutions. Through a long-term, active commitment to the environment, Viking Line has developed environmental work that extends beyond what is stipulated on the Baltic Sea. The company's head office, all vessels and subsidiary Viking Line Buss Ab are certified according to the ISO 14001 environmental standard. Viking Line's organisation and all vessels are certified in accordance with the ISM code (International Safety Management).

## Minimizing atmospheric emissions

Viking Line's environmental work focuses on its vessel operations, where the largest gains can be made when it comes to safeguarding our environment. The European Union's new sulphur directive, which will get into effect in January 2015, lowers the threshold for Baltic Sea maritime services to 0.1 per cent sulphur by weight. Six of Viking Line's seven vessels will use low sulphur fuel with a sulphur content of less than 0.1 per cent by weight, in order to reduce sulphur oxide (SOx) emissions. The new Viking Grace operates on liquefied natural gas (LNG) whereas sulphur emissions are virtually eliminated.

Two of the Company's vessels operate using a land based electricity supply while they are docked during the daytime in Helsinki and in Stockholm. Using land based electricity decreases emissions of air pollution and engine noise in ports and their vicinity.

Viking Line has also an internal programme to reduce exhaust gas emissions. In this programme, vessel operating staff and the Company's technical department are working to introduce fuel efficient methods of manoeuvring vessels.

## No discharges into the sea

Two main types of wastewater are mainly formed on the vessels: grey water and black water. Black water is wastewater from toilets, and grey water comes from showers and other washing activity. Bilge water, which contains oil, originates in the engine rooms of vessels. Viking Line vessels discharge neither wastewater nor bilge water into the sea. In order not to burden the Baltic Sea, the Company's vessels pump all their wastewater ashore.

## All waste is taken care of, bio waste to production of biogas

All solid wastes generated aboard Viking Line vessels are brought ashore for subsequent recycling, reuse, combustion, depositing in landfills, composting or other waste management by an approved recipient. On the Viking XPRS and the Viking Grace, equipment has been installed to make efficient sorting and collection of bio wastes possible. On the Mariella, all bio waste is collected in receptacles. The bio waste is then transported to a digestion plant for production of biogas.

## Environmental thinking is also visible in Viking Line's shipboard customer services

Viking Line chooses organically grown coffee as one element of its efforts to practice environmentally conscious procurement. When purchasing the seafood that is served on board its vessels, Viking Line follows the Swedish Environmental Management Council's list of sustainable fish and shellfish stocks. The Food Garden restaurants on Viking Line vessels no longer sell table water in plastic bottles. Instead they serve specially purified water poured directly from the tap into an environmentally themed reusable glass bottle.

## Divers clean the bottoms of vessels

Instead of using environmentally hazardous paints on the bottoms of vessels, their hulls are brushed by divers several times each year. In May 2013 this work was demonstrated to the media in Helsinki. Starting in the summer of 2013, Viking Line has used an upgraded brushing method that was developed and patented by the DG-Diving Group. The upgrade involves collecting all growths loosened from the bottoms of vessels during brushing into a separate container, which is then brought ashore for further treatment.

## The Viking Grace

The Viking Grace is the world's first passenger vessel in its size class that can run on liquefied natural gas (LNG). Natural gas creates substantially less hazardous emissions. Nitrogen emissions and hazardous particulates are reduced by 85 per cent and greenhouse gases by 15 per cent. Sulphur emissions are virtually eliminated. The vessel's hydrodynamically optimized hull design and highly efficient drive technology results in major energy savings. Efficient ventilation units, whose air flow varies in response to the prevailing external and internal circumstances, lead to further savings. Other factors that result in high energy efficiency are the heat recovered from the air conditioning system and the engine cooling water, the advanced galley energy management system, the high insulation resistance of the windows and the vessel's light structures. The lighting on board largely consists of LED technology. This technology is used in all entertainment and in 90 per cent of the vessel's public areas. ■



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# Knowledge transfer and international co-operation – Polish Maritime Cluster and Gdynia Maritime University experience

Expert article • 1674

The Polish maritime economy with about 12 000 enterprises is the important part of the blue sector in the Baltic Sea Region. With more than 2 bln zł total investment every year blue economy is the most innovative sector in Polish economy. Polish maritime sector is the area of innovation and sustainable growth. Maritime sector had 88 100 posts of employment in 2012 and generates 27325,7 mln zł revenues from total activity. Polish Maritime Cluster has a strong position in Baltic Sea Region and EU blue economy.

## Baltic Sea Region cooperation

During the participation in StarDust/Marchain project, Gdynia Maritime University (GMU) and Polish Maritime Cluster (PMC) took part in several international initiatives, established cooperation with many interested parties from the BSR and represented the region on the annual meeting of European Network of Maritime Clusters. What is more, they organized a conference for Marchain partners in Gdynia and prepared two projects, which might be realized in the future.

Marchain Project partners have met in Gdynia, Poland in order to exchange the experience and knowledge connected with conducting maritime projects and to set path for further cooperation, including the development of potential projects. In the beginning participants enjoyed a study-visit to the harbor. On the second day meeting was held at Economy Faculty of Gdańsk University in Sopot in connection with the InfoGlobMar conference organized in cooperation of Gdańsk University and GMU. The aim of the Conference was to provide the answers on the questions concerning the possibilities of development for maritime related enterprises in global environment.

During the summer 2014 GUM and PMC prepared two project applications for the Seed Money Programme. The former is called "BSR-COR" and is related to the intermodal shift and transport issues and was submitted for the Transport Priority Area. The latter – "Baltic Promise" aims at strengthening the overall image of the BSR by promoting common CSR code in regional SME's. It was submitted under the PROMO Horizontal Action and support from the HA coordinators was already received from the Seed Money Office.

## European Maritime Clusters Network

Gdynia Maritime University and Polish Maritime Cluster represented BSR and Marchain on Yearly European Network of Maritime Clusters in Lisbon (2013) and Sofia (2014). During the meeting that gathered the representatives of the European Commission and some of the most active maritime clusters from the European Union several important issues was discussed concerning the EU maritime policy formulation and further developments in cluster networks and EU maritime economy. Thanks to semi-formal talks with EU Commission representative, Polish Maritime Cluster gained support for realizing maritime cluster projects in the BSR and advice on obtaining the possible funding.

## European Maritime Day 2014 in Bremen

The programme of EMD 2014 was opened by the workshop entitled: "Bridging education and maritime economy in the Baltic Sea Region" organized by the employees of Gdynia Maritime University (Economy and Management Department) and the board of Polish Maritime Cluster. The workshop covered the issues of education and business in the maritime economy. Referring to more than 90 years of experience of Gdynia Maritime University and the Polish Maritime Cluster, the author, using the examples from Poland, presented the ways of knowledge transfer between universities and enterprises (especially from Pomerania maritime economy). The most common activities include: internships and meetings of various scientific circles and individual students in enterprises with managers of companies, promoting preparation of engineering, master's and doctoral dissertation closely related to the business practice, organizing seminars with the participation of representatives of the government, business and science, and conducting joint research projects. ■



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# Cooperation in marine environmental monitoring in the Baltic to support future policy needs

Expert article • 1675

**M**arine environmental monitoring in the Baltic Sea is carried out by the Member States, some aspects being further regionally coordinated than others. HELCOM, The Baltic Marine Environment Protection Commission, has a long history for coordinated monitoring between the nine Baltic Sea coastal states for hydrography, nutrients, hazardous substances, radioactive compounds, phytoplankton and zoobenthos through the COMBINE, PLC and MORS programmes, and partly coordinating monitoring of seals, zooplankton, phytobenthos and coastal fish. However, further coordinated monitoring efforts will be needed especially for seabirds, non-indigenous species, marine litter and underwater noise to support policy needs in the future.

The EU Marine Strategy Framework Directive (MSFD) provides legally-binding requirements for EU Member States to take the necessary measures to achieve or maintain Good Environmental Status (GES) by the year 2020. For this purpose, Member States must regularly assess the environmental status, define GES according to 11 descriptors, and set environmental targets for their seas. Member States are also required to establish and implement coordinated monitoring programmes for assessing the environmental status of their marine waters and to do so in a regionally coordinated manner. Member States were asked to report their monitoring programmes (Article 11) to the European Commission by October 2014.

Current monitoring in the Baltic covers monitoring for the Regional Sea Conventions, such as HELCOM COMBINE, PLC and MORS programmes, as well as monitoring for the EU Water Framework Directive, the Environmental Quality Standards Directive, the Habitats and Birds Directives and the Common Fisheries policy. Further monitoring programmes will, however, need to be developed, since not all biotic and abiotic elements and pressures are covered by existing monitoring. The future monitoring programmes should be able to provide data for the calculation of indicators in order to assess if GES has been achieved and to assess the effectiveness of measures.

As the coordination platform for regional implementation of the MSFD in the Baltic Sea, through the HELCOM GEAR working group, HELCOM is the fora where coordination and comparability in relation to monitoring and data products can be ensured. Regional coordination should ensure that similar sampling, analysis and data storing methods are being used by several countries within a marine region. In order to enhance further coordination in monitoring for MSFD and the Baltic Sea Action Plan (BSAP), HELCOM with support from the EU co-financed Baltic Sea Pilot Project: Testing new concepts for integrated environmental monitoring of the Baltic Sea (BALSAM), published an online HELCOM Monitoring Manual in October 2014, which gives an overview of current environmental monitoring in the Baltic, and can also be used by EU Member States in their MSFD Article 11 reporting.

The BALSAM project (2013-2015), specifically focusing on improving coordinated monitoring in the Baltic to support MSFD and BSAP needs, is proposing monitoring guidelines for seals, seabirds and benthic habitats, which have been identified as gaps in HELCOM monitoring. The project is also developing regional databases for seal abundance and distribution data as well as a metadatabase for seabird monitoring to improve data sharing in the future. Data management and infrastructure are also being evaluated and further cooperation in the use of research vessels and access rights are being studied with proposals for improvement. These upcoming results will be presented to the Member States and HELCOM working groups and can offer a step forward in coordinated, comparable and more cost-effective monitoring efforts. ■

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DESISLAVA DIKOVA

# Entry mode choices of MNCs in the Baltic Sea region

Expert article • 1676

**F**oreign capital has been of great importance for economic development in the Baltic region. This explains the abundance of analyses focused on various aspects of foreign direct investment (FDI) such as stocks of FDI, types of FDI (vertical or horizontal), origin of FDI and factors that attract foreign investors (for example political stability, control of corruption, advanced infrastructure and skilled labor among many others). What has received far less attention is the issue concerning the type of foreign-market entry, or entry modes, used by foreign investors to establish their presence in the Baltic countries. As a result there is relatively little discussion about how investors choose their entry mode and whether these entry modes bring different types of benefits.

There are two basic entry modes, an acquisition and a greenfield. Establishing a foreign subsidiary via an acquisition entails a corporate action in which a company buys most, if not all, of the target company's ownership stakes in order to assume control of the target firm. The alternative mode choice, a greenfield is the investment in a new manufacturing, office, or other commerce-related facility from the ground up. The decision to create an effective subsidiary unit through greenfield or acquisition is of critical importance because it is difficult and costly to reverse and has a significant impact on overall firm performance. So, are there any benefits for investors to use a particular mode of entry in the Baltic region? There is no conclusive evidence that acquisitions outperform greenfields or vice versa. However, acquisitions tend to be preferred by multinationals investing the Baltic region because of certain characteristics greenfields do not possess.

First, acquisitions are much faster means to establish presence in a foreign market. Despite the small market size, the strategic geographic positioning of the Baltic states makes them attractive to non-European multinationals which can establish both a European presence, serve the Nordic market and get access to a much larger Russian market. In Estonia for example, where 28% of total FDI originates from Sweden and over 23% from Finland, acquisitions were a means for Nordic multinationals to gain first-mover advantages and quickly establish dominance as regional players. Second, an important driver of cross-border acquisitions is industry structure. Industries like banking, insurance, food and beverages (beer), among many others, require significant adaptation of products and/or services to local market specificities. This implies profound understanding of customers' preferences, gaining customers' trust or simply getting access through established distribution systems to a large number of customers. In such multidomestic industries (as opposed to global industries such as electronics), investments in the Baltic region were

mostly acquisitions. Third, acquisitions were very popular in the early 1990s when the Baltic countries either opted for privatization through direct sales (like Estonia) or used a mix of vouchers and direct sales (like Latvia and Lithuania) to attract FDI. Although privatization-driven acquisitions accounted for a small fraction of total FDI inflows (in Estonia only 17% and in Latvia 25%), they generated further interest in local acquisitions as a way of getting access to cheaper but skilled labor. Finally, investors with little or no local experience prefer to acquire firms because this allows them to procure complementary capabilities (local knowledge) and negate the liability-of-foreignness effect.

Greenfields have been rare in the Baltic region. However, increasing the number of greenfield projects is seen as a way of boosting economic development. For example, the Lithuanian Development Agency (LDA), county administrations and municipalities, promote greenfield investments by providing suitable assistance, technical documentation and training. According to fDiMarkets.com, the largest share — 76% — of foreign investments in Lithuania in the first ten months of 2012 were new greenfield investments. So what caused the change-of-heart in policy-makers who now exceedingly promote greenfields? For one obvious reason greenfields, unlike acquisitions, generate new jobs which can be extremely appealing in the aftermath of a severe economic crisis. Second, in industries with small number of potential targets, which is the case in all Baltic states, acquisitions are more difficult to negotiate so greenfields are a good investment alternative. Third, studies reveal that greenfields are less likely to be divested than acquisitions hence policymakers may consider greenfields a more solid commitment to the local market. Finally, greenfield projects allow investors to start small before expanding further. This, in addition to the local government support, reduces initial market uncertainty and provides opportunities for a gradual but sustainable growth. ■

Despite the small market size, the strategic geographic positioning of the Baltic states makes them attractive to non-European multinationals which can establish both a European presence, serve the Nordic market and get access to a much larger Russian market.



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# New conditions, new motives and new modes of operations of Western MNCs in Russia

Expert article • 1677

In the years ahead, there will be difficult challenges for multinational corporations (MNCs) currently operating in Russia, as their major motives for operating there are quickly evaporating. Most Western MNCs entered Russia under one of two motives: resource-seeking (getting access to Russia's abundant energy resources) or market-seeking (getting access to Russia's rapidly evolving consumer markets, broadly understood as markets related to a population's needs, including medical diagnostic equipment or rolling stock for suburban commuting. Access to natural resources was already restricted, but in the next few years, it will be further restricted because of growing Russian government suspicion towards Western corporations, preferred access to energy resources being granted to corporations from new "friendly states" (namely, China), and Western sanctions imposed on Western technology providers whose products and services help explore natural resources. Most Russian consumer markets are now experiencing either stagnation or a decline because of double-digit consumer inflation, recent and expected local currency devaluation, and fiscal austerity.

In such a situation, other previously hidden motives for Russian investment by MNCs become manifest, namely, efficiency-seeking and knowledge-seeking. Efficiency may be reached as an amalgamation of cost efficiency due to local currency devaluation and technical efficiency. Several Western corporations have been wise enough to install production capacity in Russia to serve both local and foreign markets. For example, ROCKWOOL's plant in Vyborg supplies insulation materials to both Russia and Finland. A 30% local currency devaluation also makes imports less competitive, strengthening the position of Russia-based manufacturers against the flow of finished and intermediate goods from China. Besides sudden advantages in unit costs due to devaluation, superior technical efficiency is another part of the overall efficiency of Russia-based MNC manufacturing operations. Since many of the recent manufacturing facilities in Russia were greenfield investments, several MNCs (like Peugeot-Citroen) used such opportunities to build the most technically advanced facilities.

The knowledge motive may be profitably explored and exploited in two ways: intensive reverse-transfer of accumulated know-who and know-why from existing Russian subsidiaries and installation of Russian R&D solution networks using new opportunities offered by rapidly evolving local technical universities. There were only 5 Russian universities in the QS World University Rankings in 2006 and 21 in 2014. Local technical universities produce packs of "hungry young wolves," that is, graduate students and PhDs eager to crack down on technical problems at low cost, without regard for their own patent rights and without the "NASDAQ-perspective" of a start-up. To explore new opportunities for R&D offshoring in Russia, new organizational forms are needed. Large R&D projects should be divided into smaller problems, which can be solved by local networks. The partial solutions generated by these local networks can then be re-assembled at corporate R&D centers.

MNCs that operate in Russia based on efficiency and knowledge motives face higher risks, but potentially higher returns. Not all companies currently active in Russian markets will dare to remain. MNCs with activist shareholders attentive to quarterly earnings and a board of directors prone to risk aversion will explore ways to exit Russian markets. At the same time, corporations with higher risk tolerance and a long-term orientation—especially family-owned Western European firms not preoccupied with the 10-Q and other SEC forms—will benefit greatly from treating their Russian subsidiaries as "hidden manufacturing champions" and "backyard R&D centers." ■



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# Consequences of travelers' alcohol traffic between Finland and Estonia

Expert article • 1678

The largest part of travelers' alcohol traffic between Finland and Estonia is made up of Finnish alcohol purchases, both from mainland Estonia and from the ferries plying between the capital cities of Helsinki and Tallinn. But also Estonian citizens living and working in Finland are bringing alcohol with them when entering Finland, and they have also begun to buy alcoholic beverages, especially beer from the ferries when traveling to Estonia.

The main reason for private alcohol trade is that alcoholic beverages are clearly cheaper in Estonia and on the ferries than in Finland. For instance, the price of vodka in Finland is twice the Estonian price. Another explanation for this trade is the proximity of Finland to Estonia, as a ferry ride from Tallinn to Helsinki only takes two hours and there are many daily connections for this route. After the collapse of the Soviet Union in 1991 travelling to and from Estonia became much easier, and is nowadays practically friction-free as both Finland and Estonia are parts of the European Union (EU) and the Schengen area. The possibilities for private alcohol imports increased tremendously in 2004 when Finland abandoned the quantitative quotas on travelers' alcohol imports from other EU-countries in January and Estonia became an EU member state in May.

In Finland changes in unrecorded alcohol consumption and travelers' alcohol imports as a part of it have been followed on the basis of survey data from the late 1960s. Since Estonia joined the EU survey data on travelers' alcohol imports have been collected round the year on weekly basis. The survey data shows that Finnish travelers' alcohol imports doubled just after the Estonian inclusion in EU. In 2005 Finnish alcohol imports were estimated to be 1.8 liters of 100 per cent alcohol per capita, or 17 per cent of the Finnish total alcohol consumption. After 2005 travelers' alcohol imports decreased about a quarter, only to increase with some 20 per cent again after 2007. However, thus far it has remained at a lower level than it was in 2005.

Estonia and the ferries plying between Helsinki and Tallinn are clearly the most important places for alcohol purchases among Finnish travelers. With regard to distilled spirits and wine some 60 per cent of all travelers' alcohol purchases are made on travels from Estonia. With regard to beer, cider and long drinks this share is even higher, about 75 per cent.

As there are 5.3 million Finns and 1.3 million Estonians the amount of Finnish alcohol purchases affect heavily the Estonian alcohol sales figures. For instance in 2013 Finnish travelers' alcohol imports from Estonia was estimated to be 1.1 liters in terms 100 per cent alcohol per capita. These 1.1 liters alcohol per Finnish inhabitant that Finns purchased in Estonia equals 4.5 liters alcohol sold in Estonia per Estonian inhabitant. After deducting these 4.5 liters from the Estonian sales based alcohol consumption figure the average per capita alcohol consumption in Estonia drops from 14.5 liters to 10 liters.

There are no tax free sales in the traffic between EU member states. Consequently, also prices on alcohol sold on ferries plying between Finland and Estonia include excise duties. They are counted according to Estonian tax rates and are also collected by the Estonian state. It has been estimated that about one third of all alcohol sold and taxed in Estonia are purchased by Finns. This means that also about one third of all Estonian tax incomes from alcohol are paid by Finns. In 2013 Estonian state collected 203 million euro in alcohol excise duties.

A figure of 300 million euro is often mentioned as the amount of money the Finnish state loses because of travelers' alcohol imports. It is however calculated on the bases of travelers total alcohol imports, not only imports from Estonia. Furthermore in this calculation it is assumed that all these alcoholic beverages would have been purchased in Finland with prices including the Finnish excise duty rates and Finnish value added taxes. Therefore the estimated loss of 300 million euro is far too high because in a counterfactual world where travelers' alcohol imports would be totally stopped Finnish citizens would not buy the same amount of alcoholic beverages in Finland which they are importing from abroad.

Decreases in Finnish alcohol taxes have often offered as solution to cut the high alcohol imports. In 2004 when Estonia joined the EU and travelers' tax free quotas were abandoned Finland tried to keep the tax base of alcoholic beverages in Finland by lowering alcohol excise duty rates on the average by one third. From 2003 to 2005 domestic alcohol sales rose by some 6 per cent but still the Finnish state lost about 400 million euro or nearly 30 per cent of those alcohol tax incomes the state collected in 2003. After 2007 five alcohol tax increases have raised state alcohol incomes to the level prevailing in 2003. ■



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# The Baltic World – 25 years from the revolutions of 1989

Expert article • 1679

**F**or the past two and half decades, the Baltic Sea Region has been a hub bustling with commercial activity. The region is made of dynamic economies, which have experienced rapid structural change and growth. The Baltic Sea is a major outlet of trade flowing in and out of the region. Many of the countries along the Baltic shores are also significant players in European politics and global affairs.

Seen in a historical perspective, this state of affairs is hardly unusual. Given the size and weight of the major Baltic powers such as Germany and Russia, the 'Baltic World', to borrow a term from the British historian David Kirby, over time accrued more importance than its mere geographic position in Europe's northern periphery would have warranted.

In the Cold War the Baltic Sea Region, however, was one of its many frozen fronts. While it would be wrong to say that traditional links and forms of commercial and societal interaction ceased there altogether, the levels fell far below what the historical record and the inherent potential of the Baltic World would have suggested.

Then came 1989, the annus mirabilis in recent European history. The year of the opening of the Berlin Wall, the end of real existing socialism in Europe and the final, closing acts of the Cold War that had plagued international relations since the 1940s.

By 1992 the face of Europe had changed almost beyond recognition. The two Germanies were again united in one, powerful state. The Soviet Union had fallen apart, with the Russian Federation succeeding what remained of it, and the three Baltic Republics had regained their independence.

As a mirror image of eastern disintegration was western integration. The European Community's internal market project took leaps ahead with the so called 1992 agenda, and the community itself was transformed into the European Union established in the Treaty of Maastricht that year. The first post-Cold War enlargement with Austria, Sweden and Finland lined up for membership, was by 1992 well underway.

Given the constellation of the stars lighting the Baltic World after 1989, it was natural to have high expectations of the future. To a large extent these expectations were fulfilled in the following two decades. Economically, the boom of the 2000s was nearly unprecedented, fuelled by rapid growth in Russia, in Poland and the Baltic states, and also in the more established economies of Germany and Sweden. Denmark and Finland also experienced high growth.

Politically, the older, western democracies of the Baltic World remained constant. After the somewhat uncertain first steps of the 1990s, the political systems of Poland and the Baltic states stabilized remarkably, and became functioning democracies with effective governments.

The Baltic World, in many ways was and has been a beacon of success, and maybe the best example of a post-Cold War transition that has fulfilled the promises of 1989. The euro-zone memberships of Estonia and Latvia in 2011 and 2014 respectively have only proven the point.

The current perspective, none the less, is less bright than that of the celebrations of the 20th anniversary of the fall of the wall in 2009. Economic growth rests on less solid foundations than it seemed still some years ago. The Baltic World's ability to breathe a new life into their economies has not disappeared, but they are gasping. While this condition is a symptom of wider changes in the European and global economies, the Baltic World, as it appears, has entered a new era.

Much of this change has to do with developments in Russia. Already before the political crisis with Ukraine blew into a military confrontation, Russia's economy had turned to a downward cycle. This is unlikely to be a passing phase. With the EU-economy in trouble as a whole, and little help to be expected from the outside, the inner dynamism of the Baltic World is not enough to pull it from its current problems.

Rising military tension, witnessed by incidents and activity involving Russian craft in air and at sea, does not help to alleviate the situation. The Baltic Sea has once again become a spot, where different worlds meet, and this meeting is not without difficulties.

It is not also the first time the Baltic World has seen reversals of fortunes and internal power shifts. The dynamism of the remaining members of the region is still there, and recent events in Russia and Ukraine, has only served to increase their interaction and consolidate the political, economic and military bonds between them.

The Baltic World continues to unify, and in the future will prosper too. In this way it still fulfills the promise of 1989. But with Russia absent from this communion, there is cloud with a dark lining hovering over it. The inhabitants of the Baltic World will do wisely, if they will pay the attention to it, it deserves. ■

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# Casimir Ehrnrooth – the Finn who made history

Expert article • 1680

**C**asimir Ehrnrooth (Johan Casimir Ehrnrooth) is an unfamiliar name to most Finns. It seems surprising because he played a noticeable role in the history of Finland, and other countries, namely Russia and Bulgaria. He was among the most prominent descendants of the Ehrnrooth family which has given seven generals, politicians, businessmen, bankers, scholars, writers, philanthropists, etc. Ehrnrooth was born in 1833 in Seesta, Southern Finland. He carved out a brilliant military career at the time when Finland was a part of the Russian Empire. In 1868, at 35-year of age, he was promoted to General. Ehrnrooth participated in a few Russia's military campaigns, including the Russo-Turkish War of 1877-1878 in which he was a Division Commander.

On 5/17 April 1880 Ehrnrooth was appointed as Bulgaria's Military Minister. In 1881 he took an active part in the establishing of the so called Regime of Powers (in fact a personal rule of the then Bulgarian monarch - Prince Alexander I of Battenberg), when the application of the existing Constitution was temporarily suspended. For 65 days (27.IV/9.V.-1/13.VII.1881) Ehrnrooth was Prime Minister and Minister of Interior. In the same year he fulfilled also the duties of Acting Minister of Foreign Affairs and Religious denominations.

Most historians assess the Regime of Powers as unconstitutional. They claim that Ehrnrooth acted in Bulgaria as a dictator. Is this assessment true?

In Bulgaria Ehrnrooth was a proponent of Russia's imperial policy. Nevertheless, he contributed a lot to the build-up of the Army and the upholding of the territorial integrity of Bulgaria. In 1880 he was given extraordinary powers by the National Assembly to cope with the existing brigandage on Northeastern Bulgaria and he successfully carried out this task. In 1881 Ehrnrooth did not take part in a coup d'état, but in a political change which did not violated the constitution and was supported by the majority of the Bulgarian people, Russia, the European powers and even the Ottoman Empire. His understanding was that the Regime of Powers was necessary because of the existing weak national institutions, internal instability, party confrontation and lack of political culture among most Bulgarians following the five-century long Ottoman rule.

As Prime Minister he acted firmly but strictly in accordance with the laws. He did not approve a single death sentence of any even most extremist political opponents to the government. He contributed to the consolidation of the newly liberated Bulgarian state and the upholding of its integrity and the sovereignty in the relations with the Ottoman Empire and other states. Ehrnrooth is among the founders of the modern Bulgarian diplomacy.

In the course of time Ehrnrooth's role in Bulgaria's history was positively reassessed. In November 2013 a memorial slab of Ehrnrooth was unveiled in the town of Targovishte. A street was renamed after Ehrnrooth and a commemorative plaque of him was placed in Sofia. His name is considered as a historic symbol in the relations between Finland and Bulgaria.

The climax of Ehrnrooth's professional career was his appointment by the Emperor Alexander III as Assistant (1882-1888) and lately as Minister State Secretary for Finland (1888-1891). In the last years of his professional career he was also Chairman of the Committee on Finnish Affairs and Chancellor of the University of Helsinki (then Imperial Alexander University). At that time Ehrnrooth was the highest-ranking Finn in Russia's state administration.

Unlike most Finnish liberals headed by Leo Mechelin, who wanted to speed up as much as possible the consolidation of Finland's autonomy, Ehrnrooth expressed more moderate views. Nevertheless he supported and contributed to the extension of Finland's autonomy status. He played an important role on a number of issues - the equal use of the Finnish language, codification of the basic laws in Finland, granting the Diet the right of legislative initiative, the build-up of the Finnish Army, etc.

As a statesman Ehrnrooth demonstrated to the utmost his professional and moral qualities – phenomenal working capacity, extraordinary intellectual and expert capabilities, remarkable diplomatic skills, adherence to principles, realism, pragmatism, honesty, determination and consistency. He was highly erudite personality – he knew perfectly six languages and had profound knowledge in the field of philosophy, history, mathematics, religion, military matters, etc. He lead a simple life, he was a stranger to the glory and job hunting, he strictly respected the laws, he was uncompromising opponent to the abuse of power, the intrigues and unscrupulous political bargaining.

Ehrnrooth was convinced that under the existing historic conditions it was not possible for Finland to transform its autonomous status within the Russian Empire into a separate independent state. His views became a subject of an increasing criticism by the Finnish liberals. In fact, although Ehrnrooth remained a loyal civil servant of Russia's Emperor, he did not want to take part in the highly unpopular among the Finns policy of Russification of Finland. In 1891 he resigned and until the end of his life he lived in seclusion in Seesta. He died in 1913 just a few years before the proclamation of Finland's independence

Ehrnrooth's philosophy as a statesman is synthesized in the following thought of his: "Prosperous are those nations which do not what they want to do but what they must do and not when they like it but when it is necessary". He was a new type of statesman and a staunch patriot who took into account the political realities and the real possibilities to enhance Finland's autonomy. Unfortunately his activity was not properly recognised both by his contemporaries and most of the historians.

In fact Ehrnrooth is among the prominent figures in the history of three countries – Finland, Bulgaria and Russia. He himself made history and was a statesman of European magnitude. The Finns should be proud of Ehrnrooth as every nation would do so. ■

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# “Investing in children” – a political slogan or a serious challenge for European societies?

Expert article • 1681

“Investing in children” became in recent years very popular expression used in scientific accounts and political declarations. In fact, it is nothing new in the belief that the value attached to children in societies is high. In dangerous times of war children and women are protected first to provide physical existence of a given society or community. Conventional wisdom says that children enable a society to continue collective cultural identity across history. It is also obvious that children’s rearing is expensive. Parents spend time and money to satisfy needs of their kids who presumably will sometimes re-pay for this.

Therefore, what happened that suddenly in 21st century influential political bodies, including European Commission, attached attention to investing in children? The reason for political interest in children is demography and future consequences of demographic changes. Population of Europeans is continuously shrinking while people wish to have more children. The process of aging advanced, and the dependency ratio is in increase. The go-and-pay retirement programmes are in debts. Children are needed to fulfill intergenerational contract backing above mentioned retirement programmes. But at the same time awareness arose that children are more than future supporters for elderly, that they are citizens in contemporary societies.

At the turn of centuries, Innocenti Research Centre in Report Card No 1 provided evidence that in European countries it is children who suffer most from poverty. In numerous EU member states, the poverty rate for children outranked that for adults. Jens Qvertrup formulated the thesis that childhood is a segment of macrostructure that is underprivileged in relation to adults. Intensive studies on brain development proved that childhood is a critical phase in the process and that growing up in poverty restricts emotional and cognitive possibilities of individuals. Scholars in economics started to calculate costs paid by societies resulting from child poverty. Very prominent ones, like James Heckman, Nobel Prize winner, provided evidence that investment in children, particularly in small children, is much more profitable than investment in adults to re-locate them on the labour market. When economists included children in the field of scientific interest the matter of investing in children converted from moral obligation towards financial benefit for society as a whole. Therefore, not only parents and charities but also governments should contribute to material well-being and actions enabling development of children. Nonetheless, the problem remains who should be supported by government and how: families (parents) or children themselves? There is a question arising what are children: dependent members of the family or independent agents in society. Should investing in children be provided in the form of generous child credit available to parents (all of them or only low-income ones?) or in the form of free of charge services aimed at children or leisure time activities? Should children be perceived as members of society living here and now or rather as future workers and taxpayers?

The European Commission Recommendation on “Investing in children: breaking the cycle of disadvantage” applies to the EU member states to base policies on the child rights foundation. Investing in children is regarded a measure to prevent poverty in the future and to improve children well-being nowadays.

The Great Recession destroyed hope to improve well-being of children in the whole European Union. In many member states children became victims of austerity measures despite desperate efforts of international non for profit organizations like Eurochild, European Anti-Poverty Network and others to put child poverty and children well-being on the top of national political agendas. Innocenti Research Card No 12 provides evidence that in years 2008-2012 in 11 EU member states child poverty (anchored in 2008) increased. Among them are following countries ranked in increasing order: Hungary, France, Estonia, Italy, Luxemburg, Spain, Lithuania, Ireland, Croatia, Latvia, Greece. According to the Report, years will be needed to compensate losses in income of families with children in these countries. However, 7 EU member states performed relatively well in terms of hindering child poverty. There are following countries ranked from the best performer: Poland, Slovakia, Finland, Romania, Belgium, Sweden, Austria. We should bear in mind that even in these countries there are groups of children and geographic areas (like in post-industrial towns in Poland) where children well-being deteriorated. Therefore, investing in children remains a challenge for European countries. ■



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# Ukraine crisis accelerates rouble's move into free float

Expert article • 1682

**T**he Ukraine crisis is having a large impact on the Russian economy through deteriorating sentiment, shrinking foreign direct investments, financial sector sanctions, accelerated capital outflows and inflation as the rouble has weakened significantly. However, Russia's central bank has accelerated its decision to move the rouble into free float, which should mitigate negative shocks on the Russian economy in the future.

As the crisis escalated in summer 2014, the EU and the US announced sectoral sanctions against Russia. Norway has declared that it aims to follow the EU's new sanctions. According to the EU, 15 companies are subject to the sectoral sanctions. The list includes oil industry giants such as Gazprom Neft, Rosneft and Transneft and several companies engaged in the military industry. Oil companies' access to new funds in western capital markets and new oil technologies is likely to be limited. The EU has tightened access to western capital markets for sanctioned Russian banks. According to the US Department of the Treasury, in addition to the EU list, the following energy companies are subject to the new sanctions: Lukoil, Gazprom, Surgutneftegas and Novatek. Among large 'newcomers' is Eastern Europe's biggest bank, Russian Sberbank. Other banks sanctioned by the US include Bank Moskvyy, Gazprombank, Rosselkhozbank, VEB and VTB. The military industry's companies are also on the sanctions list.

As the rouble declined significantly following summer 2014, in November 2014 Russia's central bank Bank Rossii revoked the rouble corridor, under which the Russian currency moved against the dual currency basket, moving towards a free-floating rouble. At the same time, the regular intervention of a maximum USD350m per day was abolished. However, Bank Rossii has kept the right to intervene at any time 'in case of financial stability threats'. The change was necessary to protect FX and gold reserves, as the central bank's previous actions have done nothing to stop the rouble's rapid devaluation. As the Brent price sank under USD100/bl in early September 2014 and local banks continued to buy FX fearing a new squeeze in supply on new financial sanctions, the Russian rouble has been the worst performer among 24 emerging market currencies, losing almost 40% against the US dollar and more than 30% against the euro in January to November 2014.

The rouble's worst fall began in late October 2014 as geopolitical risks resurfaced. Despite Bank Rossii's unexpected 150 basis point increase in the key rate to 9.50% per annum on 31 October, the devaluation of the rouble against the dual currency basket accelerated. In addition to the rate hike, Bank Rossii sold billions of dollars in a few days in an attempt to stop the decline but it did not succeed. Blaming speculators who sold the rouble on Bank Rossii's intervention rule, the central bank eliminated the rule on 5 November, introducing a maximum USD350m per day intervention rule no matter what the spot rate.

As the central bank could do nothing about the oil price, it has decided to influence the rouble through better FX availability. On 5 November, it introduced another 'bazooka' – a 12-month FX repo to facilitate the FX squeeze after Russia's major banks lost access to Western capital markets on financial sector sanctions. The amount promised by the central bank is USD50bn until the end of 2016 and 'in case of need this amount may be raised'. The sum sounds reasonable to cover the most urgent needs of Russian corporations regarding their external debt payments. Yet, it remains the tool of last resort, as available collateral may be the problem for local banks and the price is high. However, neither the previously described tools with verbal interventions nor the FX interventions that have drained Russia's international reserves by 13% since the Ukraine crisis started in late February 2014 have helped the rouble.

In our view, Bank Rossii's earlier-than-planned move towards free float was a wise decision, as in the long run it will be supportive for the Russian economy, offsetting external shocks, especially oil price shocks. The oil price risk is high and the geopolitical environment is more than challenging. There are no major improvements in Russian macro, as inflation is accelerating and fixed investments are shrinking. ■



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# Russia and European security

Expert article • 1683

In the Baltic Rim region, there is an increasing feeling that Europe's security is passing through a process of transformation. Indeed, after the Russian invasion of Ukraine, there is a growing sentiment of insecurity. In Northern Europe, mostly in the Baltic States and Finland, and in Eastern Europe, especially in Poland, the idea of a revisionist Russia is worrying. However, there are three additional issues. First, a radicalized Islam. Second, the rise of economic and social inequality. Third, the asymmetric perceptions of threats by individual European countries, resulting in a fragmented security strategy.

For the Russian military, NATO and, specially, the United States are Russia's main geopolitical enemy. The promotion of democracy and human rights would be an excuse to force the country into submission to foreign interests, mainly to tame nationalist internal politics, thus facilitating the depletion of the country by American and European companies. Thus, Russia's natural destiny would be to accept being a junior partner in the international system, a submissive one. Rephrasing a popular motto in 1960's Brazil, "what is good for the United States is good for Russia."<sup>1</sup> Although for the West this can sound absurd, in short this view has been turning increasingly popular within Putin's inner circle and the military. As Yevgeny Bazhanov, rector of the Russia's Diplomatic Academy, recently stated, "people in power did not object to or even greeted the Western efforts to plant democratic values in Russia and teach the nation how to live in a "free state." Today, this looks like an effort to weaken power in Russia and to "force it to its knees."" (Bazhanov 2013, p. 23).

It follows that Russia should be prepared for three possible scenarios for military conflict. First a major war with NATO and Japan. Second, a regional-border conflict scenario, i.e. disputed territories. Third, an internal military conflict as a result of terrorism. It is not to believe that a direct military conflict with NATO in the short term is to expect. However, Russia has been facing severe pressure with the infringement of its strategic national interests. NATO has wiped out both politically and militarily most of Russia's natural potential allies. This can be exemplified by NATO's expansion into the former Warsaw Pact space. The monetarist economic ideology imposed by the International Monetary Fund, the World Bank, and other multilateral organizations, not only had the objective to weaken the Russian society overall, but resulted in underfunding the Armed Forces thus in operational degradation (Nagorny & Shurygin 2013).

The Kremlin is also unable to consider that countries may freely choose and the possibility that people might be tired of living under corrupt and authoritarian regimes. That they may revolt, even without foreign stimulus or help. It is clear that Putin has been trying to make Ukraine to fit the "Color Revolution supported by the West" narrative, without considering that Russia is the foreign power trying to prevent legal and legitimate national forces to reestablish peace and order. Russia will use this narrative to (re)assure its influence always when necessary. As a result, any genuine process of democratization can be considered an attack from NATO against Russia.

<sup>1</sup> The original is "What is good for the USA is good for Brazil." The phrase was coined by the first Brazilian ambassador to the United States during the military dictatorship (1964-1985), General Juracy Magalhaes.

Russia is the greatest risk for European security at this moment. Although it considers an expanding NATO the biggest threat for its security, it has been pursuing a series of provocative military actions against Finland, Sweden, and the Baltic States. One of the Ukrainian terrorist leaders said their objective was to reach the Romanian border. With such provocations, NATO has been increasing its presence in the Russian border. Plans to contain Russia have been discussed. The risk is a self-fulfilling false prophecy. The Russian military might consider that NATO is getting ready to attack.

There are two possible interpretations. One, the Russians are really preparing for war against NATO. Their provocations have the objective of creating the justification for it. Other, they want to use the false NATO's threat to legitimize the current internal politics. This is the most probable.

In both cases, the West must develop a more pragmatic approach towards Russia, at the same time being ready for increasing instability in Europe's borders. That is why it is urgent to increase the presence of NATO in border states such as the Baltics. Also to continue engaging in diplomatic talks with Russia, including disarmament and banning nuclear weapons, especially as response to conventional aggression. ■

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# Impact of the Russian economic sanctions on Lithuania

Expert article • 1684

The Western countries and Russia after beginning of the Ukrainian crisis in 2014 imposed broad scope of the economic and other sanctions against each other, but the most sensitive for Lithuania is Moscow decision in August, 2014 to stop the import of almost all agricultural products from EU, US, Canada and Norway.

In November 2014 Russia imposed country specific sanctions against Lithuanian road carriers (introduction of the particularly harsh and exceptionally slow custom checks for the trucks with Lithuanian number plates. Such sanctions are also imposed on the trucks, registered in other countries, but carrying the freights, which paperwork was carried out in Lithuania). Russian officials stated, that sanctions are imposed because of the widespread smuggling and the counterfeiting of the custom documents. But it is clear, that this is Moscow revenge for the active Lithuanian foreign policy after the beginning of the Ukrainian crisis (including the active support for the introduction of the economic sanctions against Russia, aims to increase NATO military presence in the Baltic Sea region etc).

It is also worth to mention, that politically motivated Russian economic sanctions against Lithuania is not a new phenomena for the Lithuanian companies. In the last several years Russia at least twice imposed country specific and politically motivated economic sanctions against Lithuania. In both cases (in 2009 and in 2013 during the Lithuanian EU Council presidency) Russia hit Lithuanian milk products exports and road carriers. But this time impact from the sanctions could be more harmful, because the sanctions are imposed not only on Lithuania, but also on most Western countries. It means, that because of the higher competition it could be much more difficult to substitute Russian market with the export markets of the EU or third countries.

Despite limited statistical data available at the moment of the writing it is worth to estimate the possible impact of the Russian sanctions on the Lithuanian economy. Some international experts, including EUROMONITOR, predicted that Lithuania will be most hardly hit by the sanctions and could lose up to 2,5 percent of the GDP annually. In November 2014, Prime Minister of Lithuania A. Butkevičius stated, that in absolute worst scenario of total abolishment of any economic ties with Russia, Lithuania could lose up to 4 percent of its annual GDP, but at the same time he expressed the opinion that such negative scenario is pretty unrealistic. In November 2014, the Ministry of Finance predicted that in 2015, despite the sanctions, Lithuanian GDP will grow by 3,4 percent. Leading economists are more cautious and predict the more moderate 2,0-2,5 percent annual growth in 2015.

From the first sight Lithuanian economy seems very dependent on trade with Russia. In 2013 Lithuanian export to Russia amounted 4,8 billion EUR (19,6 percent of the total export), import – 7,37 billion EUR (28 percent of total import). But only 14,6 percent of Lithuanian

export to Russia constituted of the goods of Lithuanian origin (85,4 percent of the export is reexport from third countries – both EU and non EU), which is only 2 percent of the Lithuanian GDP. At the same time Lithuania is pretty important player in the goods reexport to Russia. For example, in 2013 Lithuanian export of vegetables (almost all – reexport) to Russia was 340 mln. EUR (total EU export to Russia – 780 million. EUR), fruits – 309 mln. EUR (EU – 1259 mln. EUR, Poland – 339 mln. EUR).

Lithuanian road carriers have around 10-12 percent share of the Russia–EU road transportation market. In 2013, total export of Lithuanian transportation and other logistical services to Russia was higher than the amount of export of the goods of Lithuanian origin and amounted 1,27 billion EUR (3,6 percent of GDP). These numbers

perfectly illustrate susceptibility of the Lithuanian transportation and logistics sector to the Russian sanctions.

Another sector, which already suffers considerable consequences is agriculture and food processing (particularly exporters of milk products). In 2013 Lithuania was the third largest exporter of milk products to Russia in the EU. Its milk products export (almost all of Lithuanian origin) in 2013 was 160 million EUR (Finland – 250 million EUR, Germany – 182 mln. EUR, Poland – 141 mln. EUR). Russian market was so profitable to milk producers (particularly for cheese exports), that they did not want to withdraw from

this market even after two rounds of Russian sanctions in 2009 and 2013. The introduction of the new sanctions in August 2014 led to a steep drop in raw milk prices (they were lowered by 1/3), because the milk product producers are trying to relieve the burden of the potential losses on the expense of farmers.

Increased competition from the other EU producers in the Lithuanian home market is visibly lowering the prices of the groceries, but at the same time putting serious pressure on the producers.

In the 3rd quarter of 2014, export of the goods of Lithuanian origin to Russia was 8,3 percent lower than in the same quarter of 2013. The export of milk and other food products almost stopped. It is clear that in the results of the 4th quarter will be even worse, because the 3rd quarter included only 1,5 month of the sanctions.

At the same time Lithuanian exporters of goods and services are actively working in order to tackle consequences of the Russian sanctions. Food producers are trying to enter other markets such as Middle East and China. There are also some indicators, which show that the part of the direct deliveries to the Russian market could be substituted by reexport (with partial processing) through Belarus.

For the Lithuanian transportation and logistics sector (including reexport business) it is much more difficult to substitute Russian market, because this sector was for many years developed taking into consideration preferential Lithuanian geographic position between Russia and EU.

Some international experts [...] predicted that Lithuania will be most hardly hit by the sanctions and could lose up to 2,5 percent of the GDP annually.

Expert article • 1684

Besides the direct sanctions, considerable worsening of the Russia macroeconomic situation (because of the Western sanctions, and particularly rapid decrease of the oil price) is beginning to negatively affect Lithuania. Devaluation of the rouble leads to the decrease of the purchasing power of the Russian consumers, meaning less opportunities for the goods and services export, smaller tourist inflow from Russia to Lithuania (Lithuanian state tourism department predicts that the number of Russian tourists who visit Lithuania will shrink in 2014 by 10 percent) and economic difficulties in important export partner countries for Lithuania, such as Belarus.

To sum it up, economic impact of the Russian economic sanctions is painful for the Lithuanian economy, but it provides the opportunity to diversify the geography of export (including China and Gulf countries) and to increase competitiveness of the Lithuanian companies. The extent of the losses will heavily depend on the duration and the future character of the sanctions. ■

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# Russian sanctions and Russian confidence

Expert article • 1685

The United States and Western Europe imposed successive rounds of economic sanctions against Russia in response to Russian government policy toward Ukraine. Initially, these sanctions were targeted against individuals close to Russian President Vladimir Putin. Over time, however, they have expanded to touch on key firms in critical sectors of the Russian economy – banking and energy first and foremost. Putin's regime responded by banning the import of European foodstuffs as part of a wider array of retaliatory measures. And while the Russian government has shown some signs of engagement with the government in Ukraine, there is mounting evidence that the underlying Russian policy remains unchanged. Hence pressure is building in the West for further strengthening of the sanctions.

The challenge is to understand why the Putin regime has not conceded more to Western pressure and whether (and when) the pain of sanctions will be enough to induce a policy change. The answer often provided in the media focuses on public opinion polling data. Such data show that Putin's domestic popularity has soared during the Ukraine crisis. He had a 78 percent public approval rating in early August, soon after the European Union imposed its sector-specific sanctions. More recent polling by Levada shows not only that this approval rating has strengthened but that 68 percent of respondents would not support ending Russian assistance to separatist groups in eastern Ukraine and 79 percent would reject any attempt to return Crimea. These same polling respondents are largely indifferent to Western sanctions; small wonder, therefore, that Putin would choose to ignore them.

The difficulty with arguments based on polling data is that they confuse pride and confidence. Russians may back Putin's policy toward Ukraine but that tells us very little about their perceptions of future prospects. Meanwhile, data for consumption, investment, and capital flows tell a very different story. As the World Bank noted in its October 2014 'Country Program Snapshot', 'the Russian economy is stagnating' as a result of rapidly decelerating consumption growth and contracting rates of fixed capital investment. Such factors are the result of broader geopolitical uncertainty surrounding both the Ukraine crisis and the turbulence in world energy markets. They also coincide with a stagnation in the growth of real disposable income, a slowdown in the growth of credit to households, a rise in the household share of non-performing loans, and a surge in net household purchases of foreign currency.

Russian households lack confidence. So do Russian banks, energy firms, and macroeconomic policymakers. This is where sanctions become more important. Russian banks can access sufficient liquidity to roll over foreign currency liabilities for the rest of 2014 but they will begin to face liquidity constraints in the new year. Energy firms have ramped up production but they will soon suffer from the draw down in maintenance and new investments that should be supported by western firms. And while Russian macroeconomic policymakers can fill in a few of the gaps in both the financial and real economies, they will struggle to balance revenues and expenditures or to dampen the volatility in the external value of the rouble – particularly if energy prices continue to stagnate.

This lack of confidence is self-reinforcing and therefore non-linear. The more Russian households and firms lack faith in their future economic prospects, the more they will retrench in the present and so the more likely it becomes that their fears will come to pass. This dynamic is hardly unique to Russia and it is evident in many countries of the euro area. Ultimately, moreover, it will prove unsustainable.

At some point, the Putin government will have to look for some external source of economic dynamism to arrest the negative spiral. Despite the recent big energy deals and the promise of easier trade financing, China is an unlikely source of salvation. The Chinese leadership has economic challenges of its own and it simply does not have the financial infrastructure or extractive technology to replace what has been lost due to sanctions.

The Putin government will have to make a deal with the governments of the United States and Europe not for lack of Russian pride but because of the lack of economic confidence. Moreover, the effect of sanctions will be less important than the influence of more psychological factors. The more President Putin tries to bolster his policy toward Ukraine by appealing to national patriotism, the harder it will be for him to make the necessary concessions to western governments and so the deeper the damage that Russian households, banks and firms will do to themselves and to each other as they tighten their belts to prepare for an uncertain future. ■



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# Baltic security and NATO membership after Ukraine

Expert article • 1686

The Baltic security environment has changed considerably over the past year. In late 2013 Lithuania was still enthusiastically preparing for the Eastern Partnership Summit in Vilnius, a landmark event of its EU Council Presidency. Back then, a war in the EU neighbourhood was not on the cards. A year later, however, Latvia's preparations for its own first EU Presidency in the first half of 2015 are marked by concerns over the fragile security environment in Eastern Europe. What is at stake today is no longer whether Ukraine, Georgia, and Moldova will gravitate towards the EU, but the security of the Baltic States themselves. None of the Baltic States borders Ukraine and the geographical distance between, for example, Riga and Donetsk is more than 1500 kilometres. However, the psychological distance is much less. Events in Ukraine have deeply shaken Estonia, Latvia, and Lithuania. The following paragraphs look at the domestic steps the three Baltic States have made to adapt to the changing security environment in Europe as well as NATO measures aimed at reassuring Estonia, Latvia, and Lithuania.

The Baltic States have viewed their NATO membership as insurance against the possibility that a resurgent Russia may at some point pose a military threat. This insurance was activated after Russia's annexation of Crimea. Baltic concerns were also heightened because Russia's military presence near the Baltic States has been far more pronounced in 2014 than ever before. The origins of the Crimean crisis and the war in eastern Ukraine are still debated, and the question whether Russia is a status quo state, a limited aims revisionist state, or an unlimited revisionist state is at the heart of the current debate about Russia's intentions in Ukraine and beyond. However, for Estonia, Latvia, and Lithuania, the Ukrainian crisis has revealed their continuing vulnerability to the same Russian military tactics used against Ukraine. NATO had to take specific measures to reassure publics in the Baltic States.

This effort had two key elements: domestic measures and collective NATO efforts. First, the Baltic States have strengthened their defence capabilities. In terms of defence spending, Lithuania and Latvia have been laggards, and their defence allocations fell under 1% of GDP during the economic crisis. Estonia, in contrast, has been one of the frontrunners and is among the few NATO member states that spend 2% of GDP on defence. To remedy this situation, Lithuania and Latvia had already pledged to increase defence spending before 2014 due to strong criticism from other NATO members, most notably the US. The crisis in Ukraine added urgency to these efforts. Thus, Latvia and Lithuania have already allocated additional financing to strengthen their defence capabilities in 2014. The key element of this effort has been procurement of anti-tank systems, but it is clear that the security needs of the Baltic States extend well beyond these initial steps. In addition to strengthening their military capabilities, they must also reinforce the police, border guard, and secret services.

Second, NATO has taken a number of practical steps to reassure the Baltics. In the wake of the annexation of Crimea, NATO adopted a series of measures aimed at establishing a more marked presence in the Baltics. Steps taken included strengthening of the Baltic air policing mission, ensuring NATO naval presence in the Baltic Sea, as well as temporary placement of a limited number of "boots on the ground" in the Baltic States and Poland. In addition, the Baltic States will host more military exercises in the future. Although these are not permanent measures, they are likely to remain in place until the security environment improves.

These steps have improved the defence capabilities of the Baltic States. If Latvia and Lithuania keep their promise to hike defence spending, the military capabilities of the Baltic States are likely to improve in the coming years. There is also little doubt that the collective efforts of NATO member states have succeeded in reassuring the Baltics. It remains to be seen, however, if these measures that were aimed at reassurance will also be successful in deterring Russia from destabilizing the Baltics. It is too early to tell whether Russia indeed harbours such aims, but the Baltics and their allies should be prepared for such contingencies. The Baltics will have to invest more in their military capabilities and hope that it will be a sufficient deterrent. However, they should also keep in mind that tough times do not last, but tough people do. With appropriate help from their NATO allies, the Baltic States can make it through the tough times. ■



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# Russian military activity against Sweden – short and long term perspective

Expert article • 1687

**O**n 14 November the Swedish Chief of Defence confirmed in a press conference that in October a foreign submarine violated Swedish territorial waters. The statements were a follow-up of the intelligence operation against 'foreign underwater activities' the Swedish Armed Forces were conducting from 17 to 24 October in Stockholm archipelago. Since no conclusive evidence was presented about the country of origin of the submarine, no foreign state was named. However, most Swedish experts are convinced that Russia was behind these activities. They fit into a pattern of increased Russian military activity in the Baltic Sea and the Arctic which has been observed since 2008, and has seriously intensified in 2014 – either in the form of larger and more frequent military; of violations of the airspace of the countries in the region; or of aggressive actions against military aircraft and vessels of these countries in international airspace or in international waters. Swedish military representatives openly state that the security environment in the region has been, with the negative trends intensifying in 2014. They indicate also that incidents against Sweden have been taking place more often in 2014 and in previous years that it is known to the public. There have been several recent Russian provocative actions covered by the media: violation of the Swedish airspace near the island of Öland (September); aggressive manoeuvres towards a Swedish signals intelligence aircraft in international airspace (October); military exercises simulating an attack on military targets in Sweden (March 2013). Questions arise about the goals of the Russian actions.

In the short term, Russian military actions against Sweden, of which the 'underwater activities' are probably a part, are aimed at checking the combat readiness of the Swedish Armed Forces and their actual ability to respond to such incidents, as well as testing the Swedish signal intelligence. It is also a demonstration of Russia's capabilities to conduct military actions against Sweden. It also serves to demonstrate the Swedish Armed Forces' limited capabilities in territorial defence, which were drastically reduced after the end of the Cold War, especially over the last decade during which the Swedish military switched to participating in crisis management operations abroad.

In the long term, Russia is seeking to 'neutralize' Sweden in the political and military sense. Due to its geographical position, Sweden is important for planning and conducting of military operations both for NATO and Russia. Sweden may allow or deny access to its airspace and territorial waters for the conduct of NATO operations, which may decide on the outcome of possible Russian military actions against the Baltic countries, and whether (or not) NATO would be able to meet its commitments on collective defence. Not only Sweden's potential NATO membership matters - the current Social-Democratic/Green coalition has officially ruled out the possibility. Russia's multi-dimensional actions – political, economic, military, propaganda – are intended to ensure that Sweden refrains from far-reaching co-oper-

ation with NATO (for example, by implementing the recently signed Host Nation Support agreement). Moreover, in the event of crises or conflicts in the Baltic Sea region, Russia wants Sweden to refrain from approving the movement and stationing of NATO forces in Sweden. However, the main goal of Russia is not to bring about the worst-case scenario – which in the case of an armed attack on the Baltic states would most likely also include: sabotage or attack on Swedish air and sea bases that might be used by NATO during the conflict; taking control of the shipping lanes near Sweden; and taking over key points on Swedish territory, such as the island of Gotland. Such a scenario should not be fully excluded; however Russia's main goal is to convince the Baltic states, Sweden and Finland and NATO that it is able to execute such a plan and has the military capabilities to do so. This, in turn, is intended to act as a deterrent to NATO and the countries of the region, and translate into a reluctance to meet the Alliance's obligations. As a result, this would lead to a weakening of faith in NATO's Article 5 and thus undermine the credibility of the Alliance, which is the overarching goal of Russian foreign and security policy. The Russian military activity against Sweden and throughout the region is therefore today mainly an element of psychological warfare. It is being used to demonstrate its superior military potential and to highlight the glaring gaps in Sweden's defence system, and thus intimidating the public and influencing decision-makers in Sweden and the Baltic countries. ■



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# Will economic sanctions fulfil Baltic expectations in terms of Ukraine and Russia?

Expert article • 1688

The economic sanctions imposed during the Russian-Ukrainian crisis in 2014 have clearly brought the escalation of political tensions between Russia and the West. The Baltic States have taken a pro-active role at the European level and showed their strong support for Ukraine and decisiveness against Russia. What makes this truly remarkable is the fact that among the EU member states Estonia, Latvia and Lithuania are most vulnerable to the economic risks arising from the sanctions as well as being exposed to a heightened security risks. The Baltic States are also among those EU member states who are most interested in the effectiveness of the economic and political measures. But do the sanctions have a real potential to contribute to solving the crisis in Ukraine? What would be the positive outcome of the sanctions for the Baltic States and is it in the best interest of the West?

Although most of the relevant theoretical and empirical studies are convinced that sanctions do not work, can we expect that the traditional logic "more pain/more gain" will work in this case? First, sanctions are hardly successful if their aims are too broad or remain unclear. Second, in successful cases countries imposing sanctions have tended to be both larger and economically/militarily more powerful than the target countries. In this case the conflicting parties are of relatively equal political power and sanctions are imposed mutually. Third, previous experience of the EU over the past 20 years also shows that sanctions have been used in 30 cases and none of them could be regarded as a success.

As has been stipulated by politicians, the purpose of the EU sanctions "is not to punish Russia but to make clear that it must stop destabilizing Ukraine". Thus, the sanctions have not been imposed to cause the target country economic harm, but to send a signal that these actions are not tolerated. In practice, however, the Russian economy is facing economic recession, weaker direct investment, and rouble loosing 25% value in dollars within half a year, soaring capital flight and high inflation rates since the second quarter of 2014. Nevertheless, both the reasons of the current recession in Russia and the overall economic outcome of the sanctions stay rather unclear. The recession could be said to have been caused by a combination of sanctions, global stagnation trend, etc. Due to the weakening of the Russian rouble, also the economic outcome of the sanctions for Russia is ambivalent. Whereas banks and energy companies are mainly loosing from the sanctions and the depreciation of the rouble, steel companies have profited, as weak rouble combined with weak competition from overseas have compensated for lower domestic demand in Russia. The Russian budgetary spending has been increasing constantly since 2008, the defence costs have remained stable at the level of 3.5% of GDP, and the country's gold reserves have tripled since 2005. Over the longer term, the technological backwardness of Russia will increase, but despite this oil will still be extracted and nuclear warheads will be produced in Russia. What is most important, despite the economic pressure in Russia, no remarkable success to solve the crisis in Ukraine could be seen.

Additionally, some of the EU member states are economically highly dependent on Russia. Austrian banks have extensive business relations with Russia, Poland is concerned about the food export, Finland and the Baltic countries are almost completely dependent on Russian gas supplies and account for the highest share of export to Russia among the EU member states, etc. It is another crucial question whether it is in the best interest of the West, including the Baltic countries, to bring Russia economically down and to throw the country into a potentially serious crisis.

Paradoxically, the West, the Baltic countries and even Russia seem to be to some extent satisfied with the bipolar re-confrontation. On the one hand, Europe has called that "the current situation is not accepted", but is still continuing to import gas from Russia. Also, there is a lack of stronger coherence among the EU countries, as support for further sanctions against Russia and public sympathy as regards the parties to the Russian-Ukrainian conflict varies remarkably. On the other hand, as a result of the sanctions the Russian political elite enjoys high public support.

Hence, the Russian-Ukrainian crisis provides the international community with a valuable experience about the efficiency of sanctions against one of the Great Powers. There are some lessons already evident. First, sanctions alone are hardly successful if their aims are broad and results are expected in a relatively short period, which is exactly the case during the Russian-Ukrainian conflict. Second, the trade sanctions have proved to be relatively inefficient, as in a globalised world the substitute sources of supply could easily be found. Third, to avoid "endless sanctions against each other", the focus of sanctions should be on high level political persons directly responsible for the situation as well as preferring measures causing lags in technological development. ■



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# Regional approach in Russian policy towards Estonia in the times of sanctions

Expert article • 1689

It is déjà vu, at first glance. On May 18, 2005, Russian Foreign Minister Sergey Lavrov and Estonian Foreign Minister Urmas Paet signed bilateral Treaties on the Russian-Estonian border and on delimitation of the sea in the Gulfs of Finland and Narva. However, on September 6, 2005, Lavrov withdrew his signature from the Treaties citing details of ratification legislation passed by the Riigikogu, Estonian parliament, as the reason. Negotiations restarted in 2012 only. On February 18, 2014, Lavrov and Paet signed the renewed Treaties. However, the Treaties failed to come into force any soon. On February 21, 2014, President Viktor Yanukovich of Ukraine was removed from his post as a result of what Russia pronounced to be a coup, while the U.S. and the EU pronounced to be a legitimate transition of power. Since then, Russia and the West have been quickly spiraling into probably the worst crisis in mutual relations in 25 years, a result of which, among other things, including that Russia and the West imposed economic sanctions on each other, was that ratification of Border Treaties between Russia and Estonia was postponed again.

Despite the seeming similarities between the events of 2005 and 2014, the approach of Russian elite to Estonia significantly changed within the decade. In short, in 2005, despite Estonia was already a member of both NATO and the EU, majority of Russian elite did not consider Estonia a part of Europe. In 2014, they did. In the near future, when the current crisis in the relations between Russia and the West is over, that change will play an important role in bilateral relations, because despite postcolonial scholars of international relations have frequently warned national leaders and their fellow scholars against making judgments about countries and peoples on the basis of which region of the world they come from, both leaders and scholars still do so. Moreover, those judgments affect their action concerning countries and peoples in various regions of the world. Thus, when leaders and scholars stop considering a country a part of one region and start considering it a part of another region, their action towards the country in questions changes. Hypocrisy in treatment of countries belonging to different regions of the world bears the name of regional approach.

Recent foreign policy practice and international relations scholarship provide with numerous examples of regional approach. President George W. Bush of the U.S. during his first term in office made several under-calculated decisions concerning Europe, but tended to calculate decisions concerning Middle East twice, which resulted in a crisis in transatlantic relations, though did not save him from miscalculations in Iraq. Ten years ago Prime Minister Tony Blair of the United Kingdom was confident about assumed relationship between then Iraq President Saddam Hussein and Al-Qaida leader Osama Bin Laden, mostly because he viewed both leaders as negative personalities with background in the same region, Middle East, despite Western intelligence services lacked evidence to confirm the relationship. President Vladimir Putin of Russia in 2000s tended to be tough on his partners among Middle Eastern leaders, because he expected them

to consider his invitations to cooperation as sign of Russia's weakness and invitation to exploit, instead of reciprocating; recently he undertook steps to cure the harm caused by such approach, including new nuclear deal with Iran.

Ten years ago Russian elite considered Estonia a part of post-Soviet space and applied corresponding approach to foreign policy decisions concerning the country. The reasons were their memories about Russia's and Estonia's shared experience in the Soviet Union and Estonia's treatment of its Russophone minority, which did not correspond to their views of European standards in treatment of minorities. That approach changed in a decade. Today, though Russian elite is far from considering Estonia an important stakeholder in EU decision-making, it considers Estonia an insider in EU affairs. While optimistic part of Russian elite expects mutual sanctions to be removed already next year, moderate part of Russian elite has noted the words of Estonian Ambassador to the EU Matti Maasikas, revealed by Estonian daily Postimees on July 29, 2014, that the latter had calculated the harm to be caused by sanctions in 2015 through 2017. Whether Maasikas' calculations were based on true expectations of the sanctions to be removed in 2017 or not, and whether those expectations will prove true in 2017 or not, by that time even greater part of Russian elite will be considering Estonia a part of Europe. That will influence bilateral relations, to the good or to the bad, of which ratification of Russian-Estonian Border Treaties will be a sign. ■

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# Future growth of the Russian economy?

Expert article • 1690

**R**ussia experienced high growth in the 2000s up to the economic crisis in 2009 when GDP contracted by almost eight per cent. The economy recovered in 2010-2011, with yearly growth rates of over four per cent, but in 2012 growth declined to 3.4 per cent and in 2013 to 1.3 per cent. For 2014 the forecasted GDP growth was revised downwards from 3-4 per cent to 1-2 per cent during the year. Finally, in October 2014, IMF predicted growth of only 0.2 per cent in 2014 and 0.5 per cent in 2015. What lies behind the dramatic decline in Russia's growth and can the trend be turned around?

The stagnation of global demand for Russian commodities is part of the explanation of Russia's slowing growth as is the confidence crisis following Russia's annexation of Crimea in March 2014 and its continuing aggression towards Ukraine. The ongoing Western sanctions and Russian counter sanctions also hurt the economy. However, I would argue that the main reasons behind the decline of the growth rate are found in deeper systemic and structural elements that have characterized the economy under President Vladimir Putin.

First it needs to be said that the exceptional growth in the 2000s took place after a decade of radical economic reforms transferring the Soviet command system into the Russian market economy. This market economy was not perfect but it became possible to start and develop businesses and small and medium sized enterprises were established and grew. The economy was opened to competition, prices and trade were liberalized and consumer markets expanded making services and goods available that had been rationed, if at all existent, in the old shortage economy. Sectors like trade, private services, construction and IT flourished. Large Soviet state enterprises were privatized, sometimes in a manner that led to higher efficiency and increased competitiveness, sometimes in a way that led to continued state influence and continued politically motivated subsidies.

Despite these shortcomings, dramatic structural change took place and the economy that had been profoundly dominated by defence and heavy industry became more consumer friendly since markets transferred the power from central party bureaucrats and state producers to the citizens-consumers and profit seeking entrepreneurs. When oil prices started to rise again, the government could stabilize public finance and create a stable and credible macroeconomic framework supporting growth.

The lack of further market reforms since the mid-2000s and the backlash in form of more state intervention, less democracy and the return to Soviet priorities for defence and large state led investment projects are fundamental factors behind the declining growth today. Putin consolidated the reforms of the 1990s during his first period in

office, but since 2004 the policy changed. During Putin's second period the siloviki (security sector officials) clearly got a stronger hold of policy and governance efficiency and rule of law started to deteriorate while state corruption surged. Because of high oil revenues, the loss-making, often privatized but with state shares, Soviet-type enterprises could be increasingly subsidised, and all the allocative inefficiencies typical for the Soviet economic system were preserved. Strong public

finance allowed Russia to embark on a military reform with increasing military spending and a new huge armament programme that benefits the defence industry. Prioritized defence companies have been let to operate under soft budget constraints and soft credits, something that might have been affordable as long as growth was 6-7 per cent, but today it has a huge alternative cost. However, the present political leadership prefers political loyalty and support, which these defence

To restore growth the institutional framework need to be renewed and finally become what it was meant to be: the common rules of the game in economic Russia.

companies supply, to economic efficiency.

Accordingly, the market reforms never completely overcame the Soviet heritage that is still embedded in Russia's industrial structure. Both formal and informal behaviour of the socialist system have survived and this explains the difficulties of formal institutions in Russia. New institutions have been established but informal institutions and networks remain and this has undercut the development of real, efficient market institutions. To restore growth the institutional framework need to be renewed and finally become what it was meant to be: the common rules of the game in economic Russia.

Sadly strengthen institutions will be a hard option because some economic actors are better off with informal procedures, where they have special influence and direct access to the political leadership. Moreover, privileged groups will fight back if their position and income are at risk. Entrepreneurs that would profit from strong institutions and common rules lack the influence, as does the civil society in general, after all the imposed restrictions on civic liberties. Restoring growth through addressing structural factors and market institutions would therefore be difficult to achieve as long as Vladimir Putin remains in power. ■



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# Moscow as an International Financial Center (IFC)

Expert article • 1691

In 2010 the Russian government launched the Moscow International Financial Centre (MIFC) project and sought international assistance, including from TheCityUK (the self-described “representative voice of Financial Services in the UK”). A Memorandum of Understanding between the MIFC Taskforce, TheCityUK and Vnesheconombank was signed in Moscow in 2011 in the presence of President Dmitri Medvedev and Prime Minister David Cameron.

Subsequently a number of reports were produced, mainly by TheCityUK and the IBRD.

Right from the beginning there were fundamental delusions. An early 2011 survey of “260 participants from leading Russian and foreign entities active in the Russian financial market” reported such views as Moscow as a “regional financial centre for CIS”, and “Moscow is where East meets West. It is a blend of different cultures and nationalities. It will be easy for everyone to come to do business”.

The idea that Moscow could be a “regional financial centre for CIS” was doubtful even before the recent events involving the Ukraine. As for “East meets West”, I know from my own experience working in Russia that European orientated Muscovites generally have little knowledge of the “East” (apart from Central Asia).

While Moscow may have time-zone advantages, they are only partial because of competition from places like Dubai.

The IBRD and TheCityUK reports highlighted a considerable number of problems with Moscow’s aspirations.

Russia’s large state-owned banks have the advantage both of existing economies of scale and preferential treatment from the state (although it is never easy for foreign banks to enter a market and compete with established, even if initially less efficient, local retail banks).

The IBRD identified corruption, poor law enforcement, and a bad reputation as “major obstacles”.

It also reported that “the current legal environment makes it difficult to create new types of securities because only those types specifically enumerated are permitted. Every innovation, therefore, requires enabling legislation. Nor is a single law sufficient: in each case, amendments must be made to the Civil Code, the Tax Code, the law on Joint Stock Companies, the law on Securities Markets, the law on Insolvency (Bankruptcy), the law on Foreign Currency Regulation, and the law on Banks and Banking Activity. The creation of a separate legal environment for the financial markets would make innovation much easier.”

One option mentioned by the IBRD for Moscow was to take the Dubai path of essentially importing a “common law” legal framework for its IFC. “The Dubai IFC is an independent jurisdiction under the UAE Constitution, and has its own independent civil and commercial laws, which are written in English and which default to English law. It also has its own courts, with judges taken from the common law world including England, Singapore and HK.”

But Moscow was never going to take this totally top-down approach (any more than Shanghai will) because it makes little sense if the IFC must also serve a large domestic market. Moscow’s own top-down ideas seemed to center on a new suburb to house the IFC, and not enough was done on the basic reforms included in a Dubai-type package.

In any case, Dubai is an exception. Today’s top IFCs have generally been created organically and over a considerable period of time. New York got there because of its huge domestic markets. London initially got there for the same reason, but was also lucky because the UK’s direct successor as an economic power-house (ie the US) had a common language and similar legal system; and then London followed this up with sure-footedness. Hong Kong and Singapore got there through a combination of being international trade hubs, luck (ie much the same luck that London had) and sure-footedness.

In reality, the idea of Moscow as an IFC was almost dead from the start, and the 2014 events in the Ukraine should have completely killed it.

However, this may not be totally the case.

In November, I surveyed via email a significant group of Russians who reported that they spend “about 50% or more” of their work-time thinking about financial issues. Over 40% thought that “Moscow will become an ‘international’ financial center (for example, like London, New York, Tokyo, Singapore, Dubai) by 2020”.

And, both China and continental Europe were strongly favoured over the US and the UK as places with which Russia should have close financial relations; with over 90% saying that Russia should have closer financial relations with China.

It seems clear that US-lead sanctions are adversely affecting the view of educated financial workers in Russia about the UK and the US. But they may also be leading to a revival of the idea of Moscow as an IFC, in order to in some way make Russia more financially independent.

But, rightly or wrongly, President Putin’s Russia now has such a bad image that there is, in my view, no possibility of Moscow becoming an IFC by 2020. ■



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# Eurasian Economic Union – a union of conflicting political interests

Expert article • 1692

**T**he Customs Union (CU) of Russia, Belarus and Kazakhstan that came into force in July 2010 was quickly replaced by the Common Economic Area (CEA) since January 2012, and the latter, in its turn, is planned to be replaced with the Eurasian Economic Union (EAEU) since January 2015. Is there any reason for this name-changing of the only successful integration project at the post-Soviet space?

The succession of names hints at the purely economic nature of integration starting with the unified customs tariffs and rules and continuing well into the plans for common markets of goods and services, labour and capital as well as common economic policies in a wide range of spheres. The economic nature of the new union was particularly stressed by Presidents Nazarbaev and Lukashenko in May 2014 when the EAEU agreement was signed. However, a more careful analysis suggests that the union is inherently political with all parties pursuing their own goals.

Kazakhstan seems to be the party winning the least economically, judging by the fact that its full participation in the common market of goods has been much delayed by the technical regulations within the CU. Tariffs, rules and regulations of the CU were based mostly on those of Russia, and while Belarus and Russia had a long story of a Union State (since 2000) and time for adjustment, Kazakhstan was much less integrated with either of the other two countries. Being oil and gas exporter, Kazakhstan had no troubles in attracting foreign investments, achieving macroeconomic stability and balancing the budget. No immediate economic gains were visible when the CU has been discussed, and yet Kazakhstan opted to join in. The reasons can be found in political spectrum. Regionally Kazakhstan is more and more dominated by China whose influence in the Central Asia increases, while competing with Uzbekistan for the place of the local dominant power. It was President Nazarbaev who voiced the idea of the Eurasian Union back in mid-1990s, and he continues to support the idea while lobbying the interests of Kazakhstan's businessmen in the union.

Belarus seems to be the only true winner in this integration project, both economically and politically. Economically it enjoys special prices for gas and oil shipped from Russia earning profit on sales of processed oil products on the European market. Politically it has a certain degree of carefully measured autonomy from Moscow, as the recent role of Minsk in the Ukrainian crisis has demonstrated. President Lukashenko maneuvers between open criticism of Russia's actions and getting support from Russia in the form of cheap oil and gas and supporting credits. Loyalty has the price in this case.

Russia is not losing so much economically as Kazakhstan, but this is only at a first glance. Its losses are related not only to price reduction and foregone revenue from oil and gas sales to Belarus (expected to be reduced soon), but also to the upkeep of the union bureaucracy. According to the EAEU agreement, the budget of the union is formed from fees paid by the member-countries in proportion to the import duty distribution, meaning that Russia pays almost 90% of the budget. The distribution of the import duty was decided when the CU was formed. In the CU Russia enjoyed 57% of the votes in the CU Commission, but Russian dominance in decision-making process has ended with the CEA creation: now each member of the union has

equal voting power. Hence, Belarus and Kazakhstan have the means to outvote Russia in case they cooperate as this was demonstrated just before the EAEU agreement had been signed when Belarus and Kazakhstan expressed their concerns about Russia's dominance in certain areas and insisted on removing any politically sensible issues reducing the new agreement to purely economic by nature of issues it encompasses.

For Russia keeping and developing the EAEU is a matter of political image and status. Addition of Armenia to the EAEU and expected joining of Kyrgyzstan imply economic support to these new member-states, and the burden of providing this support will fall mostly on Russia. In return Russian might hope to get new loyal allies within the union. Indicators such as business cycles synchronization give no support to the common macroeconomic policy envisioned in the EAEU agreement, suggesting that further steps of economic integration either would be postponed to the unknown future or would result in destabilizing the union, especially accounting for the bleak prospects of Russia in the next few years.

In spite of being called 'economic', EAEU is primarily a political union, in which each member-state pursues own political and economic interests with very few of them shared by all members. The differences in economic structure of the member-countries further aggravates prospective stability of the union and suggests that few steps beyond the current CU implementation will be taken in the near future. ■



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# Russian double-headed eagle – what will it bring to its Western partners and neighbors

Expert article • 1693

**M**ain Russian symbol is double-headed eagle that is symbolizing many sides of Russian public and political life. On the map one head looks to the West and another to the East. During last year Russia turned to Asia seriously and, if for some experts this changes in foreign policy activities has been visible during last years, for many regular partners that move surprised and confused about the future relations.

Russia has been European country during all its times, from the moment of getting the heritage, religion and culture from Constantinople, as well as the eagle symbol. Historically and naturally Russian always developed East and West as before as in its modern foreign policy.

The fast growth ended in 2008 and the search for growth became a slogan of today for many governments around the world. In spite of that the search for growth has not become a slogan for common international work that is looking for something else.

Year 2013 gave the belief for new economic development on the European continent that have been changed and sold in a favor of the new political game that is probably located out of the interest range of many European countries. Europe turned into the new extra round of economic recession, supporting itself by sanctions and internal mistrust between the members.

As Europe, Russia was forced to exist in the new economical surroundings with changed currency situation, new oil prices and a conflict developed straight at its borders.

The falling activity on European direction has forced Russian Government to raise the activity in Asian and Pacific region, where the structural and political work has been actively running during last 5 years. During the last years many experts inside of Russia has been advising on the stronger cooperation work on Eastern direction, but many pro-western liberals were avoiding Russia from that partnership. Today Russia develops its cooperation to Asian partners mainly without limitations and has main target to raise the economic and technical development on the mutual basis.

Asian partnership of Russia includes not only China, but also the whole region, including also Malaysia, South Korea, Vietnam and other countries.

Despite of other myth, the cooperation spreading more far then just energy sector and include scientific and technological cooperation, cooperation in the field of transport, communications and information technology, cooperation in the field of nuclear energy and space, financial cooperation, cooperation in the field of environment, cooperation in the field of civil aviation.

Today many Russian companies went to Asia and spending time in search for new partnerships as for export as for import activities. These companies introduce all possible sectors of economy from companies of retail market to innovation developers. Products of industry and engineering, heavy industry products has already important role in Russian export to countries of Asian and Pacific region.

The special interest for Russia and countries of the Asian and Pacific region is in the sphere of high technologies - all partners has enough high-tech experience to share with each other, to provide the further economic growth.

High-tech growth is located as in sectors traditional for high-tech technologies as in conventional industries such as shipbuilding. The creation of common projects in shipbuilding industry will rise up the global competence and competitiveness of participating partners. At the same time shipbuilding is one of the fields where Russia has good like with Western partners. Russian shipbuilders will unlikely to stop that cooperation. The only situation is possible in case of escalation of sanctions policy or own decision of European partners to stop the cooperation.

Minor part of export from China and countries of the region is made by joint venture companies. So, the coexistence of all partners in common shipbuilding projects is very possible.

The start of sanctions policy forced a number of European producers to leave the market. Empty places have been already occupied by national producers and partly by new suppliers. More time will pass, the stronger position new local and foreign players will get, especially after setting up the new logistic chains.

The cooperation in logistics and the establishment of new logistics chains to Fair East transportation infrastructure became the significant part of current and future work. This work is already taken to account in the new Government strategy on transport for next 5 years. And here the creation of new transport corridors in Russia together with European partners is highly possible, especially in such areas as Arctic region.

«Weak» Russian ruble became another destabilizing factor in Russian European affairs. But the weakness of the ruble still should be evaluated clearly as well as its influence on the local production and competitiveness according to foreign products and markets.

The reports about overestimated levels of Russian currency according to Euro and US dollar have been presented to the Russian government already in previous years. The first attempts to make new estimation for Ruble have been made during last winter and were linked to escalation of crisis on Ukraine. Instead of precise economic analyses, many Western experts declared the fall of Russian economy. The reaction was reasonable, as it was part of informational battle and was also covering own local mistakes and falling interest of Russia for Western products, like tourism.

Today Russian ruble has taken the place somewhere near to its true position. Of course the currency has an extra pressure by changed oil prices and local banking speculations on the currency market.

Current level is opening broader possibilities for Russian local producers in the national and international market as raising its price competitiveness. Foreign producers not only losing the Russian local market, but also getting higher competition

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on international ones on the number of products made in Russia.

Foreign capitals vice versa may have interesting deals from now and has no barriers for investments to Russia; new currency levels provided reasonably discounted prices on assets in Russia.

Another factor of current global economy is price for oil that has negative dynamics nowadays. But the fall is impossible to happen as deep and as long as in 80s. First, there is a bigger choice of consumers; secondly, the cost of oil production is higher than before. In US, almost 40% of current oil production is made by unconventional methods that has cost for barrel around 70-80 dollars. And the US is the main player today trying to push the oil prices down by using its special market instrument - price interventions - by placing the big volumes of a single product to the market at one time.

Russian Asian cooperation will lead to creation of new trade, industrial and logistics partnerships, new global competitive players and financial centers. And in that work there is a space for relations, developed during last 20 years on the other Russian foreign policy direction, in Europe.

The belief of Western companies in Russian crisis and falling ruble will lead them to loss of traditional markets and decreased global competitiveness. On the other side, common work and common business and economic targets will bring the benefits for all.

The global development is always running by circles. And economic development is not only based on growth, but also on the way how you survive the recession times and start to act during the new development wave, to reserve the place on the top of the new hill. ■

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# BALTIC RIM ECONOMIES

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ALEXANDER SOKOLOV, OLEG KARASEV &amp; KONSTANTIN VISHNEVSKIY

# Foresight in Russia

Expert article • 1694

The beginning of the 21st century is marked by accelerating pace of technological progress and emergence of new grand challenges such as environmental issues, global political changes, technological breakthroughs, demand for new skills and many others. Foresight has been increasingly used as a tool to cope with these new economic circumstances in both developed and developing economies. It gives the government an opportunity to concentrate limited resources on the most promising areas to support. The growing interest to forward-looking activities – at different levels of strategic planning – federal, regional, sectoral and corporate – has been also demonstrated in Russia in the last decade, in particular after the economic crisis of 2009-2010.

The most important Foresight study was the Russian Science and Technology Foresight: 2030 approved by Russian Prime-Minister in January 2014. This large-scale fully-fledged study covered seven priority areas: ICT, medicine and health, biotechnology, new materials and nanotechnology, rational use of natural resources, transport and space systems, energy efficiency. More than 2000 leading Russian and international experts were engaged in identification of global and national challenges, emerging markets, innovation products and services, promising S&T fields.

The S&T Foresight 2030 has been used as a background for revision of national S&T priority areas and the list of critical technologies (to be approved by President of the Russian Federation). The priority setting included comprehensive analysis of relevant country-specific problems highlighted by official strategic documents, their discussions with government agencies followed by formulation of detailed S&T related tasks targeting particular economic and social goals. The draft list of critical technologies identified in the framework of wide expert discussions covers key research areas in a wide range of disciplines: biomedicine, ICT, advanced manufacturing et al. There were also assessed possible impact of technologies on economy and society, required resources, risks and barriers.

The new Federal law “On strategic planning in the Russian Federation” adopted in 2014 envisages regular multi-level Foresight activities aimed at establishing long-term development goals at the national, sectoral and regional levels. Coupled with the activity of newly established Interdepartmental Commission on Technology Foresight the law elevates the consideration of Foresight studies at unprecedentedly high decision-making level in the post-Soviet Russia. The introduction of special government programmes strengthened attention to Foresight as a tool for their designing and regular revision. Forward-looking activities became the basis for the development of both the National S&T Programme and sectoral programmes with a large S&T component – on aircraft engineering, shipbuilding, space et al.

Industrial Foresight in Russia meets the traditional tasks such as an assessment of available S&T capacities, identifying key technological trends. In addition, it allows combining the factors of S&T supply and the expected demand for innovative solutions thereby mixing market pull and technology push approaches. The important role in this respect is played by the recently established network of sectoral Foresight centres on the basis of leading universities and research institutes

Foresight has been also widely used by the corporate sector. The largest Russian state-owned companies elaborated corporate innovation development programmes aimed at fostering creation and introduction of innovation products and services. Relevant

technology roadmaps were elaborated at Gazprom, Rosneft, Aeroflot and many other companies. These documents are used by the corporations for strategy building on innovation products commercialization reflecting the whole technological chain «R&D – technology – product – market», communication between companies’ divisions and establishing external links for technology transfer.

Regional Foresight is a rather new phenomenon in the Russian regional S&T and innovation policy and regional development, nevertheless a number of regions have already undertaken such studies. Foresight studies were implemented in such regions as Samara, Tula, Tomsk for establishing regional strategies of socio-economic development. Each of them included building integrated roadmaps describing the factors that affect the construction of alternative scenarios of regional development, clusters and areas in which changes may occur, as well as activities to promote socio-economic development of relevant regions in the long-run. The recent trend in regional Foresight in Russia is an elaboration of roadmaps for innovation clusters to improve economic performance at selected territories with high potential.

The developing of forward-looking activities in Russia, establishing and further elaboration of a multilayer Foresight system integrating national, sectoral, regional and corporate long-term future studies, involvement of increasingly wide range of participants (including citizens), absorption and development of more sophisticated Foresight methodologies create a solid background for building a more sustainable strategic planning. ■



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# Economic cooperation of Turku region and St. Petersburg

Expert article • 1695

## The beginning of the story

The City of Turku, Finland, and the City of St. Petersburg, Russia, have been twin-cities since 1953 and have had economic cooperation from that time onwards. The economic relationship received stronger input at the end of the 1990s and since then it has discovered new forms and developed and expanded. The mutual business cooperation has taken changes in the business and financial world into consideration.

At first, economic empowerment came about by using a variety of ways to finance different projects. By the late 2000s, economic cooperation with Russia was being written into budget financing. Furthermore, at roughly the same time, a contract was signed with St. Petersburg concerning mutual economic cooperation. This meant the continuation of the policy of encouraging mutual business operations between Finnish and Russian companies, including investment in both directions.

One of the strengths behind the successful economic cooperation we have forged has been the far-reaching networks of public and private actors in Finland and Russia, covering all levels of economic life. Another has been providing extensive knowledge of both the business cultures and the business environments, and, of course, both languages.

By the end of this century's first decade, the Turku region had become one of the leaders in Finland's economic cooperation with Russia. The region's best practices were adopted and copied by other Finnish actors offering services for companies wishing to enter the Russian or Finnish markets.

The Turku region is also one of the rare places in the world where St. Petersburg has opened an official business information representative office to disseminate information on businesses and business opportunities for companies.

## Entrepreneurs first

The economic collaboration between the Turku region and St. Petersburg strives to increase international cooperation for small and medium sized enterprises while also supporting their growth. Large companies and their chains of subcontractors are involved as well. The actions taken are based on the needs of the entrepreneurs and the need to develop better business environments for the implementation of their international business.

Together the Turku region and St. Petersburg have provided extensive information services and help for the internationalisation of companies. Over the years there have been hundreds of mutual business events and business missions, thousands of business meetings and projects of all sizes on business and governmental levels, while also keeping in mind the local aspects. Some events and projects have focused on different industrial or service sectors, such as the maritime industry, metal, construction, logistics, the environment, biotechnology, ICT, and so on, but always aiming to support prosperous development. The basic principle is to provide services for all companies irrespective of their industry – an approach that has yielded excellent results.

Together we enable Finnish and Russian companies to grow, become international and to create their success stories either on their own or in cooperation with others.

## The future

Economic cooperation is the equivalent of long distance running, so we do not make too much noise about the ups and downs of economic life because that is ever present. Our cooperation is also about taking the world's changing economic climates into consideration and helping businesses work through them or exploit them.

The future of our economic cooperation rests on supporting the needs of entrepreneurs on both sides of the border and on developing business environments that assist the better implementation of international business.

Together with St. Petersburg we will keep on encouraging our economic organisations and business communities to be more active and to develop their own initiatives. Some have already started to organise their own events with their cross border counterparts. This offers a base to increase their mutual cooperation, which could also have an impact on their members. This activity needs to be encouraged and is the right direction to move in.

We will also continue to cooperate with other parts of Russia in accordance with the needs of entrepreneurs on both sides. Nevertheless, St. Petersburg will always hold a special place in the heart of the Turku region.

Finland, and especially the Turku region, has an opportunity to increase its position as a gateway for European companies seeking to trade with Russia and vice-versa. The location of our region has already been of great benefit to many companies and this advantage will likely increase in the future.

Finally, the Turku region also is a part of Team Finland, a national network for promoting Finland and Finnish interests abroad, for example: the internationalisation of Finnish enterprises, investments in Finland and Finland as a brand. In Team Finland's South-West team we provide extensive knowledge about Russian businesses across a wide network in Finland and Russia.

The future holds great potential for us – we are excited to see what opportunities it will bring. ■



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# Russian cooperation of the City of Helsinki

Expert article • 1696

Russia, the St Petersburg area in particular, has always been a very important partner to Helsinki in many ways, and one of the key reasons behind this close cooperation is, of course, the proximity of St Petersburg. St Petersburg and Helsinki are both major economic areas, and large economic areas naturally have extensive spheres of influence. Over the years, St Petersburg and Helsinki have only grown closer, for even though the physical distance between the two cities remains unchanged, in today's world distances are not measured in kilometres, but rather in time. Today, a trip from St Petersburg to Helsinki or vice versa takes as little as 3.5 hours, and in the future this is set to shorten further. Nowadays a convenient day journey from one metropolis to the other is a reality, and we can safely say that on economic level the two cities are within each other's sphere of influence.

Even though the political situation in regard to Russian relations is currently difficult, we are not planning to decrease the cooperation between Helsinki and St Petersburg. After all, we should keep in mind that cooperation is being carried out on multiple levels and that the activities between two cities are different from those between two countries or companies. We are closely monitoring the development of the situation, and currently the sanctions imposed on Russia concern areas in which Helsinki does not operate nor has operated in the past. However, it would be disingenuous to claim that the current political and economic climate does not also impact the cooperation between the two cities. In particular, the bleak economic outlook of Russia, the instability of the rouble, the legislative changes that make it more difficult for foreigners to operate in Russia and possible further sanctions are all directly or indirectly reflected on Helsinki as well. For example, possible changes in the EU's financing programmes or the disappearance of financing opportunities on the Russian side would significantly hinder cooperation in areas that are important and beneficial to both sides, such as environmental and cultural activities. The protection of the Baltic Sea in particular is an issue that affects the well-being of us all regardless of the situation. In Helsinki, the current situation is reflected most concretely in the fact that tourism from Russia has collapsed and exports and imports have stalled. We must keep in mind that every percentage point in the statistics represents actual jobs on the personal level and tax income on the city level.

Because of this, Helsinki is prepared to do what it can to calm down the situation. The only way to resolve the situation is to maintain dialogue and to understand the reasons behind the actions, even if not approving them, which is why increased cooperation and discussion can help us find solutions faster. It is this kind of long-term cooperation that has spread Russia operations throughout the organisation of Helsinki, and it has been a joy to observe that friendships have also been forged on the personal level. The authenticity of such cooperation is measured during difficult times, and Helsinki has long been an international centre of Russian expertise, a fact that could also be more effectively utilised on the EU level. In addition to the city organisation, there are also numerous other parties operating in Helsinki that specialise in Russian issues, such as ministries, research institutions and other public and private operators. For example, Helsinki is home to some of the best libraries specialising in Russian research in the world. This is a significant asset that we aim to make clearer through improved coordination in order to promote more effective utilisation, especially in the area of economic development.

However, the centre for Russian expertise should work both ways. Unfortunately there is currently a massive disparity between Finland and Russia in regard to placement operations and investments, as investments from Finland to Russia greatly outnumber those from Russia to Finland. Finland is well-known, close by and has long placed among the top countries in the world in various business and investment environment surveys, but even so Russian investments have not found their way here. This indicates that there are still many challenges to overcome on many levels, starting from inadequate placement mechanisms and the inflexibility of the system and ending in pure prejudice. However, we believe that there are many innovations and products in Russia for which there would be demand in the EU market and for which Helsinki could serve as a good launch platform. After all, we have well-developed start-up and business development ecosystems and networks, which can provide genuine added value to businesses and help raise them to a new level. As a result, we believe that there is great potential in this area, and not just for Helsinki either, which is why we intend to continue investing in the development of similar activities in cooperation with national and regional operators.

Helsinki also has a physical presence in St Petersburg along with other partner cities in the form of the Helsinki Centre, which greatly facilitates operations between the two cities. The Helsinki Centre is a city representative office that operates out of Suomi-talo (Finland House) in the St Petersburg city centre, home to nearly all national and many regional operators. The Helsinki Centre helps us maintain local relations and operations with the city of St Petersburg, interest groups and the media. Even though it is a city representative office, the operations of the Helsinki Centre have constantly developed towards the support of economic development, and the aim is to further increase this focus going forward.

In the future, the international operations of the City of Helsinki will increasingly focus on economic development, which means, for example, closer cooperation with companies and the introduction of an economic development perspective to all operations. The Smart and Clean City and the Open Data projects in particular are areas which are currently being strongly developed in Helsinki and in which cooperation with other cities could greatly benefit all parties involved. Helsinki has a great deal to offer in these areas of expertise, and on the other hand we are constantly seeking solutions for making urban everyday life more convenient, improving the pleasantness of the city and environmental questions. In these kinds of operations, the greatest developments often come from companies! ■



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# Office real estate market in St. Petersburg, Russia in 2014

Expert article • 1697

Despite the negative macroeconomic trends in Russia, St. Petersburg office real estate market was more active in H1 2014 compared to same time period in 2013. This is reflected in the growth of high-quality office real estate that amounted to 2% during H1 2014. Over than half of the new supply (58%), belongs to Class A office space. In addition there has been growth in the take-up (take-up represents floor space acquired within a market for occupation) of high-quality office space in St. Petersburg. In the first half-year of 2014 the growth has been 1.9 times more compared to H1 in 2013. Most of the growth took place in the business districts of "Petrogradsky" and "Moskovsky Ave" which are attractive areas for tenants due to good subway connections.

The positive trend in the office market of St. Petersburg is also reflected in vacancy rates (The Vacancy Rate represents immediately vacant office floor space). There has been a drop in vacancy rates of Class A business centers by 3.9 p. p. compared to the end of 2013. However, one of the biggest reasons behind this increase was a lease deal conducted between the real estate company GHP Group and the Gazprom Company. This lease deal was the biggest transaction in the past six months. Despite of a drop in vacancy rate of Class A office center segment, a small growth was seen in vacancy rates of Class B office center segment. The growth was 0.6 p. p. in H1 2014 compared to the same period year 2013. This suggests that some of the tenants changed their former Class B offices to higher quality Class A offices. An interesting fact is that the average lease rates have remained stable in the high-quality office real estate in St. Petersburg despite of the difficult financial situation in Russia.

The Q3 period in 2014 showed that the active office market development, which was seen during H1, continued even in Q3. Total of 64,760 square meters were put into operation consisting of seven quality office buildings. This means an increase of 38% compared the same period 2013. The greatest demand in Q3 was seen in office spaces of 100-500 square meters which represents over half of the total number of transactions. Generally speaking this indicates that St. Petersburg office market attracted especially small and medium-sized companies during Q3.

As a result of completion of new office space, the vacancy rate increased in Q3 compared to the first half year of 2014 and is also slightly higher compared to the end of 2013. In addition the rental rates (in roubles) increased by 3-4% in high-quality office space compared to H1 2014. This can be a result of new quality office buildings put into operation in Q3 and the depreciation of rouble.

An interesting detail is that the amount of short-term lease agreements is decreasing. Most of the foreign companies as well as medium and large Russian companies are chasing for long-term lease agreements. This development in lease terms can be seen as a result of the active and positive development in the office market in St. Petersburg. The companies want to take advantage of the favorable situation now at this rental level in high-quality office space.

One of the trends in St. Petersburg office space deals is that the amount of oil and gas companies has increased heavily and this trend is also expected to continue in the future. However, one of the main reasons for this market development is Gazprom's move from Moscow to St. Petersburg. About 40% in the total volume of absorption is caused by Gazprom companies and its structures. From this perspective can be concluded that the office market is unbalanced in terms of demand and that the market is highly dependent on Gazprom and its affiliates.

Despite of the positive development in St. Petersburg office real estate market in H1 and Q3 2014, it can be expected that the difficult economic situation as well as political uncertainty in Russia will affect negatively to the market. If the EU sanctions against Russia will not be lifted before the end of the year – which at the moment seems more than likely – the impacts on the commercial real estate market in Russia can be more severe. In general, companies tend to postpone expanding of their office space or relocating operations until the overall political and economic situation is more stable. Due to uncertainty of the market the vacancy rate in new office buildings reaches even 50% by the delivery date in Q3.

On the other side if the market situation stabilizes, the office market in St. Petersburg can continue its positive development even faster than expected. ■



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# Foreign investments in commercial real estate in St. Petersburg – trick or treat?

Expert article • 1698

## Investment situation in the beginning of 2014

Real estate investment market in Russia is known to be highly centralized – majority of foreign investments is made in Moscow. However, there is one real estate sector where Saint Petersburg holds the leading position in terms of volume of real estate stock per number of inhabitants – retail real estate. Such investors as, for instance, Finnish retailers K-Group and S Group, German OBI Tengelmann Group and Metro Group, French Auchan Group have been present at the market and some of them have announced development expansion plans for the future.

This evidence created interest to discover which specific factors made Saint Petersburg retail real estate market attractive for foreign real estate investors. Topic became a background for research within author's Master Thesis. Empirical data was taken from the interviews with real estate consultants acting at the market. For the interviewing all major consultants were approached and final response rate amounted to 81% which made result of interviews highly justified and reliable. Moreover, broad approach of interviews made it possible to extend some results and conclusions to all stock of commercial real estate.

According to the interview respondents, foreign investments in Saint Petersburg retail real estate market were driven by several reasons: higher profitability and shorter term of return of investments (compared to investors' national markets), growth of consumers' wealth and purchasing abilities, demand for new goods and products, financial possibilities from abroad financing. Special accent was made on attractive location of Saint Petersburg – direct access to the Baltic Sea, 170 km from Russian-Finnish border Nuijamaa and 350 km from Helsinki made Saint Petersburg a successful hub for different ways of transportation, and city was regarded as European gateway of Russia. Location seemed to become one of the main reasons for European retail investors to enter the Russian market by establishing their entities in Saint Petersburg. Already mentioned "investment centralization" in Russia reflected in the research results – most of the interviewees compared real estate markets in Saint Petersburg and Moscow. Based on this comparison, Saint Petersburg outperforms Moscow in terms of level of prices (land, construction, infrastructure, personnel and maintenance costs), market transparency and availability of land for development.

Therefore, investment situation at the moment of research (February 2014) seemed to be favorable and promising. However, political situation in Ukraine which took place in the following months and is still in force, added to the investment agenda news factors to consider.

## Investment situation in the end of 2014 and further: threats and opportunities

Political circumstances and tense opposition between Russia, EU and USA affected significantly economy of Russia at macro- and microeconomic levels. GDP didn't reach 1% by the end of third quarter 2014, inflation rate, on the other side, inclined to 7% and official economic forecasts for 2015-2016 were reviewed. Investment market and especially market of foreign real estate investments is known to be highly sensitive to political and economic factors. Continuous weakening of Russian ruble worsened financial results of foreign investors who report their profit in currencies other than ruble. Earlier announced development plans were mostly put on hold by the existing investors and launch of new investments projects has been postponed or even cancelled.

Nevertheless, recent market reports give reasons and hopes for positive in the future. For example, Trade barometer published by SVKK (Suomalais-Venäläinen kauppakamari) in the end of October 2014 indicated that Finnish investors continue to consider Russian market as potential and profitable in long-term perspective. Real estate investors are usually recommended to focus on two main issues during periods of crisis – to secure existing investments and to track potential investment opportunities. Both aspects can be justified by financial reasons – sale of asset in period of volatility and instability is likely to cause a drop in price and, vice versa, there is a possibility to make a purchase with good discount.

It should be highlighted that in challenging business environment all the market players need to pay most possible care and attention to their current activity and specific actions. Risk management is an efficient and useful procedure in crisis periods. Keeping eyes open and being sufficiently and extensively informed about market situation enable investors to remain stable, professional, safe and, as a result, successful. ■



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# Development of Kaliningrad region – modification scenario

Expert article • 1699

For the last decade the Kaliningrad region in Russia has overcome drastic changes. Although some researchers state that Kaliningrad's geographical position is not being used by Russia as an asset, some facts demonstrate otherwise. Presently, the Kaliningrad region is one of Russia's best performing regional economies, strengthened by a number of elements: strong population growth (due to the migration program, lower death rate, higher birth rate, and Baltic federal university), status of Special Economics Zone, implementation of major infrastructure projects, development of industrial areas, ice-free ports, world's largest amber deposits. Moreover, according to the National rating agency, Kaliningrad region rates as a region with high investment attractiveness and ranks within the same category as Moscow, Saint Petersburg. As of "Forbes" evaluation Kaliningrad considered the best city in Russia in terms of availability of skilled labor, lower administrative pressure, and development of infrastructure. Yet, talking about Russia in general, main obstacles outlined by "Forbes" are a lack of skilled labor, a lack of access to financial resources, poor infrastructure, tax, and administrative burdens. Implementations of Federal Target Program, Federal Targeted Investment Program are efficient instruments to realize the state economic and social policy for long-term tasks and realizing large infrastructure projects. In line with these Programs Ministry of Economy of the Russian Federation evaluated the state program "Socio-economic development of the Kaliningrad region 2020" as the best and ranked first in the rating published in 2013.

Nevertheless, the political factor plays a vital role in general investment climate and directly influences investment flows. Current embargo on food imports fosters a totally new scenario of the development of the Kaliningrad region. The isolated Kaliningrad region depends more on European imports than any other Russian region. Thus, the situation with the embargo on import from European countries can negatively affect the general economic condition of the region. Still, the effect of foreign sanctions is twofold: short-term and long-term. There is no doubt that entry of foreign sanctions interrupts businesses and affects local economy negatively in terms of wage cut, unemployment rise (due to some industries output decrease), and business bankruptcies, especially those, which are dependent on imported resources. According to official data, 40 percent of total food products consumed in Russia are being imported from other countries. In the Kaliningrad region, the share of imported products from the European Union reaches 80 percent. 16 percent of goods fall under the Russian embargo imported to Kaliningrad. On the other side, the regional government has prepared a regionally significant program of import substitution and rapid doubling of agricultural production in the local plants. At the moment, it all depends on the amount of funds that will be directed to the field of agriculture and the priorities of development within the industry. Priorities for the investments have already been stated, which is the development of import-substituting industries: greenhouses for growing vegetables, horticulture, land reclamation, cattle breeding, poultry farming. Thus, looking at the long-term scenario embargo on import can only open opportunities for the region's development in a number of different fields, such as vegetable and fruit cultivation etc. So the majority of these products can be either substituted by the suppliers from countries that are not targeted by the embargo or that can be replaced by Kaliningrad manufacturers.

The Kaliningrad region has long been vulnerable to food supply security as an exclave. Hence this is the time to not only consider, but also take certain actions towards developing local agricultural production, building its own storage locations to hold reserves of vegetables and fruits, and not to be dependent on the suppliers of neighboring countries. Food embargo in this sense can definitely positively affect the agricultural industry and replace foreign competitors by the local products. Additionally, local producers can increase part of sales market.

The situation of the Kaliningrad region though should be carefully considered on a federal level in terms of boosting the investment. Taken the sanctioned condition, it is more likely that number of foreign investments will continue falling. Therefore, the development of the region will depend on the investments of small and medium enterprises. Without public investment, it is less likely that number of private investors can grow, especially under current political conditions.

Local municipalities of the Kaliningrad region should play a vital role in stimulating investment. The key factor to increasing the investment attractiveness and stimulating the growth of assets is actively developing and implementing investment policies within the region and municipalities. Creation of different investment programs and their practical realization in the regions and municipalities is already an ongoing process. There is a number of programs, projects in the field of public-private partnership, state support for boosting the investment and it seems this number will only grow in line with the changing political and economical situation.

Finally, development of agricultural sector may be the priority at the moment, but it is definitely not the only sector with greater development possibilities for the long-term. Such sectors as shipping industry, IT segment, amber industry, biotechnology, energy sector and tourism offer great potential for development and growth in the near future. Thus, improvement of investment conditions and creation of favorable environment for investors remains as a general target for the Government and local municipalities. ■



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# Finland's future position as a hub of Russian tourism

Expert article • 1700

- Russians spent over USD50bln on traveling abroad in 2013 – ranked 4th in the world after Chinese, U.S. and German travelers
- Russia's share app 40% of Finland's tourism revenue - EUR1.4bln in 2013
- 1/8 of the Russians' visits abroad to Finland (H1 2014)
- Russians' share of foreign hotel accommodation in Finland was 28% in 2013 (decreased by 13% in H1 2014)

Figures above show that Russian tourism has an important role even in the global league – and especially in Finland. It is also a fact that the volume of Russian tourism has dropped down this year as a result of weakened ruble and geopolitical tension. Instead of current situation, a focus of this article is to look forward and review actions in a longer run. The assumptions are that competition for Russian tourism will increase, marketing improve towards more customized solutions and Finland's position become challenged. Finland may need innovative new actions to improve and secure its future position.

Have we done enough to customize our service offer or should we do even more to secure our position? Are we active and innovative enough in our marketing efforts? Key part of a good business is to make sure you don't lose the clients you already have. It is traditionally easier to sell more to customers that know you well than to someone you don't have a relationship at all.

## Selected threats of Finland

- Increasing future competition for Russian tourism – customization, tailoring etc.
- Improving international travel infra and connections from St Petersburg – i.e. new airport facilities, future entry of low-cost carriers, new direct flights
- Desire of new experiences and travel destinations – e.g. self-made internet travel plans etc.

Estonia is a good benchmark of effective development actions taken to boost the Russian tourism. It was not more than few years ago in 2007, when political tension almost froze both business and tourism flows between the countries. Within the last few years Estonians have started to implement actions to improve the situation. As an example the online reservation system for border crossing by car is minimizing the waiting time to cross the border (meaning some minutes instead of few hours in the Finnish border at weekend time). Also the holiday resorts built to North-Eastern Estonia are customized for Russians and providing Russian service, customized activities, tax-free shopping etc. The latest rumors also say that Estonian Consulates would start to deliver 3-5 years' Schengen visas (instead of normal 1-year).

As another example of development, new and modern airport was finally opened in St Petersburg this year. There are also investment plans for airport train connection from the city center. Basically there are no international low-cost airlines operating from St Petersburg yet, but some negotiations were started already some years ago. Both airport train and low-cost airlines will probably become available by the Soccer World Cup in 2018. Modern infrastructure and cheap flights to European capitals may also challenge Allegro train and Finland.

## Selected opportunities of Finland

- Strong country brand – especially in the North-Western Russia
- Further customization of the services to match with Russians' needs, language, consumption culture and preferences
- Improvement of both public promotion programs and physical presence, as well as private sector marketing – a mix of traditional and digital tools, social media channels etc.
- New attractive service offers and tourism destinations inside the Finland
- Effective border system – sufficient human resources and e-solutions to minimize border crossing time

North-Western Russia is a unique spot if we measure the country brand of Finland. Finland's reputation as a country of quality is strong. For example in St Petersburg, leading Finnish construction companies sell "Finnish homes" and Finnish food products are a synonym for a high quality. This is a good base to build on Finland's tourism brand, but further actions are needed to secure the future position. An international competition for Russian tourists will get tougher and Finland needs to better customize its products to match with the segment's desires. To do this we need more understanding of Russian consumer behavior and culture, as well as how to sell our services. Currently only smaller companies next to eastern border, department store Stockmann in Helsinki and some others are examples of carefully customized solutions for Russians. Russians are willing to invest in quality when they celebrate something or simply enjoy the holidays, and we must be capable to actively provide right things with the right timing. As an example of public sector actions, Finland's tourism promotion agency Visit Finland could review presence (existing in many other destinations) and increased activity in St Petersburg.

To be repeated, the key of good business is to make sure you don't lose the clients you already have. ■

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# Tourism development between border regions: Kaliningrad (Russia) and Warmia–Mazury (Poland)

Expert article • 1701

**T**he Kaliningrad region has a unique exclave geopolitical location: it is located in the center of the European continent, bordered by the Republic of Poland and Lithuanian Republic. Tourism is one of the priority and fast evolving sectors of economy, which has not lost its appeal even after the 2008 crisis. The pace of industrial growth (4% per year) predicts a gradual increase in the rate of development of the tourism industry. The current structure of tourism in the region is dominated by domestic tourists (86%), but it is expected that in the near future there will be changes.

Ratification of the 2012 agreement on small border traffic (SBT), significantly increased the possibility of crossing the border, both for citizens of Russia and Poland. It had an impact on the frequency of the state border crossings and export (import) of the capital in the neighboring state. In the Kaliningrad region at the present time, there is a common practice for foreign citizens (from Poland and Lithuania) to cross the border repeatedly (3-5 times a day) for buying excise goods (cigarettes, alcoholic beverages, gasoline).

Based on government statistics of Kaliningrad District, in 2013, the number of tourists visiting Kaliningrad District increased by 15%. With SBT increased the number of border crossings from 2.5 million to 6.2 million. Based on the statistics of the airport Khrabrovo, in 2013, number of passengers increased by 10.5%, including more than four times the increase in the number of people using a discount airline ticket airfare subsidy program majoring in Kaliningrad. Number of tourism businesses in the Kaliningrad District in 2013 increased by 24%, an increase in employment in the tourism sector by 15%. An investment in the hospitality, the sphere of public catering and tourism conference amounted to 4.5 billion rubles; increase in the number of hotel rooms by 18%.

According to statistics, from January to May 2014 in the framework of the border, SBT has crossed 1.5 million people. 980,000 of them are Polish, and 520,000 Russians. According to data from Polish sources, in the same period, according to SBT, up to 1.4 million people crossed the border. It is 250,000 more people than in the same period of 2013. For the first nine months of 2014 the total number of intersections was 5.5 million.

The construction of tourism project on the Baltic coast. It was decided to extend the recreational area outside the city Svetlogorsk and Zelenograd, which does not really fit in with this objective in view of the existing buildings. The extension of the zone concerns Kulikov area where it will be a complex of hotels, a spa and health resorts with a small cluster of games. Moreover, in the region of Kulikov is planning to build a medical center mineral waters as Baden-Baden. The building area of 600 hectares is calculated on a minimum of 10 years. However, due to FIFA World Cup in 2018. Part of the building along with the seaside pedestrian streets will be open.

However, the crisis of relations between the Russian Federation and Poland had a big impact on tourism. From May 2014 has significantly decreased the number of Russian tourists traveling to Poland. Such a situation there has been due to negative expectations and fears on the part of tourists and economic reasons: the rate of growth of currency (euro and Polish zloty) in relation to the ruble. At the same time the leaders of both the Kaliningrad region and the Warmia and Mazury support positions to expand the further development of bilateral cooperation and visa-free travel for tourists that will develop tourism and related industries.

Currently Kaliningrad is in fourth place in the ranking of the best tourist destinations in Russia. Sustaining economic relations including cooperation in the development of tourism is extremely important in view of the organization of FIFA World Cup in 2018. Kaliningrad is one of the cities and the organizers will try to attract tourists from around the world. ■

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# “Main Stream” agency

Expert article • 1702

**O**ur agency is situated in the Russian city of St. Petersburg. This city was created by tsar Peter I in 1703 on the bank of the Neva River, which connects St. Petersburg with the Baltic Sea. St. Petersburg is a great port with its own naval history. But when the ships of many countries come to our city, it becomes not St. Petersburg, but Interburg on the Neva. In 2007-2008, we worked with the TV program called “Interburg on the Neva”.

So St. Petersburg is not only a great port – it is a great museum. We love our historical ships – the “Aurora” and the “Krasin”. The “Aurora” is a department of Central Naval Museum. It is a well-known ship, which divided Russian history into two parts in 1917. But it also took part in the Russian-Japanese War of 1904-1905 and today many descendants of participants of this war come to “Aurora” on May 27 and tell each other about their forefathers and their work with archives, dedicated to them.

The second ship – an ice-breaker “Krasin” also has its own naval history. It took part in rescuing operation of Italian expedition of Umberto Nobile in 1928 and many other rescuing operations. During the Days of Finland in St. Petersburg on the board of the “Krasin” we met participants of postwar (World War II) trawl operation of the Baltic Sea. Their memoirs were very interesting.

The ecology of the Baltic Sea is one of the important themes of Union of the Baltic Cities Commission of Environment. We met representatives of WWF (World Wild Fund for Nature) and had an interview about the life of whales and Baltic seals, how their life depends on the climate change and we also had an interview with a oil and gas environmental policy officer about ecological expertise and necessary information on monitoring of pollution.

We participated in the EU-Russia Innovation Forum, where issues of ecology of the Baltic Sea were discussed as one of the most significant problems today. One of the programs was dedicated to innovations in education, cooperation between Russian and Finnish schools.

The plots of our TV programs were dedicated to St. Petersburg, as a port, as a museum and also as a great Theatre: this year the 24 International Theatre Festival called “Baltic House” took place in St. Petersburg. As one of the most significant European theatrical forums, this festival has become an integral part of both St. Petersburg and European cultural life.

The “Baltic Star” prizes are annually awarded in the field of culture (for working in the Baltic countries towards the establishment of relations between cultures). This year (2014) our agency participated in two Forums of Young Leaders “Bridge” in Turku and in St. Petersburg and in the II International Congress of Eurasian maritime history.

One of the themes, which connects Russian and Finnish historians was exploration of region of Hango battle in 1714 with the purpose of localization the place of the battle. One of the interesting reports, delivered on this theme, was “Main Results of Study of Gangut Battle & Research Tasks at the Modern stage” (St. Petersburg State University). The II International Congress of maritime Eurasian history has brought together many scientists, historians and opinion leaders, clearly showing the high quality of international communication and opinion exchange on maritime studies, science and engineering.

This year III Forum of Young Leaders “Bridge” (between Turku and St. Petersburg) took place in Turku during the 16th Baltic Development Forum. All the participants of the Young Leaders Forum were divided into groups to visit industrial companies of Turku such as bioengineering, architecture, jewellery, food companies and also the Concert Hall of Turku.

The second part of “Bridge” IV (2014) was in St. Petersburg. Here the visitors were acquainted with the business incubator “Ingria”. We visited also the Innovation Forum in Lenexpo. In the review on History of the “Bridge” Forum we can see, that St. Petersburg and Turku have been sister cities for 60 years. Currently numerous partnerships have been installed between Turku and St. Petersburg. In the future, both cities want to expand cooperation between the active young leaders in business, politics and culture, who are interested in the development of bilateral ties.

The second branch of our work is booking of foreign artists and DJ’s of different styles of music. Our agency has already worked with some popular world stars of the music scene.

Our agency has an informative website with our events. So you can use our portal for advertising your news related to science, culture, business, sport and other topics. [www.mainstream-agency.com](http://www.mainstream-agency.com). ■

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OLGA HANNONEN

# Russian second home owner – friend or foe?

Expert article • 1703

**R**ussian second home ownership has been a subject of heated debates both in the media and in the Finnish parliament. Over the last 14 years there have been 17 written interrogatories by Members of Parliament concerning foreign property ownership, and three legislative initiatives to restrict land ownership to non-EEA citizens in Finland. While the peak years of Russian purchases are already in the past, the debates around the phenomenon are far from calming. The most recent concerns in the media have been about Russian property purchases next to strategic objects. Studies show that the debates around Russian property ownership in Finland are by many accounts based on prejudices and fears, as well as on the general lack of knowledge about Russian purchases and Russians. One of the biggest concerns that has been expressed in the press and in the written interrogatories from parliament is the character of the Russian owner. A Russian second home owner is often portrayed as a rich businessman who comes with big money to purchase overpriced properties from the shores of Lake Saimaa. In many accounts money laundering has been linked to the image of Russian second home tourists.

To make the picture more precise, the total number of Russian property purchases in Finland comprises 4043 properties (2000-2013) according to the National Land Survey of Finland, which is about 70% of all foreign property purchases during the same period. In comparison to domestic property purchases foreigners barely comprise one percent. Property purchases here refer to transactions involving plots of land with or without a building on it. Who are these Russians and why have they decided to buy their recreational property in Finland – this is one of the basic questions that I ask in my doctoral thesis.

During my fieldwork in the Savonlinna region in summer 2010 I conducted 25 interviews with Russian second home owners. Half of the interviews took place directly in the second homes, which gave me the opportunity to see the Russian leisure environment. Russian second homes vary in size and amenities, including 'granny cottages' without running water and newly-built designer homes suitable for year-round use. The majority of cottages are, however, well-equipped and winterised.

The Russian second home owners interviewed were predominantly couples over 40 years old; only five couples among my informants were younger. Most of the respondents had families with children or grandchildren, and two couples already were retired. The majority of the respondents were from St. Petersburg, while one-third were from Moscow and one family was from Petrozavodsk. In terms of professional background, the Russians comprised a very diverse group, including individuals in construction, law, accountancy, business, tourism, and other fields.

The main purpose of second home purchases by Russians is for recreation. They look for a calm and safe environment where they can spend their free time with their family. Finland has the image of a safe destination both in terms of personal safety and safety of investment. In addition Russians get the possibility to own a second home in pristine nature with personal lakeshore access. Lakeshore ownership is restricted in Russia by law, thus such an opportunity in Finland attracts Russians. In general, Russians want to escape the

hectic and busy city life and spend their free time in the countryside. In this regard they do not differ much from an average second home owner from Finland. Due to the distance they cover, including the time spent on border formalities, they prefer to have comfortable cottages with modern facilities. Second home ownership in Finland is also an escape from the insecure lifestyle and leisure conditions in Russia.

In comparison to other European countries, Russian owners do not reap the benefits of, e.g. residence permits or social security benefits in Finland. Yet these are the things that a modern Russian second home tourist considers before investing in a leisure property abroad. At the same time that social and legislative pressures on Russian second home ownership in Finland are intensifying, bringing potential future risks for owners, Russians are still purchasing second homes in Finland indicating that they are choosing the quality of leisure over certain benefits.

Since the peak year of 2008, Russian property purchases have been decreasing and last year (2013) purchases comprised about half of those of 2008. In comparison to purchases from 2012 the decline was 15%. Due to the current political climate and the volatility of the exchange rate of the ruble with its drastic recent decline, Russian investments will continue to drop. In case Finland wants to keep Russian second home investments, Finns must relatively quickly decide whether they perceive Russian owners as friends or foes. ■

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# On the socio-economic situation in the Republic of Karelia

Expert article • 1704

The figures' dynamics for the nine months of the current year's performance reveals a slowdown in the real sector of the economy. Reduction of real money incomes of the population, decline in the consolidated budget revenues, dependence of the republican economy on the world prices conjuncture for export goods, domestic demand constriction, reduction of the investment and consumer demand, and a number of other issues determine largely instability of the economic system. Investment projects on modernization of existing and creation of new industrial plants and agricultural facilities go on implementing in the Republic. In comparison with low figures in the industrial production sector for the last year (index 89%), volumes of production in the manufacturing industry increased in 2014. In January-September 2014, volumes of production in wood-processing industry increased by 6.9%, in pulp and paper industry - by 1.5 times, in manufacturing of machinery and equipment - by 8.1%.

Negative dynamics of the production volume is marked in the food processing industry, chemical and metal manufacture. Index of industrial production in the Republic of Karelia made 105.1% in January-September.

Index of industrial production in mining sector amounted to 101.2%. Further growth of the mining enterprises production is connected with introduction of new industrial sites. Thus, since the beginning of 2014, there have been put into operation talc-chlorides and basalts block quarries in Medvezhiegorsk region, a crushed stone quarry in Lahdenpohja region.

In the current year, the positive dynamics retains in the activity of logging companies. Production of raw timber made 110%.

The leading wood processing companies are functioning stable this year. The promising development projects in the Republic in the sphere of woodworking industry include the implementation of the second stage of the investment project Woodworking plant "Kalevala" Ltd. for production of wood-based panels from the oriented shavings OSB; expanding of the woodworking production company "Setles" Ltd. Index by type of economic activity: production of cellulose, wood pulp, paper, cardboard and some goods produced from them made 148%, what is above the national average figure (106%). Paper production volume increased 1.6 times in comparison with the corresponding period of 2013.

Index of agricultural production in comparable prices in all categories of farms amounted to 98.5%. The consumer price index made 105%.

In the ranking of the Russian Federation constituencies concerning the growth of prices for socially insured food products Karelia occupies the 39th place. Share of profitable organizations made 54%, what is by 1.2% less than last year.

Debts payable and receivable of large and medium-sized enterprises have increased. The largest share in the budget spending structure for the Republic of Karelia makes socio-cultural spending, which accounts for 73% of total expenses, including insurance of 32%, 22% for social policy, 16% for public health care and sport.

As of July 1, the number of unemployed people, registered at the employment agency, decreased by 1.6. The registered unemployment rate made 1.9% of the economically active population.

Measures undertaken by the Government of the Republic are aimed at the support of the existing production modernization, investment and innovation. Particular attention is paid to solving problems of company towns, unemployment issues, social support.

In September 2014, the Government of the Republic of Karelia discussed the main features of the draft regional budget for 2015 and the planning period of 2016 and 2017.

The budget expenditures in 2015 will remain their social orientation and are expected to reach 26.7 billion Rubles. The total revenues of the Republican treasury for 2015 amount to 24 billion Rubles. The deficit thus amounted to 2.7 billion Rubles. The receipt of tax and non-tax revenues of the budget in 2015 is estimated at \$ 177 billion Rubles. The total amount of gratuitous receipts is forecasted to make total \$ 6.9 billion Rubles.

Some problems of the 2014 budget revenues formation remain for 2015 as well.

The Government of Karelia and its head pay much attention to the preparation of the federal target program (FTP) for the development of the Republic for the period up to 2020. The FTP is regarded to be a strategic priority for the Government of Karelia. In case the FTP is approved on a federal level Karelia will get a great incentive for its development.

The FTP is regarded as an exceptional attention of the country's leadership to the problems of the region. One may sufficiently note that the Federal Target Programmes have been developed and approved just for four constituencies.

The FTP has been reviewed by 17 federal executive power bodies. According to the request of the officials from the Government of Karelia the total planned volume of funding makes up to 600 billion Rubles for the period up to 2020. The most ambitious project, which was proposed to be included in the draft Programs, is the project "Pudozhsky megaproject". Several deposits of titanium-magnetic ores located in the eastern part of the Republic and construction of three mining and processing plants are supposed to be developed in the frameworks of this project. The total cost of the mega-projects is estimated as trillion Rubles, the FTP is supposed to include the first stage associated with the construction of infrastructure for the future cluster.

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Expert article • 1704

A considerable amount of FTP major objects concerning production, infrastructure and social sphere will be implemented on conditions of public-private partnership and project financing mechanisms. In conclusion, it should be noted that the economy of the Republic will continue developing depending on the growth rate of the country economy. ■

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# Clusters in the economy of a cross-border region and Finnish experience

Expert article • 1705

Improvement of the investment and entrepreneurship climate and establishment of the infrastructure for innovations are urgent for cross-border regions of Russia, Republic of Karelia being one of them. It is important to solve the issues, as the pace of reviving the economy of the region is slow, growth of real expendable income and real salaries of people is slowing down and there are some other factors influencing competitiveness of the republic and its preparedness for implementing large-scale investment projects.

We consider the cooperation in the field of atomic energy very promising, which is confirmed by the visit of the Head of the Republic of Karelia A. Hudilainen on the meeting in Oulu on 16 October 2014 where he said that great amount of components for atomic station in Finland can be produced in Petrozavodsk on LLC "PZM".

Karelian science organizations are interested in cross-border cooperation in this area. For example, Petrozavodsk State University in cooperation with LLC "PZM" and "AEM-Technology" realizes project of development of high-tech manufacture of stamp-welded slide and wedge gate valves for atomic, heat-power and gas-and-oil industries which is implemented with the financial support of the Ministry of Education and Science under the contract 02.G25.31.0031.

To turn the tide, it is necessary to secure effective use of resource potential and the advantages of geographic location. In this case it seems natural and feasible to use the experience of Finland, the closest neighbor of Russian Karelia. With the account for permanent changing trends in the world's economy, this country has been successfully using a cluster approach as the key tool of industrial and investment policy. Besides, in our opinion, by using the cluster approach, the innovation system of Finland acquired high capabilities for adaptation that provide for continuous structural transformations in the economy by meeting the challenges of the global economic situation.

Our research identified the following clusters in Karelian economy that have major potential for the development of the region:

1. forest industry cluster;
2. mineral raw materials cluster;
3. bioenergy cluster as part of energy cluster of Karelia;
4. recreation and balneological cluster including tourism as a sub cluster;
5. R&D and educational cluster.

In our opinion, R&D and educational cluster - resting upon the potential of Karelian research and training units in close cooperation with Finnish research and training facilities - should be the catalyst for the processes of establishing clusters in the economy of the republic. In turn, Petrozavodsk State University should have the leading role in the educational cluster of the Republic of Karelia. The University has vast R&D and educational potential and long-term experience of cooperation with Finnish universities, research facilities and enterprises.

An urgent need of establishing bioenergy cluster has arrived. The key bioenergy resources in Karelia are peat and fuel wood, i.e. logging and timber processing wastes and firewood. Peat can be extracted from the deposits that have already been investigated and approved, but there even more peat fields that have not been surveyed. Municipal utilities' energy generation facilities are natural consumers of those resources. However, the share of biofuel in the balance-sheet of energy fuel consumption in Karelia makes only 19,5%, despite the fact that a network of boiler houses in Karelia is the key source of heat energy for people. This sector has wide opportunities for transferring technologies and innovations.

The approach in question will allow Russia and Finland to advance from export trade stage to long-term innovative production cooperation and joint implementation of large research and production projects. It will also contribute to establishing new production facilities, enhancing social and economic infrastructure, and gaining stability in financial and budget spheres. It will improve the quality of goods and services, level of diversification and institutional maturity of Karelian economy.

In our opinion, there are prerequisites for such a scenario in strengthening contacts at all levels between the Republic of Karelia and Finland, which has taken place after A. Hudilainen was appointed the Head of the Republic of Karelia. ■

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# Development of high-technology manufacture of stamp-welded slide and wedge gate valves for atomic, heat-power and gas-and-oil industries

Expert article • 1706

The Petrozavodsk State University in cooperation with engineering company ZAO «AEM-technology» and with the financial support of the Ministry of Education and Science of Russia develops a complex project. The purpose of this project is to acquire in Russia the manufacture of isolation valves for heat-power, atomic and gas-and-oil industries to complete satisfaction of demands in stamp-welded slide and wedge gate valves on domestic and foreign markets.

The need of this project is also determined by the growing demands in developed net of long-distance pipelines and new atomic power stations and new power units for them.

There are plans in Russia for constructing new and extend capacity of existing oil pipelines. In the period from 2012 to 2020 there will be demand in construction of 1500 kilometers of oil pipelines, 43 oil pumping station, 800 000 cubic meters of oil reservoirs. This will make possible to increase oil receiving possibilities from oil pumping stations by 70 percents with ensuring transport volume of 54,5 millions tons of oil by 2020. The extending of oil-products system includes projects: construction of pipeline «Syzran - Saratov - Volgograd - Novorossiysk» (project «South»), increasing capacity of pipeline «Kirish - Primorsk» (project «North»), construction of pipeline «Ksotovo – Nagornays (Moscow)».

Also the construction of new power units for atomic power stations (APS) till 2025 will result in demand in 300000 block valves of different implementation types, including stamp-welded design. At the present time several APS power units are built: power units № 3 and № 4 at Rostov APS, power units № 1 and № 2 at Novovoronezh APS, power units № 1 and № 2 at Leningrad APS, power units № 1 and № 2 at Baltic APS. The construction of about 40 different power units till 2025 planned by Rosatom. Acquiring of slide and wedge gate valves manufacture will improve position of ZAO «AEM-technology» on the market of pipeline block valves for atomic, heat-power and gas-and-oil industries.

The development programme of valve manufacture was worked out on the basis of General Scheme of oil industry development up to 2020 and sanctioned on the long period programmes of ZAO «AEM-technology» including: Programme of complex diagnostic, technical rearmament, reconstruction and capital repair on the period up to 2017, Programme of innovational development of «AK «Transneft»» on the period up to 2017, Programme of energy preservation and advance energy efficiency of «AK «Transneft»» on the period up to 2015, sanctioned by Rosatom Road-map of Atomic Power Station construction in Russia.

The main project goals are to:

- Acquire new technological processes of stamping, welding and nanopatterned coverage applying;
- Form technical and technological solutions in the area of construction, exploitation and production of stamp-welded slide and wedge gate valves for atomic, heat-power and gas-and-oil industries;
- Achieve anticorrosive characteristics of pipeline valves body parts;
- Creating of new high-technology manufacture of stamp-welded armature;

The developed slide, block, back flow and back pressure valves will be used in the function of locking devices for work fluid low stoppage in oil-and-gas pipelines and pipelines of new power units for APS.

The slide valves of high of advanced reliability and technical safety are developed for installation on highly hazardous line sections of mainstream pipelines to increase their defense level from severe accidents with regional, national and global social, economic and ecologic aftermaths.

The block and back flow valves are developed for work fluid control in the pipelines of reactor systems of APS, also including systems of 4 level of safety (NP-001-97);

The back pressure valves are developed for installation on the gas pipelines as devices for preventing back flow of natural, oil and synthetic hydrocarbon gas in the areas of its producing and storage in inward and outward devices of explosion-dangerous zones.

The important part of the project is the implementation of nanotechnology in the manufacture of armature for atomic, heat-power and gas-and-oil industries. The positive experience of developing and appliance of nanopatterned coverages will be used for further developing of new materials with nano components for other equipment, produced by Rosatom plants.

This project is implemented with the financial support of the Ministry of Education and Science under the contract 02.G25.31.0031.

The specific information about the project of development of high-tech manufacture of stamp-welded slide and wedge gate valves for atomic, heat-power and gas-and-oil industries is presented in authors publications. ■

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# BALTIC RIM ECONOMIES

Pan-European Institute



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