GOING FOR GREEN GROWTH IN THE BALTIC SEA REGION

2010

Policy Recommendations for Regional Co-operation

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Preface

For the first time, the 2010 Baltic Development Forum Summit coincides with the Baltic Sea States Summit (1-2 June 2010) and thereby provides exceptional meeting opportunities for all high-level stakeholders in the region: Heads of Government and the Baltic Development Forum -network, covering chambers of commerce, confederations of industries, business councils, banks and financial institutions, private companies, cities, regions, academia as well as international and regional organisations. On this occasion Baltic Development Forum (BDF) is working closely together with the Nordic and Baltic confederations of industries and will present recommendations as to how to revitalize the economy and the drivers of competitiveness.

The Summit will focus on making the Baltic Sea Region a wider European model for sustainable growth, green jobs, innovation, competitiveness and deepened integration with full respects of the EU's acquis communautaire. With the EU strategy for the Baltic Sea Region – the first mega-regional strategy within the EU – regions have the chance of becoming a new platform for policy innovation in Europe, providing inspiration on how to design sustainable growth, improve competitiveness on global markets and create jobs. The Summit title "European Challenges – Regional Solutions: An agenda for Sustainable Growth, Investments and Jobs" reflects these issues.

Danish Industry Foundation (Industriens Fond) has provided BDF with a grant for preparing a policy paper on how to create growth and jobs in the Baltic Sea Region. In the context of the EU2020 and the EU Strategy for the Region, the purpose is to present a short concise report that can respond to the above grant and make policy recommendations based on two perspectives:

- Where and how can regional players – private and public – take joint actions complementing productively, what takes place at the national and EU levels?
- What benefits can this bring to industry and enterprises in terms of productivity, investments and growth in the region?

Within the above mentioned context, the objective is not to present yet another strategy but to focus on economic growth and competitiveness in a few areas that are of importance to industry and business.

In preparing the paper, a number of academic and economic professionals have contributed to the process, participating either in one of two small round table discussions or providing written comments on the draft. The group is listed at the end of the report.

Chapter 1: Executive summary

The EU is about to re-launch a growth strategy in the wake of the serious recession that are only now showing some signs of dissipating. It builds on three interconnected planks: creating a more financially and environmentally sustainable economy, boosting innovation, and ensuring high employment and social cohesion. The proposed direction fits well with the EU strategy for the Baltic Sea Region adopted in 2009. The challenge now is to convert these principles to concrete policy actions on the ground. We suggest that implementation in the Baltic Sea area should be built on two overriding principles and four priority areas as described below.

Private sector job expansion and investment

Medium term growth must be based on private sector job expansion and productive investments rather than consumption and borrowing. While the Baltic Sea area as a whole is in better economic shape than the rest of the EU, the fact remains that public sector consolidation is required while the massive jobs lost during the recession must be recreated. For restoration of public finances, the easy way out is higher taxes and slimming growth oriented public spending such as research spending. However, that will only compound the problems the EU faces in remaining an attractive and competitive region for job creation and innovation in a world of intensified competition from emerging economies like China and India. What the region need is reforms of labour markets, pension systems and public delivery systems to expand labour supply and reduce public deficits at the same time.

Internal market as a spur to innovation and productivity

The region should spearhead a move towards preserving and extending the internal market. Indeed, there is a risk that the crisis may lead to backtracking on achieved successes and refusal to consider internal market deepening as national governments try to protect local markets: the recently released report by former Commissioner Mario Monti is a timely reminder of that risk.

Four priority areas

In this report Copenhagen Economics recommends four priority areas where the region could reach substantial benefits by joint rather than national action.

Priority one is energy and climate policies. EU has adopted ambitious targets for increasing the share of renewable energy in the total energy mix with legally binding national targets. The Baltic Sea region should opt for a joint implementation of these targets by sourcing renewable energy from the lowest cost sources rather than insisting on each country meeting its own target from domestic sources only: this could save the region's consumers and firms perhaps € 5 billion, a sizeable sum in a period of budgetary consolidation and private income losses from the recession. It would also provide a more stable and transparent investment climate for the energy companies in the region. At the same time, it should increase co-operation on regulation of electricity and gas markets and expansion of internal grid systems in these two areas.

Priority two is innovation. Compared to its competitors, the Baltic Sea region as well as the rest of EU suffers first of all from fragmented research institutions operating in narrow national contexts. There is little international competition for funding and insufficient pressure to achieve excellence and critical mass in core areas of innovation and research. If the Baltic Sea Region is to remain an attractive region for innovation driven firms, we need much more co-operation between research and higher education institutions in the area. Designated areas of more joint funding should be energy and environmental technologies where massive increases in research are required and where firms in the region have substantial strength and capacity to absorb and exploit research results. Moreover, funding for higher education should increasingly follow a system of "money following the activity". This would allow high quality institutions across the region the ability to attract students whilst receiving the funding. Finally, a minimum percentage of overall national research funds should be exposed to international competition from institutions within the region.

Priority three is sustainable transport. The Baltic Sea region is somewhat peripheral, with firms located in the region facing longer distances to customers than competitors in the EU. At the same time, CO_2 emissions from the sector need to be addressed: freight transport related to the regions is expected to increase substantially over the next 10 years. This is very much an issue of better performing railway and port systems that will allow more transport kilometres to be lifted from lorries to rail and ships as goods are transferred within the region to final customers. The region has a strong position in international transport and logistics: being at the forefront in delivering sustainable solutions will provide locally based firms with an edge in international competition.

Priority four is a digital internal market. Recent studies have shown that national regulations as well as other barriers by fragmenting markets are holding back benefits that may reach op to 4 per cent of EU GDP. The region has a strong position in segments of digital services, including substantially more E-Government services than the EU average. As a consequence its share of the benefits may be very high. We suggest that the region should examine what it could do to remove the well identified internal barriers in the region, thus spearheading efforts at the EU-level.

All of the four identified priorities above share three characteristics. First they are doable: what needs to be done is relatively well identified, requiring most of all political will to deliver. Second, they do not require more public funding; they are indeed likely to reduce costs for the private and public sector and will hence help deliver needed budget consolidation over time. Third, they will *not* obstruct a deeper internal market for the EU as a whole; on the contrary they should help create some momentum for that process.

List of policy proposals

Macro policy priorities

- Reform of labour markets and pension systems to boost growth and reduce strains on public finances at the same time
- Maintain and strengthen incentives to invest and expand tradable sectors, particular in countries that are over reliant on loan financed growth in consumption

Innovation policy priorities

- Cluster areas of excellence and societal need should be prioritised in the selection of national and cross-border research projects in a world of specialisation and competition for top talent
- Students in further education to be allowed to bring along student grants as well as tuition costs when they travel abroad.

- A minimum percentage of the total national research budgets in the region within a broad research area to be subject to international competition: define what the research should accomplish but allow other Baltic Sea countries to bid.
- More autonomy for research institutions to recruit researchers, define competitive wage conditions for top talent and collaborate with other institutions
- A common green card scheme for highly specialized workers: once joint criteria full-filled, job access to the entire region is assured. The idea is to attract top talent who should see greater merit in applying for a work permit, allowing them to work in the entire region rather than just one, typically rather small country

Energy policy priorities

- The Baltic Sea region commits itself to a joint implementation of the EU directive on renewable energy. The prospective agreement between Norway and Sweden of joint implementation of EU renewable energy directive could be extended to the whole area as a step towards a wider EU reform.
- Insuring implementation of electricity grid investments plans for the region.
- Strongly recommending the TSOs of the region to play an active and central role in the integration of power markets in the region

Sustainable transport priorities

- Progress on Green Corridors stay high on the agenda for the Baltic Transport area in a streamlined process identifying the most important links through the region that connect with customers and suppliers in neighboring countries
- Year-by-year review of progress in breaking down the numerous barriers to internal transport in the region is initiated
- Stakeholders (transport users and producers) to be involved in setting priorities for the region

Russia

- Extend the Green Corridor concept for the Baltic Region to Russia with a focus on key projects that have high short to medium probabilities of success.
- Encourage Russian WTO accession and keep free trade agreement between EU and Russia as an objective, following WTO accession.
- Support complementing regional fora for business dialogue with Russian counterparts in the Region and to encourage "modernisation" in Russia.

Chapter 2: EU 2020 Strategy in a Baltic Sea context

The EU Council in March 2010 (re)launched EU's economic strategy under three main headings where action is needed

- A more sustainable economy
- Knowledge and innovation
- High employment and social cohesion

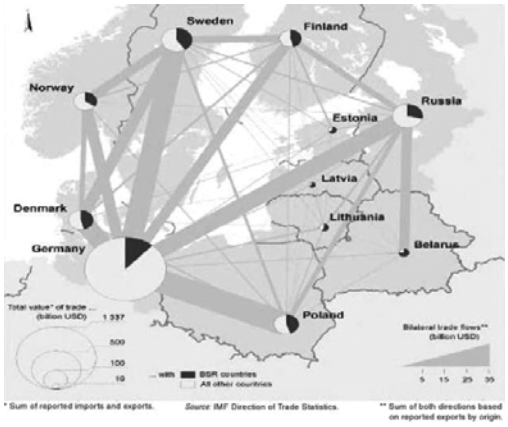
In the EU Strategy for the Baltic Sea Region the following areas correspond closely to the above mentioned headings:

- The Baltic Sea Region as an environmentally sustainable place
- The Baltic Sea Region as a prosperous place
- The Baltic Sea Region as an accessible place
- The Baltic Sea Region as a safe and secure place

With the EU strategy for the Baltic Sea Region, the EU countries of the region have a unique opportunity to link national and European growth initiatives to a regional context and thereby improve the opportunities to design and target the efforts strategically. The success of the new regional platform depends on a common will to make the best use of it. Also the active support of industry and the business sector is needed but it requires clear focus.

The many dimensions listed above are in reality highly interrelated over many dimensions. First, the economic crisis has lead to a serious worsening of fiscal positions. Hence overall policy reforms need to bring about medium and long term budget consolidation which certainly requires higher employment rates as well as overall expenditure restraint. Moreover, reducing emissions of green house gases and expanding renewable energy require development and deployment of new technologies in the coming decades: energy and climate policies are strictly linked to innovation policies in general. Development of stronger transport links within the region and with the region's trading partners will increase productivity and regional cohesion. At the same time, the links should contribute to a more sustainable transport sector, emitting less CO2.

Figure 1: Trade flows in Baltic Sea Region



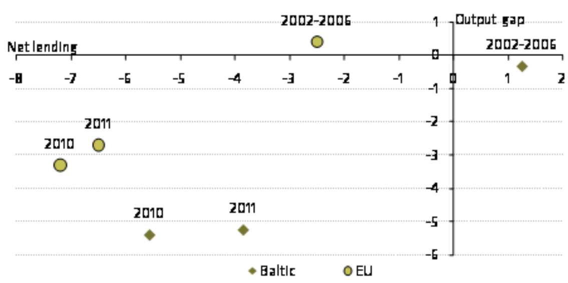
The challenge is to develop a policy package for the region, defining areas of co-operation that can help deliver on these objectives, providing benefits over and above what member states themselves can accomplish, and complementing and spearheading actions at the EU level. Just looking at trade flows reveal that the region's economies are interlinked: trade with the other countries account for the bulk of trade in the Baltic countries, over a third in Poland, Sweden, Denmark and Norway, substantially less in Germany cf. figure 1.

This paper recommends priority in the areas designated as priorities by the EU.

2.1 Get growth back on track – economic and financial sustainability

During the economic recession, the Baltic Sea region has suffered and the countries are to a large degree, facing substantial deterioration in public finances and risking a long period with high unemployment. Most countries come from a long period of robust activity: from 2002-2006, most countries in the region had GDP levels in excess of "normal" utilisation of capacity. Expressed technically there was a positive output gap. A after the crisis which started in 2008, the region is now facing an average estimated output gap of roughly 5 per cent of GDP in 2010 and 2011. Medium projections from the OECD suggest that it may well take some time before spare capacity can be removed from the economy by growth. Over the same time period, government fiscal balances have moved from surplus to very substantial deficits, particularly in the Baltic countries (Estonia, Latvia and Lithuania). Current balances show quite diverse developments within the region but, apart from Poland, most countries should have surpluses already from this year. There is some relative comfort of the region being in a somewhat better position than the EU as a whole on all three balances: less spare capacity, less public deficits and less deficits on current account balances.

Figure 2: Output Gaps and net lending, Baltic Sea Region and EU average



Note: Output gap relative to potential GDP, Net lending as percentage of GDP
Source: European Economic Forecast -Spring 2010, European Economy 2, For Norway: OECD Economic Outlook No. 86.

The key policy ingredient in an overall policy package that addresses these twin challenges has two main components:

- Reform of labour markets and pension systems to boost growth and reduce strains on public finances at the same time
- Maintain and strengthen incentives to invest and expand tradable sectors, particular in countries where growth has been too reliant on loan financed consumption

The required reorientation of growth drivers is essentially a job for national governments in the area but this will have implications for trade patterns between countries in the region that are highly integrated.

2.2 Boosting knowledge and innovation

EU has outstanding research institutions but suffers from too fragmented R&D policies run mostly along national lines, limitations in converting basic research into business innovation and faces a global scene where key competitors in US and in particular Asia are rapidly moving up the learning scale, challenging EU producers in still wider area of products.

The response to this challenge needs to be a structural one rather than just more public support for innovation. Indeed, the EU and most Baltic Sea region countries already spend as much on public RD as US, Japan and China; the challenge is getting more bang for buck[2] and improve incentives for more productive private sector innovation. Private business innovation on the global scale is being increasingly internationalised, with firms linking up with the best research institutions where ever they are placed rather than relying on institutions physically located within their national borders. Poor governance structures, insufficient autonomy and badly designed incentives for higher research institutions are contributing factors to the EU trailing US performance by a wide margin[3]. These are priority areas for national reform, with some countries in the region further advanced in the reform process than others.

The EU has adopted a strategy of promoting a European Research Area; creating a true internal market in knowledge and innovation. Competition for research funds should increasingly be based on merit within and, not the least between countries rather than tradition and inertia[4]. Moreover, individual research institutions as well as regions and perhaps even countries may need to specialise in certain research areas to get sufficient critical mass to provide the level of quality required to attract top researchers and private sector innovation funds. Students and researchers should benefit from framework conditions that allow them to study where quality is highest and where the studies on offer match the skills they need to develop.

The Baltic Sea region can play a role in spearheading such efforts. There are already a number of areas where specific joint research programmes are being developed in designated subjects such as climate, energy and environment.

Priority area 7 of the EU strategy for the Baltic Sea Region is important and particular emphasis should be place on flagship projects related to promoting innovation and stronger science links.

There is scope for extending such *top down priority setting* in areas of common political interest within a context of the wider EU strategy. A number of studies suggest rather uniformly some key parameters for such a strategy. First, research should not be spread around too thinly but focus on areas where there are strong clusters of academic and industry excellence[5]. The argument is essentially that building on strength is easier than building from scratch. Furthermore, physical proximity between research and firms to facilitate spreading of knowledge and developing a specialised workforce are important drivers of innovation, particularly in pharmaceutical and life science industries. This is not about "picking winners" but backing strong institutions, often on a cross national level to expand their knowledge base in areas that can boost long term innovation.

There is a strong overlap between these two areas with the Baltic Sea region being strong in forestry products, transport and logistics, life sciences, energy and analytical instruments[6] both for industries and higher education and research institutions.

Top of the list is likely to be innovation in climate and energy policies for the following reasons. Estimates by OECD suggest that meeting climate change objectives requires a three doubling of private sector R&D funding over the coming decades[7] and possible equally large increases in public funding. Such a massive increase of R&D funding requires international co-operation to be fully effective to exploit comparative advantage in research across the region. Studies for the EU indeed suggest that clustering of a number of strong research institutes – perhaps 6-9 – is one way forward to drive the EU's move towards high quality research institutions that can match the expectations of private firms.

On top down research co-operation we thus recommend that:

- Cluster areas of excellence and societal need should be prioritised in the selection of national and cross-border research projects in a world of specialisation and competition for top talent (including life sciences, energy and climate technologies)

But there should also be a more bottom-up approach that provides incentives to create a more internal knowledge market in Baltic Sea region where the initiative and priority setting of private enterprises can play a key role.

In this respect we suggest the following four concrete steps for bottom up and business driven co-operation on innovation:

- Students in further education could be allowed to bring along student grants as well as tuition costs when they travel abroad. Second, a minimum percentage of the total national research budgets in the region within a broad research area be subject to international competition: define what the research should accomplish but allow other Baltic Sea countries to bid.
- Give more autonomy for research institutions to recruit researchers, define competitive wage conditions for top talent and collaborate with other institutions[8]
- Introduce a *common green card scheme* for highly specialized workers: Once joint criteria full-filled, job access to the entire region is assured[9]. The idea would be attract top talent who should

see greater merit in applying for a work permit allowing them to work in the entire region rather than just one, typically rather small country. The scheme could co-function alongside national schemes, focusing more on national needs.

A better functioning internal market is the key to higher productivity and innovation in the EU. The recent report of former Commissioner Mario Monti highlights three challenges to the internal market that may be taken for granted as an accomplishment of the EU[10]: increasing national hostility towards market integration per se, incomplete extension to new sectors, including not the least parts of the service sector and complacency among policy makers regarding inter market as "yesterday's business". The report states that maintaining and expanding the internal market requires a "package deal" character in which member states, with different cultural dimensions, concerns and political preferences, find sufficient appeal to accept concessions to past positions for the benefit of the EU.

A potential focus area mentioned in the report referred above is the digital internal market which could be of potential special interest to the Baltic Sea region for at least three reasons: It has strength in information and communication technologies, widespread application of e-Government service products that could be sold to a much larger market and a well educated work providing a good basis for further expansion. Barriers to expansion have been identified to be rooted in a wide area of national practices and legislation: the region could lead efforts to break down such barriers, starting with the region itself.

Priority area 6 of the EU strategy for the Baltic Sea Region is important and particular emphasis should be placed on flagship projects related to removing remaining single market barriers.

2.3 Climate, energy, environment, transport – green sustainability

The Baltic Sea region faces substantial benefits for enterprises, consumers and tax payers by opting for enhanced co-operation in the area of green sustainability.

Climate and energy

The development of renewable energy, particularly the generation of power, suffers from an overly national approach while several studies, including those commissioned by the Baltic Development Forum, demonstrate sizeable gains from trade in meeting national renewable energy targets. Indeed, the savings to be reaped by going for a regional Baltic Sea approach rather than a national approach, could save investments costs of perhaps € 5 billion over the next decade[11]. The EU directive on renewable energy allows individual member states to go for joint implementation of the targets for renewable energy but so far very few countries in the Baltic Sea region (or other EU countries) have taken up the opportunity[12]. The region has particularly strong potential in renewable energy from wind and bio mass in generating power and heat. The region has also strong industrial firms in these sectors that would benefit from such co-operation.

However, beyond exploiting the possibilities for trade to comply with directive on renewable energy, enhanced co-operation in the area of renewable and green power needs an efficient integration of power markets that has a proper infrastructure and harmonised market design for trade of electricity and gas across the borders in the region.

This holds especially for the integration of wind power as wind power is a volatile energy source requiring substantial new investments in grids between the Baltic Sea countries. The corporation of European system operators (electricity) ENTSO-E reports that roughly a half of total investments in grids in EU-area of nearly €23 billion are to be located in the Baltic Sea area[13]. One of the main drivers for investments is integration of the Baltic countries and the European energy market, hence new interconnections between

Sweden and Finland, Finland and Estonia and Lithuania and Poland. This will also benefit the overall focus of enhancing the interconnection of the Nordic countries and the continental Europe, as this will add an "east corridor" as an alternative to the "west corridor" going from Norway/Sweden partly through Denmark to Netherlands, Germany and Poland. This integration of the Baltic countries has also been recognised as a key investment by the EU and the investment has been granted with a share of 25% (€230 mill.) of total contribution to interconnectors within the second financial decision under the EU Economic Recovery Package.

Priority area 5 of the EU strategy for the Baltic Sea Region is important and particular emphasis should be placed on implementation of the BEMIP (Baltic Energy Market Interconnection Plan) projects.

Increased interconnections are not enough to secure an integrated market. The market design must also be harmonised by improved congestion management on interconnectors and by balancing markets. This is to harvest the mutual benefits from exchange of power especially important in a future power system with increased wind shares.

As recognised by The European Regulators Group for Electricity and Gas (ERGEG)[14] one main issue is the integration of the Baltic region (Estonia, Latvia and Lithuania) with the Nordic market. ERGEG launched (in Spring 2006) the Electricity Regional Initiative which aimed at speeding up the integration of Europe's national electricity markets by creating regional electricity markets in Europe. It was seen as an interim step towards creating a single market for electricity market in the EU. The Electricity Regional Initiative is comprised of seven regional electricity markets. Among them is the Region Baltic and North, which is equivalent to the Baltic Sea Region as defined in this report.

A second main step could be to go for full market integration in the region, which in concrete terms would be to create market coupling between Germany, Poland and Lithuania and on the interconnectors between Sweden and Germany (Baltic Cable) and Sweden and Poland (Swe-Pol link).

We propose the following concrete steps for the Baltic Sea region as regards climate and energy policies:

- The region commits itself to a joint implementation of the EU's directive on renewable energy. The prospective agreement between Norway and Sweden of joint implementation of EU's renewable energy directive could be extended to the whole area as a step towards a wider EU reform.
- The region ensures implementation of electricity grid investments plan in the region and more co-operation on the regulation of electricity. This would support the concrete grid projects put forth in by European energy regulators and to support the regional initiatives driven by ERGEG and the national regulators.
- The region promotes the role of national energy regulators to play an active and central role in the integration of power markets in the region

The Baltic Sea

The management of the Baltic Sea itself is arguably the most obvious area of required joint action for two reasons. First, the sea is now heavily polluted and provides health risks and has reduced the income from fishing as well as tourism in the coastal areas of the region. Second, common action is required to solve this problem: pollution of common waterways requires common action as benefits of local/national action vastly exceed local benefits: investments in water treatment systems in Poland may bring benefits not just to Poland but the whole region. There is a substantial Baltic Sea Action programme in place to reduce further *inflows* of polluting substances from rivers etc. with some progress being noted. Nonetheless, the fact remains that the quality of the water remains far below North Sea levels[15] with levels of concentration of such substances well above levels

20 years ago, which are only now beginning to stagnate.

We propose the following practical step for co-operation on Baltic Sea:

- Strengthen the impetus for reform in the management of the Baltic Sea by adding a more specific business perspective: what benefits could be reached for the tourism and the fishing industry in particular and what are in reverse the costs of non-action

Transport

Increasing CO2 emissions from the transport sector is a challenge for the entire region, with forecasts of substantial increases in freight flows until 2020[16]. From a business perspective it is crucial that the policy response at one and the same time preserves and improves the basic service provided by transport, namely mobility[17]. Given its peripheral position in the EU, the regions' firms face long distance to customers and suppliers, implying that costs of transportation wear more heavily on final business costs than more central parts of the EU[18].

A key element is to improve the efficiency of the transport system, focusing on improving the inter-rail (from "train-to-train") and intermodal shifts (between lorries, ships, rail).

The potential from moving freight from lorries to rail and ships, in the context of long haul transport, have been on the table for many years, but has failed to materialise because the present "combined" options do not provide the mobility and speed that pure road transportation based solutions provide.

The barriers to more efficient inter-modal transport are well-identified. At the very general level, transport operators need to develop new business models which see their individual service as just one element of a long supply chain. What is the best combination for the final customer of the options at hand, being road, ship, rail or air transport? At the more specific level, there are number of economic,[19] regulative[20], legal/administrative[21] and technical barriers[22] that block the development of such business models also in the Baltic Sea region. In short, there are a number of very practical steps that can and should be taken to improve mobility and sustainability in the transport sector.

The agreement to launch Green Corridors in the Baltic Sea region is meant to overcome the obstacles standing in the way of more eco-friendly transport solutions in the region. Required ingredients for success include coordinated political support and stakeholder involvement[23]. There is a risk that implementation on the ground may suffer from proliferation of policy actors leading to projects being "uncoordinated" and with "absence of policy direction hampering effectiveness"[24].

Priority area 11 of the EU strategy for the Baltic Sea region is important to improve both internal and external transport links.

We recommend three practical steps for transport policies:

- Progress on Green Corridors stay high on the agenda for the Baltic Transport area in a streamlined process identifying the most important links through the region that connect with customers and suppliers in neighboring countries
- Year-by-year review of progress in breaking down the numerous barriers to internal transport in the region is initiated
- Stakeholders (transport users and producers) to be involved in setting priorities for the region

2.4 Russia in the Baltic Sea Regions

The EU countries in the Baltic Sea region have the Russian markets as an immediate neighbour. Special attention should be given to ways of promoting this economic neighbourhood through cross-border cooperation and stronger trade and investments relations. Despite the set-back in 2009, the Russian economy has grown with 5,5% during the last 10 years and this year the economy will most probably be the fastest growing in the region.

Russia is a major energy provider for the Region. This will not change even in the medium term in spite of EU efforts to diversify and save energy. Within few years the Baltic Sea will become Russia's largest energy export corridor. Efforts should be made to ensure that this energy relation will be based on market principles. The Energy Charter Treaty contains these principles and Russia should be encouraged to follow the principles. As the majority of the Russian foreign trade flows soon will go via the Baltic Sea region, the regional interdependency is obvious and policies should reflect this fact. It will also increase the need for secure and clean shipping in order to safeguard the Baltic Sea against pollution.

Russia's present economic performance is most certainly below potential. Structural reforms in Russia may increase the importance of this market further. Administrative inefficiency, rule of law and corruption remains a matter of concern – if not the greatest concern of foreign investors in Russia (Foreign Investment Advisory Council). Efforts to increase competition on the internal Russian markets are needed. It seems that the Russian government is serious about follow-up on such issues.

The EU has offered a Partnership for Modernisation. The EU will focus on the framework conditions for modernisation: rule of law, less corruption, implementation of international rules and regulatory harmonisation in line with the objectives of the road map for the Common Economic Space agreed by EU and Russia in 2005. It is the task of governments to create the framework that will allow for modernisation to improve the investment conditions. It is up to business to take the opportunities and encourage this development.

The Russian markets are not easy to penetrate. Border crossings are often real obstacles for trade and regularly trucks are waiting in kilometre long lines. Many trade and investment problems need high political attention in order to find a solution. The EU's mechanisms for addressing bilateral trade relations with Russia need full support and backing to be effective. The long-term objective should be a comprehensive free trade area between the EU and Russia but it will be dependent on Russian WTO accession.

A new ambitious framework for developing the bilateral economic relations is called for and negotiations on a "New Agreement" between EU and Russia are highly wanted (replacing the Partnership and Co-operation Agreement). Complementing and supporting regional fora for dialogue on business affairs and economic relation with Russia should also be supported as a way to promoting convergence. Not least the Northern Dimension Business Council deserves support as a means of finding common solutions.

The Baltic Sea region has the chance of developing transport and logistics hubs to Russia. The new partnership on transport within the Northern Dimension framework deserves full backing.

Beyond economic benefits, market based integration with Russia may carry political stability that will in particular benefit the Baltic Sea Region.

We recommend concrete steps to promote the integration of the Russian economy into the Baltic Sea region.

- Extend the Green Corridor concept for the Baltic Region to Russia with a focus on key projects that have high short to medium probabilities of success.
- Encourage Russian WTO accession and keep free trade agreement between EU and Russia as an objective, following WTO accession.
- Support complementing regional fora for business dialogue with Russian counterparts in the Region and to encourage "modernisation" in Russia.

Experts: Round Table discussions and written comments

During two roundtables discussion the following people took active part:

1. Christian Ketels, Associate Professor Harvard Business School, Senior Researc Fellow, Stockholm School of Economics
2. Guy Clausse, Director, European Investment Bank
3. Ola Yndeheim, Senior Adviser, Nordic Council of Ministers
4. Hans Brask, Director of Baltic Development Forum
5. Thomas Wohlert, Industriens Fond (The Danish Industry Foundation)
6. Per Tryding, Secretary General, Baltic Chamber of Commerce Association Sydsvenske Handelskammer.
7. Henrik Schramm Rasmussen, Senior Consultant, Confederation of Danish Industry,
8. Jakob Ekholdt Christensen, Special consultant, the National Bank of Denmark (host)
9. Martin Thelle, Partner, Copenhagen Economics
10. Sigurd Næss Schmidt, Managing Economist, Copehagen Economics
11. Jacob Warburg, Chief Economist, Ministry of Foreign Affairs of Denmark
12. Christian Hjorth-Hansen, Adviser, European Affairs, Confederation of Danish Industry
13. Per Jørgensen, Ramboll, Director, Strategy and Business Development

The following people have provided input on draft versions of the paper:

14. Timo Laukkanen, Senior adviser, Confederation of Finnish Industries
15. Kari Liuhto, Professor and Director, Pan-European Institute
16. Jerker Sjögren, Special Adviser, Ministry of Enterprise, Energy and Communication
17. Mr. Esa Hyvärinen, Vice President, Public affairs, Fortum Corporation,

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