

Effects of Baltic EU Membership on Northern Europe

*Conference organised by the EU Presidency
and the European Commission
Supported by the Ministry of Foreign Affairs of Latvia
and the City of Riga*

Riga, June 20–21, 2001
At Stockholm School of Economics in Riga,
Strēlnieku iela 4a, Riga

Conference Report

UDK 327(474)
Ef 200

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Conference Report - Riga: Latvian Institute of International Affairs, 2001 - 48 p.

ISBN 9984-583-31-1

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Printed by HABITUS

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Rapporteur: Daina Bleiere, Research Fellow,
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Enlargement of the European Union to include the Baltic States and Poland will deeply affect the Baltic Sea region in the political, security and economic dimensions. In recent years, especially in the context of the development of the Northern Dimension of the European Union, different aspects of the consequences of enlargement have been widely discussed. On June 20–21, 2001 at the Stockholm School of Economics in Riga a conference organised by the EU Swedish Presidency and the European Commission, supported by the Ministry of Foreign Affairs of Latvia and the City of Riga took place where the impact of enlargement on the Baltic Sea region, as well as co-operation between Russia and the enlarged EU was discussed. Due to the participation of high ranking officials, distinguished scholars and members of the business community from the EU and its candidate countries, as well as Russia, the discussions provided a very good insight into the issues, especially with regard to the economic consequences of enlargement and prospects of transborder co-operation. Most of the problems the conference focused on are of long-term significance for all the parties involved, hence the publication of this conference report has not only “historical” significance as an expression of views and mood of the participants representing governments, institutions, and the scholarly and business communities. The report can serve as a departure point for continued discussions.

The conference was opened by Mr. **Sven-Eric Söder**, Secretary of State of the Swedish Ministry of Foreign Affairs in a keynote speech at the official dinner.*

The welcome address was given by Mr. **Indulis Bērziņš**, Latvian Minister of Foreign Affairs who pointed out that economic and political mutual understanding with neighbours had been a political priority of Latvia since the beginning of her statehood.

* For text please see appendix.

This year Latvia celebrated the 80th anniversary of the *de jure* recognition of the Latvian state, and in this context Mr. Bērziņš remembered the first Latvian Minister of Foreign Affairs Zigfrīds Anna Meierovics, who argued for the development of close co-operation both between the Baltic States as well as with the Nordic countries.

Mr. Bērziņš stressed that Latvia is satisfied with the level of institutionalisation of co-operation between the Baltic States and the Northern countries and that this has developed from the format 3+5 to a full “number eight”, which helps Latvia to enhance her progress towards the EU and NATO – the two inseparably connected aims of Latvian foreign policy.

Bērziņš pointed out the EU provides significant financial and technical assistance and the prospect of future membership in the EU has strongly stimulated political and economic reforms and thus helped to promote stability in the EU candidate countries of the region, including Latvia.

The first enlargement in the Baltic Sea region took place in 1995, when Finland and Sweden became members of the EU, which significantly stimulated development of trade and transborder co-operation in the region. This encourages us to anticipate further development of this process, perhaps, in geometric progression, when Estonia, Lithuania, Latvia, and Poland will become members of the EU in the near future. Enlargement of the EU will focus more attention to Northern Europe on the whole, and would provide more opportunities for co-operation with states that do not strive, at least for the time being, for EU membership.

A good example of this kind of co-operation is the Northern Dimension. It provides the EU partner states with the opportunity to develop a comprehensive dialogue with the EU. Such a format is very practical, because it provides an opportunity to strengthen co-operation with Russia and the northern regions of Russia’s European part. Russia in its new foreign policy concept has acknowledged co-operation with the EU as one of its main priorities, pinpointing the main spheres of co-operation – energy, ecology, and struggle against organised crime. Any development in these spheres is impossible without the co-operation of all countries of the region.

Latvia as a future member of the EU has a deep interest in the development of a mutually beneficial partnership with Russia. The success of the transformation of Russian society and state is a success for the whole of Europe and the other way round. Mr. Bērziņš stressed that constructivity is the most precise name for describing relations with Russia.

Ms. **Catherine Day**, Deputy Director General, Responsible for Europe, Central Asia, Middle East and South Mediterranean in the European Commission expressed her pleasure that the European Commission has been able to participate with the Swedish Presidency in organising the conference, because of the many factors that impact on the European Union and the region after enlargement. Though this is often forgotten the EU has had a Baltic dimension since its foundation. Germany as one of founding members of the EU always had its outlook on the Baltic. This is not a completely new process for the EU.

The weight of the Baltic dimension in the EU has been growing steadily over the years with the accession of Denmark in 1993 and Finland and Sweden in 1995. What we

are seeing is a progressive evolution of the Northern dimension in the EU. The next stage that will be the accession of the three Baltic States.

We have to discuss not so much the impact of the accession on the Baltic States as its effect on the EU, because the next enlargement is going to change the centre of gravity in the Union, to change the way we think about ourselves and also to change the way others look at us.

Enlargement obviously will bring a lot of opportunities. It will also bring a lot of challenges. One of the challenges will be how the expanded European Union will relate to neighbours such as Russia with whom we already have a common border with Finland. But after enlargement there will be a number of new borders.

Day examined three dimensions of the impact of Baltic EU membership. First, the impact on the three Baltic candidates themselves, second, the impact on the existing Union, and, third, how the European Union’s relationship with Russia will develop as a result of enlargement.

Everybody who has been coming to Latvia over the number of years has been impressed by the speed and the pace of change – the impact of the enlargement is already here in many ways. The way that people are interrelating politically, economically is already changing. We tend to already forget when we became involved in the negotiations what kind of a milestone the accession of Latvia, Lithuania, and Estonia will be. It is good just to remember how unlikely it seemed some years ago now that they will be in the closing stages in the negotiations for membership.

It is obvious that the impact will be greater on the candidate countries themselves. There will be enormous changes that are already on the way. We tend to focus now on the end of the negotiations that obviously politically is the most important goal. But we tend often to forget that what we are really doing is preparing for the period after enlargement, not just for the moment of accession. What we are doing together is a very important investment in the Baltic States’ future. Countries like Latvia are going to fully join a group of like-minded countries that are going to work together in the future. This will change the way in which countries in the region think about themselves, from being used to thinking about themselves as small countries, they will become a part of a much bigger group in which they will have a voice, and influence making policy. This requires a keen understanding of what is each country’s national interest. But it also requires countries to get used to thinking about what is in the interest of the Union. In the Baltic States, one of the many new challenges will be to begin to think like member states in regard to external policy, for example, to think differently about the relationship with Russia in future as part of the European Union as compared with the past.

When we think about opportunities that come from participation in the common market, opportunities for trade, investment, growth and of participation in regional networks of one kind or other, it is not difficult to make an economic case for the impact of enlargement. Thinking about the European Union, too, we realise that the very nature of the Union is going to change. It is not because of the accession of three fairly small member states from the Baltics that the whole Union will change, but because of the size

of the overall enlargement process. We have never had so many candidate countries applying at the same time. This is causing a certain amount of soul-searching about what the European Union is going to be in the future. The EU will, however find new ways for working and will be able to overcome internal difficulties.

Much has already been done to change the shape of the Union before enlargement. There has been active co-operation in a number of regional forums between candidate countries, existing member states and neighbours, for example, in the Council of the Baltic Sea States where a tradition of working together has already been established and identifying of areas of common interest, and which very much foreshadow the way in which work will be done in the future. Regional organisations in the future will have more EU member states; hence internal EU co-ordination might assume greater weight.

The development of the Northern Dimension will significantly enhance the weight of the northern member states in the European Union of tomorrow. The EU is readying itself for this by thinking geographically, by looking for synergies on a regional basis between how different European Union policies work and interrelate together and how the EU works with its neighbours. The way in which the EU worked under the Swedish Presidency to give more substance to the Northern Dimension will be an investment in the long term in how the Union will work in this part of the Europe.

EU's relationship with Russia will become even more important as the result of the enlargement. The issue of the accession of the Baltic States to the European Union is not a political problem between the European Union and Russia; hence the most interesting question is what exactly will be the relationship between Russia and the expanded European Union.

One of the most sensitive issues is the question of movement of people after enlargement. Union policies on the free movement of people, visa requirements, etc. are in a process of alignment between the Union and the candidate countries. The systems, which previously operated differently, will inevitably change upon enlargement. There is no need to give an impression that after enlargement there will be a new dividing line in Europe. It is perfectly possible to handle issues like control of legal and illegal migration in a sensitive way, which allows control, but which also works in a smooth and uncontroversial way. A time between now and the moment of accession itself ought to be used to draw on a flexibility which does exist inside the European Union rules on movement of people and to see how to work out a new relationship which can be introduced to avoid the kind of political problems which can happen if new rules are introduced overnight and people will perceive that the European Union has become a fortress. What is important is that the debate has moved on from the enlargement itself to the question of discussing the details of the impact. The enlargement is the accepted fact of future political life on our continent and the question is how the expanded European Union and the Russian Federation as neighbours will interrelate with each other.

Kaliningrad is enormous interest to Russia and to the European Union. Its location will have a particular situation after enlargement. At the beginning of this year the Commission published a communication on what it sees as a number of issues which

need to be discussed. The Commission has no particular prescription to offer, but it thinks there is a need to have a technical and political discussion on how to deal with an impact of enlargement on the Kaliningrad region. The Commission has begun discussions with the Russian authorities. There is an impression that they are still thinking about this and trying to work out issues, which relate to how much autonomy they will have and how much central control. These are issues that are not yet fully worked through in Moscow. Time between now and the moment of accession must be used properly in order to make the ultimate transition as smooth as possible.

In 12 to 18 months changes in Russia itself as well as the increasing weight of the European Union as a regional player are both converging effecting the efforts of both parties to try to find a new relationship. The EU and Russia are working together much more intensively both in the political and security area as the European defence identity develops, and even more intensively in the economic area where they have launched a new dialogue on energy and where at the recent EU – Russia summit it was decided to work on the concept of the common economic space for the future. These are important signals that both parties understand that the enlarged European Union will be even more important for Russia in the future and the realisation in Russia of the growing importance of the EU and wish to engage much more substantively than has previously been the case.

In conclusion Catherine Day underlined that it has been accepted for quite some time that enlargement is going to be a reality. The discussion has moved from whether we should enlarge and when we should enlarge, to how to make this process work. It is obvious that the enlargement to the Baltic region is going to have a profound impact on the European Union in the ways which are, perhaps, more clearly understood here than further to the South and it is important that Northern member states not only engage in discussion with each other, but also engage in wider discussion with the southern part of the EU, so that we do not have an enlarged and divided EU, but still one Union which understands all facets of her interests in the future. This enlarged European Union which will come physically closer to Russia and in many ways will also come closer over a wide spectrum of relations whether they be political or in the area of security and, perhaps, most intensively in the economic area. The growing confidence of the European Union as a political and regional player and the growing confidence of Russia itself will be two factors that will combine to help us to work out together a much more satisfying relationship than we have had in the last ten years. The fact that almost the entire Baltic region will come together as the European Union and that the Russian Federation will, perhaps, facilitate this process, will create major investment opportunities. There will be a large number of the northern member states all operating according to the same rules and free internal markets. Opportunities for regional development will be enormously enhanced as a result of membership. Ms. Day expressed the belief that this will create an opportunity to think differently in the future about European – Russian relations than in the past.

This keynote speech sketched in brief three main issues around which the discussion at the conference was organised – effects of EU enlargement on the Baltic Sea region, on Russia, as well as its impact on economic development in the region.

Session One: Effects of EU Enlargement for the Baltic Sea Region

The first session was moderated by **Dmitri Trenin**, Deputy Director of the Carnegie Moscow Centre.

Mr. Uffe Ellemann-Jensen, Chairman of the Baltic Development Forum, Denmark, expressed his satisfaction that for the first time a EU Presidency is organising this kind of conference with candidate countries. By doing so the Swedish EU Presidency has created an example for the future, an example to be followed by future EU presidencies. The theme of this forum was wisely chosen in the light of the European Council in Gothenburg. Talking about the effects of the Baltic membership in the EU on Northern Europe U. Ellemann-Jensen praised the European Council that after ten years of the Baltic States' independence it has been able to keep European integration on track. It has been made clear that it is possible for the best-prepared candidate countries to complete their negotiations before the end of 2002 allowing them to participate as full EU members in the European Parliament elections in 2004.

At the same time he was critical about the chain of events that came before Gothenburg when petty national interests threatened enlargement. This was totally unacceptable because the time in not to create doubts before the most important item on the European agenda – the enlargement. The reaction from the other EU countries to the Irish “No” to the treaty of Nice had to be firm and cool. The Irish have created a problem for themselves, it must not become the problem for the EU and certainly not for the candidate countries. Therefore the message for the Irish must be the same as the message that was delivered to the Danes in 1992, when the Danes rejected the Treaty of Maastricht at the referendum – renegotiations of this treaty.

As regards perspectives of the Baltic Sea region, Ellemann-Jensen quoted American President George W. Bush, who during his European visits in June 2001 said some very important things. In Sweden the American President declared his vision of Europe – with more countries, with more free trade and one that welcomes Russia to become a true partner for Europe and the United States. Russia ought not to fear an expanded Europe; on the contrary, Russia ought to welcome an expanded Europe on its borders. The American President appropriately pointed out that it was time to move beyond suspicion, behind mutually assured destruction and to talk of mutually assured respect. The President's comments are especially pertinent for the countries of the Baltic Sea region. The speedy accession of Latvia, Lithuania, Estonia, and Poland to the EU and even closer integration with Russia are decisive preconditions for releasing the Baltic Sea region's huge remaining potential. When Latvia, Lithuania, Estonia, and Poland become EU members and consequently continue their catching up, the annual GDP growth is expected to grow 2–4 % higher than the EU average. Consequently, Poland might almost double its GDP in coming years and the Baltic countries may increase their GDP's by more than 50 %. This is very promising scenario for the whole Baltic Sea region.

One of the reasons why the Baltic Sea region has such a promising future is that the region is well positioned in the global information technologies (IT) race. We have a competitive advantage, being one of the leading IT regions globally. And this advantage could be developed further through intensified regional co-operation and co-ordination. Information technology is a strong catalyst for growth and efficiency; it offers enormous opportunities to link up the Baltic Sea region in a completely new way. Already we can see how business and individuals benefit from modern technology. What has happened in the Baltic Sea region in the information and telecommunication sector is most spectacular and unprecedented. Germany has been “nominated”, metaphorically speaking, as the new EU “locomotive” and it has the highest rate in IT business transactions. The Nordic countries today rank among world leading countries in the use and manufacture of new IT and telecommunication products. But this country – Latvia, as well as other candidate countries are seriously catching up with the EU countries. Estonia, Latvia, Lithuania, and Poland have one of the most modern telecommunication networks and a computer literacy that is higher than in many EU countries. Russia also has some very positive signs, the IT sector is developing, especially software development, and multinationals like Motorola or LG Electronics has established themselves in St. Petersburg.

Another promising sector in the Baltic Sea region is the energy sector. Energy has been on the top of the Baltic Sea agenda for some time, as dependence of Western Europe on energy imported from Russia is affecting every energy sector and has wider European implications. The same applies for many environmental problems in the Baltic Sea region, which contains 132 registered environmental hot spots. This is an alarming figure. The Northern Dimension Action Plan focuses on energy and on environment and creates a lot of opportunities for countries and companies to cooperate. The newly established Northern Dimension environmental partnership can even act as a model for all other sectors.

In the conference that took place in Tallinn in April 2001, the business community's message to politicians was a very clear one – we need a coherent region with no country lagging behind and we need an improvement of the region's business environment to achieve this goal. This is why the Northern Dimension's Action Plan is an important policy document. This Action Plan created necessary tools for achieving this goal, namely, ways to co-operating in all the fields that are necessary in order to create the Baltic Sea common market with fair competition, equal treatment, no discrimination, creating a climate of quality and of predictability. The business community is looking for the same kind of dynamism that led to the Single Market in the European Union. The Swedish EU Presidency has carried the Northern Dimension Action Plan far, but we need to go further and the time is short. If we could combine the Northern Dimension Action Plan with Jacques Delors White Book on the Single Market than we will be able to create more than a plan, we will be able to create history. This discussion will be at the heart of the debate of the Third Annual Baltic Development Forum in September this year and Ellemann-Jensen expressed hope to see many participants in St. Petersburg.

Concluding his remarks, Mr. Ellemann-Jensen described his vision of how the Baltic Sea region would be like in five years from now in the summer of 2006. The

Baltic States will be full members of the EU together with Poland and no significant transition periods were necessary when they joined the EU in 2004. In 2006 the Baltic Sea common market is almost on track. Following the Swedish EU Presidency in 2001 the Action Plan was combined with Jacques Delors White Book on the Single Market and the Baltic Sea common market is becoming a Baltic Sea free trade area with the European Union developing a very special relationship with Russia as well as with other CIS countries bordering the region. The EU enlargement will have led to a relaxed security situation and the three Baltic countries will have joined Poland in NATO. This will be seen as an addition for the common security for everybody in region, common security is after all what European integration is first and foremost. At the end he expressed hope to be in Riga at the first Latvian Presidency of the EU.

Dr. **Christian Ketels**, Principal Associate at the Harvard Business School, Cambridge, Massachusetts (USA) presented the first results of the Harvard Business School international research project "On Building a Regional Agenda for the Baltic Rim". The main aim of this project was to research what will be the impact of the accession on the Baltic States.

Previously similar projects have been carried out on the Middle East, Central America, and Latin America aiming to understand how co-operation among a group of countries of a geographical region can enhance prosperity and productivity growth. The project team chose the Baltic Rim because they presumed that it is a tremendous opportunity to study the existing dynamism of different parts of the region, the differences between the countries, and also how they will use the opportunity offered by Baltic accession to the EU. The project explores what could be the obvious advantages of accession to the European Union for the three Baltic States and what will be the more ambitious goals opened by the accession. The conclusions drawn offer some thoughts on the political economy of accession.

Speaking about the conceptual framework of the project, Mr. Ketels stressed that the point of departure was what is really driving the prosperity of the Baltic States? What has to be done to improve the development of prosperity in those countries? He pointed out that researchers have found in their research in many countries that there are two main areas of factors influencing prosperity. One is well known, macroeconomics, and the political and legal context. The second area is the microeconomic foundations of prosperity. These are factors that determine the context in how firms behave, invest and compete, how the private sector takes up the challenge of its business environment, and the quality of the microeconomic business environment that countries of the regions provide. In many countries the discussion has been dominated by macroeconomic factors and the legal context. However, the microeconomic foundations of prosperity and behaviour of the companies is the main driving force and hence the impact of accession to the microeconomic environment was studied. Accession will change many things because it will change the environment much more closer to you, influence the way how we will interact with companies and businesses around us.

It is clear that accession will have a major impact on the situation in the Baltic States, on their ability to serve much larger markets, gain easier access to consumers in the European Union, and gain access to trusted EU institutions.

The challenge is that it leads Western Europeans to think accession is something of a gift to the new members of the club. Regional co-operation can be much more than this. On the microeconomic level we would see many factors that actually effect both the old members and the new members of a club alike. The most important factor is the increase in competition also for the existing players of the market. Even if the Baltic States are just a small part of the common European market, it is a new factor that creates very different conditions for traditional players in the European market.

It is much easier for the Baltic Rim as a region as a whole to attract foreign investment. The successful economies of Sweden and Finland can gain by sharing together with other parts of the Baltic Rim in trying to develop a common agenda for this.

Accession provides benefits for both sides, not just for the accession countries. It is misleading to think in terms of comparative advantage, because this leads the accession countries to believe that they can take advantage of their current competitive advantages, such as low wages and relatively well skilled employees. As a point of departure it does make sense. But, if accession countries are successful, wages will rise. A mirror image of this problem could be found in the EU countries where politicians and the general public view accession as some kind of gift for the accession countries. The European Commission does not have a very easy time in dealing with this. Dr. Ketels pointed out that the results of the project indicate a more optimistic view on competitive advantage, of mutual benefits in improving the national business environment through Baltic accession.

Countries that are trying to become members of the European Union should always think what to do to improve their productivity and develop their niche that would help raise wages and the prosperity of the country. As was stressed by Dr. Ketels, a more positive message should emerge to show current EU member states which now see accession as a gift or a moral obligation, but not as a means to improve the microeconomic business environment and competitiveness for the current member states and their industries.

Mr. **Roberts Zile**, Special Task Minister for Co-operation with International Financial Institutions (Latvia), focused how closely interwoven are political decisions with economic relations. Each enlargement creates challenges for existing member states, no less with this enlargement. After enlargement the first six EU member countries will produce no less than 75 % of the EU GDP. This means that these countries will become even bigger contributors to the EU budget. This might bring about changes in solidarity principles and in structural policies. 50 to 53 regions in candidate countries will be low-income regions.

Globalisation means that there is an increase in global competition. There are three global development centres, one of which is the EU, among whom competition is

increasing. The Baltic Sea region has a very good potential to become the fastest developing centre in Europe.

This region has some comparative advantages, mainly the high level of education, even when including the Baltic States and Poland. There is a digital divide between those who have an access to digital devices and those who have not. Another advantage is more or less a similar mentality of people living around the Baltic Sea, their Christian traditions; a very important comparative advantage in the future will be the removal of political and economical obstacles for almost every country around the Baltic Sea.

Trade trends show that the CIS is becoming an ever smaller part of Latvia's external trade. Political decisions often have an impact on the development of trade. In the spring of 1998 the political turbulence in Latvia's relations with Russia decreased Latvia's trade with Russia dramatically. This was followed by August 1998 that influenced Latvian foreign trade with Russia even more as it did once again after Latvia became a WTO member country.

Prof. **Sergey Vasilyev**, Chairman of the Leontieff Centre in St. Petersburg (Russia) and Visiting Scholar at the Carnegie Centre, Moscow, commented that enlargement will promote the development of a unified infrastructure in Northern Europe – in energy, transport, information technologies, as well as in unification of standards, approximation of laws and regulations of economics. This is an extremely positive process, which enhances the productivity of economics of the Baltic region countries. At the same time it is a possibility for Russia to intensify its relations with Europe. After enlargement Russia will have an extensive border with the EU, and this will potentially help to develop a common economic and information space.

But this will call forth also some challenges for Russia and the EU. The first challenge is trade barriers. Minister Zile underscored the influence of politics on the development of trade relations between Russia and Latvia. In Prof. Vasilyev's opinion, obstacles were created not only by political crises, but also by trade barriers. The EU upholds some barriers to Russian exports. One solution is Russia's membership in the World Trade Organisation (WTO) as soon as possible. The another solution is to reach an agreement with the EU allowing Russia to join its free trade area.

Common economic space of Europe is another challenge. Russia would be ready to adopt several EU standards. Co-operation in the sphere of ecology could be promising. In the last ten years awareness of environmental problems in Russia has diminished, even though the situation is deteriorating.

The second challenge for Russia will be a visa regime after the enlargement. From the Russian viewpoint it is very important that the free exchange between people would not be interrupted. The widening of the Shengen zone will result in more restrictions for Russia, not their mitigation.

Much discussion has been devoted to the problems of Kaliningrad. The issue is not so much a lack of good will on both sides, but rather that Russia has not yet decided what status she wants for Kaliningrad, while the EU has not decided what status it is ready to

offer. There is a large area for a common dialogue on cross-border co-operation. Russia has very good experience of cross-border co-operation with Finland after its integration with the EU and this experience ought to be used in relations with other countries that will become members of the EU.

Mrs. **Signe Ratso**, Deputy Secretary-General, Ministry of Economic Affairs, Estonia pointed out that the Baltic Sea region is a region with a population of more than 90 million people. At the same time it is one of the most dynamically developing areas in Europe. In 1997–1999 the annual average GNP growth was higher than both the EU and USA average. All economies bordering the Baltic Sea expanded last year and the economic outlook of 2001 is also favourable. According to the IMF, the highest GNP growth is forecast for Latvia – 6 %. This 6 % is quite realistic. It is followed by Estonia with 5.5% and Finland. EU enlargement can enhance already visible processes. It will create a more stable and more predictable business climate in the whole region. Then it will create a higher degree of economic integration between future and present members of the EU in the area, which already manifests itself in growing trade and foreign direct investment flows. Convergence between EU members and candidate countries will bring real GDP per capita growth. These three factors could increase the GDP and competitiveness of the whole region and will make economies flourish.

S. Ratso looked at the following three factors. First, a more stable and predictable business climate. Before accession applicants need to meet political, economic and *aquis* criteria established by the Copenhagen Council. As all the candidates have to confirm their legislation and regulations with those of the EU, the business climate will become more stable and predictable for investors. One of the indicators is the credit rating given by international agencies, which have improved for all respective countries of the region. This year Estonia participated for the first time in world competitiveness ranking and received a high 22nd place in the front row of highly developed countries, ahead of all the Central and Eastern European countries. Reliability is shown by investors on the basis of questionnaires filled out by the foreign investors. This reliability at least partly can be attributed to Estonia's success in the accession negotiations.

Second, integration of trade around the Baltic Sea has been greatly fostered by the European Agreements. There are free trade agreements with EFTA countries, a trilateral free trade agreement between Estonia, Latvia, and Lithuania, and free trade agreements with other candidate countries, which create a free trade area of more than 600 million people for Estonia.

All five main trade partners for Estonia actually come from the Baltic Sea area. Figures for 1997–2000 show that Germany's and Latvia's shares have remained the same, the share of Russia has declined and that of Finland and Sweden increased. For Latvia the only country in the leading five partners outside the region is the UK. Russia still has first place followed by Germany, Lithuania, the UK, and Estonia. As for Lithuania, Russia also leads followed by Germany, Latvia, the UK, and Poland. Trade between the Baltic countries shows that Estonia's trade figures with Latvia are twice as big as with those with Lithuania. If we

think about trade developments in the future, it is important to point out the significance of the EU share in the general foreign trade. For example, for Estonia in 2000 62 % of trade was with the EU countries and 11 % with candidate countries. If we take all the Baltic States together, already today the largest share is with countries which will be in the near future a part of the common internal market.

Another characteristic feature is the strong complementarity and the vertical integration of the companies, which will certainly increase together with the accession. There is a high level of subcontracting. Trade with the EU will become even more favourable after accession. The EU internal market will also dismantle non-tariff areas. In order to enhance this process, co-operation between the Baltic States, for instance, in harmonising conformity assessment procedures will be important.

Accession of Latvia, Lithuania, and Estonia will be favourable also for Russia, Ukraine and other countries with whom we have had long-term economic relations. For imports from Russia, basically raw materials, on which tariffs in the EU are low, there will be no major trade diversion after the accession. Market access in the EU will also improve in the service sector, which already makes up a big share in our economies. If we make use of comparative advantage in the information communication technology areas, free capital movement will be certainly enhanced for direct investments. Major investors in Estonia come from neighbouring countries in the region – Swede, Finland, Norway, Germany, and Denmark.

As regards real convergence and GDP increase, Ratso referred to forecasts made by the European Commission. The economic effect of accession could increase the average annual growth in AC-8, that is all the candidate countries except Bulgaria and Romania. Enlargement would result in higher physical investment due to EU transfers, increase in the labour force and higher productivity growth. The EU-15 can expect at that time a positive demand and supply due to increase of trade. The countries, which have the highest trade share with the candidates, for instance Germany, could profit most.

Dr. **Nils Morten Udgaard**, Foreign Editor of the newspaper *Aftenposten* (Norway) at the beginning of his comment mentioned the peculiar situation of Norway as a part of the Nordic region, which has chosen not to participate in the Union.

Norway is pending between the discussion on whether there should be new accession negotiations with the European Union or whether she should retreat and become a Switzerland of the Nordic area – wealthy and self contented and forgetting about the rest. That decision has not made yet and it can take some time.

Dr. Udgaard quoted a remark of Catherine Day, that she hopes that the Baltic countries will think differently about their relationship with Russia when they will become members of the EU. She talked about the EU as a regional player, but Uffe Ellemann-Jensen talked about a possible Baltic Sea free trade area in 2006. All these intentions are based on the presumption that the Baltic countries have solved their historical security problems. Security has not been mentioned here. It is necessary to point out that we have had in the last weeks a very interesting input into the security debate in Europe. Dr. Udgaard reminded of the EU

Gothenburg summit where President George W. Bush, the Swedish Prime Minister Joran Persson, and the European Commission President Romano Prodi gave speeches. They are men with a will to do something on the security issues. The next day Bush went to Warsaw and gave a very important speech. He said that all Europeans are welcome in NATO. If we look back on what happened in Europe since 1988, the most striking thing is that the United States have become a more important actor in Europe than earlier. Mr. Bush's speech is an example of that. He spoke about security, about markets, values, the whole spectrum of security issues. And he had very clear ideas about the role of Ukraine and other former Soviet republics and, of course, the Baltic States.

The answer to the question that has been put to participants at this conference – what will be the effect of the enlargement on the Baltic Sea region – very much depends on the solution of the security issue. This solution is not clear at the moment and it will be important for the relationship between the European Union and the Baltic States and Russia, if the United States and its relationship to Russia will be the steering factor of the Baltic countries' relations to Russia, if the United States will be the main security partner of the Baltic States or if it will be the EU with its European tradition, its European trade interests, and its perhaps different ways of doing things. This is the decisive question we cannot answer here, but at least we can ask, how should these things be resolved and should there be co-operation between Americans and Europeans, or should there be more competition. If we look at the EU security and defence policy, it is moving very slowly, but it is the core of political self-assertion of Europeans vis-à-vis Americans. Dr. Udgaard maintained that the area where this self-assertion and effect of it will be felt most clearly is in the Baltic area during next couple of years.

The discussion at the end of this session concentrated for the most part on three topics – prospects of the Baltic States accession to the EU, economic advantages and challenges of the Baltic States' accession to the EU as well as security implications of this process.

On the first topic Voldemars Hermanis, a Latvian journalist, raised the issue of the high level of euroscepticism that exists in Estonia.

Ms. Ratso mentioned several possible explanations of this phenomenon. Perhaps, there are some people who think that NATO will be sufficient for security, and the EU will bring a lot of bureaucracy. She pointed out that the media often exploit extreme cases of bureaucracy in the EU, which does not have a positive impact. Politicians have not used their possibilities to explain the positive sides of EU membership. As regards business people, they often are not content with the demands of the EU, but they often don't realise that this is something they should have to do anyway to be competitive in the foreign markets because the Estonian market is too small.

On the other hand, some participants in the discussion raised the question on the weak support for enlargement in some EU countries and asked if more co-ordinated policies of the EU would not be more productive.

U. Ellemann–Jensen agreed that public opinion polls in the EU countries show rather weak support for Eastern enlargement, the weakest support is in some major countries like France and Germany. He attributed this to the fact that political signals have not yet been given to the European population and because solutions for practical problems in the Nice treaty are not satisfactory. Some stronger methods should be given to the present members of the EU, especially concerning economic prospects. This is not the situation where the members have to pay to have new members in. There are growth possibilities, possibilities of growing markets.

C. Day pointed out that the EU has an agreement on the whole European political idea and is working together how to get it through, but 15 countries have very different ideas on many problems. At the same time at Gothenburg a very clear signal was given. We should not have to have battles over every question. There has to be more debates in the EU, because it is a political project in the first place. The EU has to find a way to get a message through to the population. The Irish vote is not a vote against enlargement, it is partly an expression of concern about Ireland. Irish people are afraid to be involved in military alliances.

U. Ellemann–Jensen admitted that he knows of some examples where in the Baltic countries people run into corruption. However, these countries have had only ten years to achieve a legal system similar to the Denmark. Legal systems and legal traditions are needed in order to combat corruption. People are working very hard on it. Probably a generation is needed.

R. Zile on his part stressed that the Baltic States came from a system which was very corrupt, although in a different way. There has been progress in fighting corruption, but it is not enough. The Latvian government is preparing many activities in this area. There are good debates in the Latvian public and good ideas are put forward. The authorities will follow these up. On the other hand, in Minister's Zile opinion, the image of the corruption level in Latvia abroad is too high, because in many cases when investors are not successful, they often say that corruption is to be blamed.

On the security problem Atis Lejiņš, Director of the Latvian Institute of International Affairs asked speakers what was their opinion regarding the possibility that the EU accession will be delayed and the Baltic States join NATO first?

Dr. Udgaard explained that he had NATO in mind when he spoke about the USA. After the Cold War NATO for the first time has become more important for Americans than for Europeans. The Europeans like their co-operation with Americans, but they not depend on this co-operation as much as during the Cold War. NATO has changed, it has become even more clearly an important political organisation as an expression of American political intentions. You can see this reflected in Poland and in the Baltic countries. It is an important psychological and political change that NATO has not become less important for Europeans and more important for Americans.

Ms. Day pointed out that joining NATO and joining the EU are parallel processes, but they are not interdependent. There is no need to dramatise what organisation candidate countries are going to join first. It is for each country to decide whether it wishes to

join both organisations. Joining the EU is a contribution to so-called soft security, which is the most relevant kind of security nowadays. There is no competition with the USA. The EU wants very much to have a grown-up relationship with the United States. EU defence and security identity is recognition of a fact that you can't be a major economic player in the world and not to take political responsibility. Her opinion was that the Baltic States' joining one organisation first will have not necessarily any dramatic consequences.

Latvian political scientist Dr. Artis Pabriks was of the opinion that for Latvia the only possible vision is complete security, which is participation in both organisations. If Latvia joins NATO first, the result could be twofold: to contribute as a small actor to European and Transatlantic co-operation and contribute to our readiness to joining EU. Membership in NATO would solve not only psychological problems for politicians and the general public, but also helping Latvia to become an even stronger candidate for the EU.

U. Ellemann–Jensen pointed out that in the security concerns of the Baltic States everything is mixed up – history, psychology etc. One good reason for taking Baltic States into NATO is that this will erase the idea that such things as spheres of interest could be reintroduced in Europe. There could not be anymore talk about special spheres of interest, “near abroads” etc. NATO is no threat to anyone. The new relationship that seems to be developing between the USA and Russia may lead to recognition by Russia that there are some facts that have to be dealt with because of history and that these facts do not pose a threat to Russia. We still have to deal with some history that has not been dealt with in our own countries. What will come first – NATO or the EU? It might to be a good idea to go into the EU first. One good reason is that the EU also is something that has to do with history. The goal of European integration is peace and freedom, but the means are economic co-operation and integration. This is why the EU has to do with security as well. The another reason is that, when you are a member of NATO you will have to spend much more money on your defence than you are spending now. In order to strengthen your economy you ought to be in the EU. In the Baltic States public opinion polls show that public support for EU membership is low. If you are in NATO first, there could be a temptation to follow the Norwegian example of “splendid isolation”. As the Baltic States don't have oil like Norwegians to build up their economic prosperity, they do need to be in the EU as well as in NATO.

Dr. Nils Muižnieks, Director of the Latvian Centre of Human Rights and Ethnic Studies, reacted to Day's statement that Russian – Baltic relations are going to be different after accession with a question: How after accession will the Baltic States look differently at Russia and might it not be even more relevant that Russia will look differently to the Baltic States? It seems that in Baltic–Russian relations it is primarily Russian domestic politics that sets the tone. In 1998 just after Latvia in a referendum adopted a new liberalised citizenship law, the Russian Duma started to consider a law on economic sanctions against Latvia.

Ms. Day explained that her remark ought to be understood in post-enlargement. Not only the Baltic States will look at Russia in a different way, but also Russia will look dif-

ferently at the Baltic States. The focus on the past will decline with time. Hopefully, there will be shift on both sides of the new EU–Russia border.

Dr. Dmitry Trenin on his part thought that EU membership of the Baltic countries will change the self-identification of the Russian community in the Baltic States. It will be easier for ethnic Russians to identify themselves with Europe than with Latvia and this will contribute to the lessening of tensions in this country. Hopefully, Russian domestic policies will become progressively more enlightened. Sanctions have no part in enlightened policy.

Grigory Krupnikov, Head of the Jewish Community in Latvia asked if Baltic membership in NATO would come first, what would happen to membership in the EU?

Dr. Udgaard in his answer stressed that Baltic countries have to have working relations with Russia in any case – by just geographical fact of being a neighbour of Russia. If the Baltic States don't solve their problems with Russia without their own contributions they will be less interesting partners for Europe.

U. Ellemann–Jensen pointed out that the enlargement of NATO is not an issue that has to be discussed with Russia. The question is whether a country wants to be member of NATO and whether NATO wants to take up new members.

Dmitry Trenin admitted that if the Baltic States join NATO first, there will be complications with Russia. In this way we are not addressing the main problem which is European security, which cannot be solved by adding more countries to NATO. In ten years since the end of the Cold War, Russia has not been integrated in the European security community. The best way for Russia to deal with the issue of NATO enlargement and the Baltic States would be to strengthen its relations with the EU as well as to intensify and deepen relations with NATO. Are we satisfied how the Russia–NATO Council is working? For a short time Baltic NATO membership could create turbulence, even if it projects stability in the longer perspective. Baltic membership in either organisation is an issue for Balts themselves. The central issue of European security is how the West will deal with Russia and how Russia will deal with the West.

Session Two: Impact of an Enlarged EU on Russia, with Focus on North-West Russia

The session was moderated by Dr. **Christer Pursiainen**, Director of the Aleksanteri Institute, Finland, which is a centre for Russian and East European studies at the University of Helsinki.

Dr. **Ramunas Vilpišauskas** from the Institute of International Relations and Political Science (Lithuania) presenting a paper “New Prospects for Old Neighbours” raised several issues, especially that of the Kaliningrad region. Lithuanian scholars and diplomats have been working on this problem for some time. The enlargement of the EU basically implies that candidate countries have to implement the EU *acquis*. This means that they have to participate in the Single Market. They also have to keep to the common EU policies – common foreign trade policy, common visa regime and so on. The issue is whether the EU, which intends by way of enlargement to end the division of Europe and to extend a zone of stability and prosperity, will not create additional barriers between new member states and their neighbours, in this case Kaliningrad?

R. Vilpišauskas looked upon the problem what future factors will determine how this challenge will be dealt with. Membership of the Baltic States and Poland in the EU will have a direct impact on their neighbours, the Kaliningrad region, other parts of the Russian Federation, and other neighbouring countries as well. They will have to adopt common external trade policy, visa policy, transit and energy policy, which are not exclusively EU competence areas, because member states also play a role in this. This means that in some cases this may result in higher barriers to trade and exchange of goods and people with the Kaliningrad region. The overall effect, however, will depend on several factors. One factor is the EU policy which, in Mr. Vilpišauskas opinion, so far has been ranging between status quo or using the current framework versus innovation, which means that the EU recognises that the specific nature of the Kaliningrad region might be cause to devise special instruments for dealing with this issue. Russia's role is decisive; here the two different ends of the same continuum is centralisation, on one hand, where all policy is conducted by Moscow, and there is no differentiation of Kaliningrad in terms of its relations with the EU and, on the other hand, there is some kind of autonomy given to the Kaliningrad region, which has been called as “pilot region” without defining what this really means.

As regards foreign trade policy, the European Commission has produced a paper on EU policy on the Kaliningrad region in the context of enlargement. Dr. Vilpišauskas expressed surprise with one of the conclusions, namely that import tariffs imposed on Russian goods, particular from Kaliningrad on the part of Lithuania are among the highest in the European Union. This is not correct. Lithuania imposes a more liberal trade regime towards Kaliningrad region as well as the Russian Federation in general than the European Union. That means that import tariffs in some cases will increase on Kaliningrad goods as a result of EU enlargement and some trade diversion is therefore

likely. But trade amounts with so-called sensitive goods (machinery, fertilisers etc.) are very small and trade diversion will not be significant, hence one should not dramatise too much a potential increase in tariffs. More important are possible negative effects caused by non-tariff barriers on products, certification procedures and antidumping measures which the EU is very much inclined to apply. The EU holds first place among WTO members in the use of antidumping measures. The impact will be very asymmetrical. Lithuania imports are less than 1 % from the Kaliningrad region of its total imports. The economic effect of these restrictions will be very small, and perhaps only for the Baltic region will it have any significance. For Kaliningrad it might be more important, because Lithuania is an important export market for Kaliningrad, but these changes nevertheless would not be very significant.

How could this potential challenge be dealt with? If we take two factors – European Union policy ranging between some kind of innovative solution to status quo and Russian policies ranging between low centralisation, meaning giving autonomy to Kaliningrad region, and high centralisation, we have four different scenarios. Of course, some aspects might be overlapping.

Economically, implementation of the Partnership and Co-operation Agreement would be the most sensible solution resulting in a free trade zone between Russia and the EU, and the harmonisation of product standards and certification procedures. Progress in this area is not very promising. Nobody seriously talks about the establishment of a free trade zone. The other potential scenario, which will require innovation on the part of the EU, is the Kaliningrad region as a pilot region. It will require Russia also to give a more concrete content to this still very vague idea. However, it seems that the prevailing mood in the EU is not to devise any special solutions to this case. Also signing a free trade agreement with the Kaliningrad region alone will complicate very much the use of rules of origin of goods. So it is a rather unlikely scenario. For the nearest future the most likely scenario will be the Northern Dimension scenario where there will be some kind of co-operation between the Kaliningrad region and euroregions but this is usually not linked to trade issues as this is exclusively the European Union's area of competence. There have been recently some talk on what is called common European economic space which could provide a potential for new initiatives between the EU and Russia. However, it is probably even less likely now than the implementation of the free trade zone, unless, perhaps, we keep it as a vision for the next ten years.

Another problem is visa policy. The number of people crossing Kaliningrad's borders every year is quite high taking into account that less than 1 million people live in Kaliningrad. Currently they do not need visas to transit across Lithuania to other parts of the Russian Federation. They do not need visas if they stay 30 days in Lithuania. Similar benefits apply in Poland. These rules diverge from Schengen rules and Lithuania is planning to abolish them in 2003, Poland already in the middle of this year. These visa policy issues seem to provoke the most controversy in Russia and usually are given as examples of new barriers, which could result from the enlargement. At the moment the most likely scenario seems to be what could be called the procedural improvements, at least

this is the EU preferred scenario. This means that there will be some improvements like lower prices for visas for the Kaliningrad region inhabitants, multi-entry visas, more consulates, encouraging the member states to establish more representative offices in the Kaliningrad region, simplifying customs procedures, even using a transition period after Lithuania and Poland become members of the EU. Russian authorities had been quite strongly calling for the preservation of a visa free regime, but now emphasise a visa free regime for Russian citizens who are travelling from Kaliningrad to other parts of Russia. It remains to be seen if such an option could be implemented and whether the EU will agree to such a solution. Similar challenges can be found in other areas, which are not the exclusive competence of the EU institutions. Transit to some extent could be dealt with in bilateral negotiations between Poland and Russia, Lithuania and Russia.

In conclusion Dr. Vilpišauskas raised three questions which, in his opinion, are key questions: Whether the Kaliningrad region, because of isolation, can become a source of instability, or whether it will be a platform for devising a new type of co-operation between the Russian Federation and the EU? The second alternative could be the most beneficial for everybody involved, but this will depend on EU flexibility while at the same time adhering to the *acquis communautaire*; it will depend also on the willingness of Russia to give more content to the idea of a pilot region. The second question is to what extent the issues should or could be influenced by the neighbouring countries? Lithuania has been playing quite an active role in this respect, but in the past year the discussion has been shifted more to the bilateral level between Russia and the EU. This is to some extent natural and a good trend for candidate countries because in such a way accession negotiations would not become hostage of potential difficulties in dealing with Kaliningrad region challenges. On the other hand, every new enlargement brings something new with new members and, hopefully, there will be a possibility for Lithuania, Poland and maybe other neighbouring countries of the Kaliningrad region once they become members of the EU to suggest initiatives to the EU institutions. The third question – it is important to remember that enlargement is just one of factors that influences the future of the Kaliningrad region. In some aspects policies inside the Kaliningrad region, policies conducted by the Russian Federation authorities will be more important than effects of EU enlargement. It is most important how economic policies are devised and conducted and how the market economy is established in the Kaliningrad region. This might be a bigger challenge than the enlargement of the European Union.

Mrs. **Inese Vaidere**, Vice-Mayor of Riga talked about the relationship of the city of Riga with Russia and how possible effects of enlargement on these relations are seen from the city of Riga viewpoint. Mrs. Vaidere reminded the meeting that in two months Riga will celebrate its 800s anniversary. Riga has about one third of Latvia's population and about half of Latvia's economic resources. Riga historically has played very different roles. It has been a crossing point of interests of different powers, of the West and the East. At the same time it has played the role of a bridge, connecting different parts of Europe. This can be seen from the many wars in its history as well as trading activities

through centuries. Riga has grown mainly due to the activities of its traders. The 800th anniversary celebration is in the first place an occasion to remember Riga's trading role in The Middle Ages when its competitors from Germany, Russia, Finland, Sweden and other countries became important co-operation partners of the city. In the 13th–16th centuries Riga as a member of the Hansa Union was a city of business, development and prosperity. As a member of the Hansa Union Riga was granted the status of the independent town and, what is very important, a right to issue its own money.

Latvia's accession to the EU will provide its capital with an opportunity to develop its relations with cities of partner countries on a quite new level. The coming together of economic development with other EU countries will provide Latvia with new possibilities as well as with new incentives for widening of economic relations with neighbouring countries, i.e. with Russia on the whole and with particular Russian cities. Latvia backs active EU policies in the North that promote security, stability and better use of its economic potential. Economic growth in Northern Europe and enlargement of the European Union is a signal for new investments, especially in the energy sector, in development of new multimodal transport corridors, in modernisation of the telecommunication sector, in development of a harmonised e-environment. Interests of all countries of the region demand a mutually balanced involvement of Russia in regional processes.

It is rather difficult to forecast what will be the relations between Riga and Russia after the enlargement, however, the main principle necessary for development of relations is good neighbourly relations based on internationally recognised principles and on mutual respect. Riga perceives its relations with Russia as a part of dialogue and input into stimulating the development of the region. Preconditions for successful co-operation are common business interests and shared priorities. Riga as the city of a future EU member country which is looking for constructive co-operation partners in Russia with whom to work together.

It should be mentioned that forums like this one give a very good input in reaching a common understanding for particular business interests and priorities and advance mutual co-operation in general. Riga has more than 800 years of experience in co-operation. It is an important seaport as well as a culture centre with an international tradition developed through the centuries. This legacy has helped to develop a multiethnic mutually enriching environment in Riga open to new ideas and projects. Riga in the context of EU enlargement is a geographically advantageous place for exchanging ideas and goods. Riga has become an internationally recognised conference centre. Riga is also a crossing point of sea and land communications with a well developed infrastructure. Latvia and Riga provide good quality services for our Western and Eastern partners as well as for Latvians.

There is big potential in developing relations between Riga and St. Petersburg. Among other co-operation aspects one very important one is the seaports. In the St. Petersburg region construction of new seaports is already under way, but the problem of supply roads to these seaports has not been solved yet. It is possible that as a result car-

goes going through those seaports can become so expensive that it would not be profitable to exploit them. In Riga and in other places in Latvia there already are established seaports with a good infrastructure, good communications and service, in addition to being ice free. Riga has a positive attitude to Russia and wants to build relations on principles of mutual beneficiality.

Dr. Vatanjar Yaghya, who is Professor in International Relations and also a parliamentarian in the St. Petersburg Duma, continued the theme of developing regional co-operation. He stressed that he did not represent the official point of view of the St. Petersburg Parliament, but is presenting only his own thoughts on EU enlargement and on the role of several subjects of the North–Western part of the Russian Federation.

Prof. Yaghya praised Dr. Udgaard, because he was the only one of speakers in conference morning session who put the problem of integration in the Baltic Sea region in the global context. Processes in the Baltic Sea region could not be isolated from the globalisation processes. The natural development of the EU goes hand in hand with processes of natural development of countries that are becoming its members. And it is a part of the developing world economy. The USA share of the world's GDP is about 19–21 %, which equals that of the EU. After 20 years the enlarged EU will still have approximately the same share as that of the USA. The USA in response to EU pressure established NAFTA, a major economic grouping. At the same time the USA is trying to involve in this process all of Latin America. The Netherlands and Liechtenstein are also holding talks with the USA, Canada, and Mexico to be associated with NAFTA. It is practically impossible to analyse these processes apart from processes in the Baltic Sea region. Much is said about the Northern Dimension, but we forget that officially the idea of the Northern Dimension was first voiced by Prime Minister of Finland Paavo Lipponen in 1997, before that there was the Northern European Initiative of the USA, which has the same parameters. The Northern Dimension is an initiative designed for regional co-operation between the EU and Russia, and not only with Russia. It was told here that the Northern Dimension can work only if Russia is involved, which is not quite true. In the first place it is about investments in the Baltic countries. Russia is mentioned only in the second place. Perhaps it is natural looking from the point of view of the EU and its Action Plan. But it should be mentioned that it is impossible not to take into account the position of Russia on this issue. Any regional co-operation programme of the EU ought to take into account all proposals and interests, among them also the proposals and interests of Russia. Unfortunately, before the EU summit in Feira (Portugal) in 2000 there were consultations in Moscow, where Russia proposed several initiatives to be included in the Action Plan, which were not reflected in the Action Plan. It contains only four areas with regard to Russia – security, nuclear safety, environment, and the Kaliningrad region. This narrows significantly interest in the Northern Dimension Action Plan for Russia. In addition the Northern Dimension at this point is still a declarative enterprise. The only concrete result is that EBRD will give 100 million

ECUs for the Kaliningrad region and St. Petersburg for environmental protection. There are only discussions, not real actions behind the initiative. Prof. Yaghya recalled that the first impulse for the Northern Dimension initiation came from Finland and also to some extent Sweden in order to attract investments for their northern regions. Integration with the EU led to the diminishing of competitive power of their agriculture, migration to cities and growth of unemployment. Nordic countries, and especially Finland wish to attract investments to North West regions of Russia, to build stability in these regions. There are three agreements of the Russian Federation that could be looked upon as model agreements for the future – co-operation agreement between Poland and Russia on St. Petersburg and border regions of Russia, the agreement on co-operation with Kaliningrad region, and an agreement between Finland and Russia on transborder co-operation. These agreements could serve as model agreements between Russia and the Baltic countries when these three countries will enter the EU – on co-operation between the border regions of these countries with those Russia. There is also some kind of contradiction between the Northern Dimension and the Swedish programme “Russia as a Part of Europe”. This programme did not develop in the EU framework, in Russia, but it has a right to exist, especially, taking into account that Sweden has not detracted the programme.

The very modest results of the Northern Dimension so far follow from the following obstacles: 1. No bigger country of the EU perceived the Northern Dimension as its priority. Germany’s position is very characteristic in this regard if we take into account that it has significant interests in this region. 2. Southern members of the EU display discontent, sometimes openly, but more often in a hidden way on the Northern Dimension initiative, because it could mean restructuring of the EU budget in favour of Northern countries. 3. It does not have its own budget, but is funded from existing programmes, and only starting with 2006, with the new EU budget, does it have some chance to get any significant amount of money. Besides, the Northern Dimension does not have any mechanisms of action except for its summit.

Despite his critical attitude to the Northern Dimension, Prof. Yaghya thought that it is a very important programme for the development of the North West regions of Russia. It could have a positive effect in case it would be implemented. It can lead to development of Russia’s direct co-operation with the European Union, especially taking into account that in the next ten years the EU and Russia will have a common border only in the North West. He referred to a recent speech in Moscow of the Estonian Ambassador who expressed the opinion that accession to the EU will lead to development of Estonia’s co-operation with the North West of Russia on the whole, not only with some smaller subjects of the Russian Federation as is the case today. Participation of the North West in such programmes is some kind of quality mark of the region, it helps to grow in influence and to attract investments. The Northern Dimension could help to attract foreign investments, especially in transportation and communications. The Northern Dimension could find itself in an unfavourable position when the EU Presidency will fall to the Southern countries.

Mrs. **Helena Bandura**, Deputy Chief of Department in the Ministry for Economic Development and Trade of Russia (Moscow) analysed possible results of enlargement on trade with Russia. EU enlargement has an irreversible character. In ten years there would be 20 members of the EU depending on how the process of accession negotiations will proceed. Membership in the EU will effect all spheres of activities of the respective countries, particularly their foreign trade. For Russia the Eastern enlargement could have positive as well as negative consequences for foreign trade.

The positive consequences could be favourable terms for access of Russian goods to the more spacious internal market of the EU. New members should have to meet also conditions of the Partnership and Co-operation Agreement between the EU and Russia. This will mean also application of WTO rules to Russia in some areas, even before Russia becomes member of the WTO. This is especially important now when Russia is involved in intensive negotiations with the WTO. Future enlargement of the EU will extend Russia’s borders with the EU and will stimulate transborder economic co-operation of the neighbouring regions of Russia and the Baltic States, which could take the form of regional agreements on co-operation. Accession of Poland to the EU, taking into account the union of Russia and Belarus, may result in new opportunities to build transport corridors with the European countries, especially transport communications through the Kaliningrad region. Enlargement of the EU will also create the necessary conditions for building a civilised customs border with the Baltic States and to lessen damage to Russia from smuggling and various violations of custom regulations which often affect Russian relations with the Baltic countries. We hope that firms holding Russian capital will have equal status throughout the EU area. Some positive effect on our trade relations could result from adoption of higher quality standards by the new members of the EU. This would allow to import in the Russian Federation goods of higher quality. However, the introduction of EU standards could also have a negative effect. It can negatively effects the export possibilities of Russia to the new member countries of the EU as some groups of Russian goods do not meet these standards.

The positive effect for Russia could also arise from application of EU tariffs for the new member countries, especially for industrial goods. EU tariffs are lower than the tariffs of the Baltic States. However, high quality industrial goods do not constitute a large share of our exports and the lowering of tariffs would not result in a big increase of Russian exports to the enlarged EU.

The EU has a common system of preferences and this system will be applied by the new member countries to Russian goods. However, the EU preferences are applied to goods with a high level of processing capacity, which today do not enjoy a high percentage in our exports. The problem is also that the system of preferences of the EU is applied not only to Russia but to a wider range of countries and this can result in higher competitive pressure on Russia from third countries. Nevertheless, we hope that enlargement will develop an export potential and will create opportunities for more exports of high quality goods.

The most negative effect of enlargement for Russia could be that the new members will adopt EU energy policy rules, which do not allow more than 30 % of energy to come from

one source. This could result in diminishing of Russian energy exports to the new member states of the EU. The EU also applies restrictions to nuclear energy imports.

Russia can suffer high losses due to the EU antidumping rules. This will lessen Russian exports to the new EU countries. However, Russia hopes that there will be a possibility to revise these antidumping measures, because after enlargement the structure of production will change and lists of goods to which antidumping measures are applied should be reconsidered.

Another negative consequence could be the introduction EU transport tariffs, which can significantly increase transit costs through new member countries of the EU for Russia. This already took place after Finland's accession to the EU and Russia was forced to reorient its transport flows to other countries, mainly, to the Baltic States. If this will happen after the Baltic countries join the EU, it will create difficulties for Russian exporters.

Dr. **Erik Berglöf**, Director of the Stockholm Institute of Transition Economics and East European Economies (Sweden) in his commentary stated that the discussion on effects of EU enlargement on Russia is an example of how the debate between Russia and the EU is proceeding. It is important to move it forward because both sides have been talking very much past each other. On the EU side the Russian concerns have been met with a very biased view on enlargement effects. On the Russian side there has been a rather emotional response fearing that the process will not only be beneficial for Russia. The recent conversion of Russia toward a more positive attitude towards EU enlargement is the result of NATO enlargement, which is seen as a major threat. There are signs however, that this attitude is changing.

The EU response to the Russian complaints has been that its rules apply to a very small number of commodities, but this is not true. The EU has been hitting Russia with its antidumping measures, and Russia is not alone to suffer treatment. In the end the EU citizens are paying a very high price for this policy.

EU trade policy costs about 75 % of combined GDP inside the EU. To tell Russia that this trade policy will be extended to additionally 12 or more countries and that this will not have any negative consequences for Russia cannot be taken seriously. There are essentially two consequences of EU enlargement. One deals with prices, the another with the effects of competition. The discussion on prices has been focused very much on exports, but the interesting approach should be about terms of trade. There has not been a study on the effects on Russia of terms of trade after the EU enlargement. When we look at the effects from competition it is a very difficult process, because you have to look both at the benefits of the agglomeration factor that increases competition at the centre while at the same time opens opportunities for countries that are not part of this increased agglomeration. The risk is that Russia will be loosing in competitiveness in comparison with countries that will join the EU.

Perhaps, at the end of the day, Russia will have very large net benefits from the EU enlargement. It is also important that a framework is provided for discussing all conse-

quences, benefits and losses as a result of enlargement, and to be sensitive to concerns that the Russian side have been raising. Benefits to Russia would not come immediately for trade and investment, but from gaining benefits enjoyed by the current candidate countries— to have some outside anchor for their reform process. In this sense Russia has more to gain, there are benefits in a political sense, there is a potential for the EU to give Russia the same sense of direction, the same sense of opportunity that current accession countries make use of.

Dr. **Werner Adam**, former Foreign Editor of the *Frankfurter Allgemeine Zeitung* (Germany) stressed that for many years Russia was preoccupied with opposition to NATO enlargement. and rejected many offers from the EU for a closer relationship. This has been changed by the present administration. The Putin government, although it is still against NATO enlargement, has declared that it has nothing against the Baltic States' membership in the EU. And in Moscow Russian politicians perceive the EU as another safeguard for Russian communities in Estonia and Latvia. However, there still is no guarantee that Moscow will remain relaxed about enlargement. The Kaliningrad enclave, surrounded by territories that most probably will become EU territory, offers a potential flashpoint in that the important Russian naval base there is a challenge if a true European defence arm and common foreign and security policy will be developed. Dr. Udgaard said that most of European countries never felt so safe as they feel today while Americans leave an impression that they have never felt so vulnerable. Different views of the United States and its European partners on defence, etc. must be kept in mind. There are countries in Europe that would not accept the Baltic States as members of NATO, that it would be too much of a provocation for Russia. G.W.Bush said that the USA regarded Russia as partner and even as a friend. But for Russia another thing is what President said last week in Warsaw that NATO is open not only to Estonia, Latvia and Lithuania, but also to Georgia, Ukraine, etc. Dr. Adams said that he has not heard any convincing Western argument to explain to Russia why it is necessary to extend NATO to Russian borders. The West has very much to offer Russia in terms of economic development, co-operation, as well as security. This involves not only Kaliningrad and a free trade agreement. Russia also can contribute by increasing co-operation with the European Union. There is a wide range of subjects for co-operation – from environmental to combating organised crime, the institutional framework is already here – the Council of the Baltic Sea States, also the Barents Sea Council. The Barents Sea with its rich resources of oil and gas offers great opportunities for trade that were blocked by 75 years of the Soviet Union's existence. The Northern Dimension as formulated by Finland and very much furthered by the Presidency of Sweden in the last couple of months could join the work of these two councils and develop increased future co-operation. An impact of the enlarged European Union on Russia in general and its North Western region in particular will be that it will rid political uncertainty and rivalries and hence open up true economic opportunities.

Mr. **Marek Ostrowski**, Editor on Foreign Affairs Issues from *Polityka* Weekly Magazine (Poland) said that EU enlargement is in many ways connected to NATO enlargement. He was alarmed by Mr. Ellemann-Jensen's remark that it may be possible to put EU enlargement first and NATO enlargement later. His point was that NATO enlargement should be decided in Prague next year and presumably any further EU enlargement is around 2004, if we are optimists. If in Prague NATO is not enlarged, and the Baltic States are not taken into account, public opinion should be told why. If we say you must wait because we must accommodate this delicate question with Russia, then, if it is said publicly, NATO will never be enlarged.

The next point is the border issue, although it is connected with the first one. Recently Mr. Ostrowski was in Berlin and talked with people from leading thinktanks. He was advised that before the EU could enlarge Poland needed to improve its Eastern border. He was dismayed by the way how this problem was addressed, i.e., perceived as a Polish problem. In Mr. Ostrowski's opinion, this is not a problem for Poland, because three million Russians and Ukrainians come to Poland every year according to official statistics, and Poland can manage this perfectly well.

One more problem is Kaliningrad. Mr. Ostrowski stated that what is needed is a big European initiative, like, perhaps, big European university in this city named after Immanuel Kant, or something else with great imagination just to let Russians understand that Europe really cares and wants to engage them in Europe. However, there are no such big initiatives. Perhaps, the Baltic Sea region countries could do something in common.

The last point is trade. Poland is in the forefront of this problem. Russia is Poland's third economic partner just after Germany and Italy. Poland has a huge trade deficit with Russia. When we ask why, there are too types of answers. One is the political climate should be improved, the second is that there is a free market now and if you have not competitive products, you loose. But these answers are not consistent.

Mr. **Andrey Avetisyan**, Head of the Department for European Co-operation Unit, Ministry of Foreign Affairs of Russia pointed out that the previous speakers – representatives from NGO and scientific centers from Lithuania and Russia presented viewpoints on Kaliningrad that are very close to the Russian official position. The Russian Federation is interested in developing co-operation with the EU. This holds true also as for the new members of the enlarged Union. At the recent EU – Russia summit in Moscow, Russia proposed a common European economic area. Now work is under way on concrete steps to be taken to implement this idea. Integrating Russia in the European scientific area was also raised, as well as on prospects for using the *Euro* in bilateral relations. This means that this process of integration proceeds in parallel with the process of the enlargement of the EU.

At the same time there are possible negative consequences of enlargement, already mentioned by H. Bandura. We should finish consultations with the EU before the enlargement takes place. Mr. Avetisyan expressed his belief that the Baltic States would be among the first ones to join. Why should Russian–EU relations be settled before enlargement took

place? Becoming members of the EU, new member countries take on obligations with regard to third countries. New members of the EU would not automatically join the Russia–EU Partnership and Co-operation Agreement. The Russian Parliament would have to ratify it for every one of the twelve new members. We will have to present very good arguments to convince the Parliament that enlargement of the EU really will bring benefits to Russia. Thus the aim of our consultations with the EU on development of trade and economic relations is such that we think Baltic membership in the EU can help re-establish the amount of trade Russia previously enjoyed with these countries.

Political consequences of enlarging the EU to the Baltic countries means that the EU–Russia common border will be with the Baltic States in particular. The new situation that this will bring about will be the ability to combat organised crime. We have a common action plan for combating organised crime with the EU. After the Baltic States join the EU, they will join this action plan and will combat this evil more effectively. Another new aspect is the so-called EU defence identity. Because the Baltic States will receive guarantees of security within the framework of the defence identity, many delicate problems will be solved. Russia is open to co-operation with the EU on defence and security issues.

The problem of the Russian-speaking population in the Baltic States could be most effectively solved in the context of the enlargement because of the Copenhagen Criteria. As was correctly mentioned by Mr. Ostrowski, after enlargement it will be a problem of the EU, not only of Latvia or Estonia, and there is no need to bring this into the EU. Perhaps, it would be better to solve this problem so that all inhabitants of the Baltic States become citizens of Europe as everybody else. Membership in the EU will have a positive effect on the Russia's relations with Estonia and Latvia.

Visa and consulate problems are presently more complicated. This problem is more connected to the problem of regional co-operation. It is obvious that people are keen to rebuild lost economic and trade ties. An obstacle to this trend is that visa problems are not solved properly. Russia therefore began negotiations with the EU on a comprehensive visa agreement. Russia's aim is to ensure that Russian citizens automatically get national Schengen visas when the Baltic countries join the Schengen regime with countries with which Russia previously had a visa free regime. Russia understands that will not be possible, but it would like to obtain the best possible conditions for Russia.

The Northern Dimension offers Russia an opportunity for training in co-operation with the EU before the enlargement has started. There are several bilateral projects of Russia with Lithuania, a trilateral initiative of Russia, Poland, and Lithuania for the training of customs officers. Russia is going to prepare also a list of possible projects on transborder co-operation with Estonia. In this the EU contribution also would be necessary.

The issues of Russian–EU and Russian–Baltic States relations provoked a lively discussion.

Mr. Hans Magnusson, Head of the Department of Central and Eastern Europe of the Swedish Foreign Ministry commented on Prof. Yaghya's criticism of the Northern

Dimension. It must be seen as EU policies for the North of Europe, which includes obviously both candidate countries in this region, present members of the EU, as well as North Western Russia. It is not true that proper attention was not given to Russia in comparison with the candidate countries – perhaps North Western Russia was given somewhat more attention than the Baltic States. Sweden had several priorities during its Presidency, including the Northern Dimension. However, this did not exclude other proposals that also are to be developed further during the next few years. Sweden is aware that Spain will have the presidency and that it is necessary to put the Northern Dimension on a firm basis in the EU and also within the European Commission. So there will be rather a clear set of follow up mechanisms and meetings of foreign ministers and senior officials, involving business and NGO's, for example, and also handing over this project to the Denmark Presidency. Also in the Commission there are more resources for dealing with the Northern Dimension. Prof. Yaghya, pointed out that there is no separate budget line for the Northern Dimension. It would be good idea to have one as the EU has for the Mediterranean, but it has not been possible so far. But Sweden works with the Commission to have a better alignment and co-ordination of various financial instruments within the Commission or at the disposal of the Commission, so that different PHARE, TACIS and INTERREG instruments can work together better to make it possible for cross-border co-operation. There is a good initiative from financial institutions within the Commission to create a Northern Dimension Environment Partnership which can bring some new resources for projects concerning the environment, nuclear waste and so on, in particular, for North West Russia.

S. Ratso commented the regional perspective. Namely, investors from the Nordic countries that started to invest in Estonia now have enlarged their activities also to Latvia and Lithuania. They are interested in investing in North Western Russia if the economic climate would be favourable for this. After the accession Estonia's, as well as other Baltic States' comparative advantage of labour costs will diminish, and perhaps Russia could benefit from this.

She asked her Russian colleagues when the trade agreement between Russia and Estonia will finally be signed. Since the 1990's Estonia has had unilateral free trade with Russia, even though Estonia is among the very few countries of the world which does not enjoy most favourable nation treatment from Russia.

H. Bandura denied that there is any discrimination of Estonia in trade relations. As regards this particular trade agreement, this is a question for the Russian Foreign Ministry.

A. Avetisyan, however, was not ready to say anything about the signing of the trade agreement with Estonia. He pointed out that obligations on some positions in the EU far extend those envisaged under the WTO agreement. As soon as Estonia will enter the EU, the Partnership and Co-operation agreement between Russia and the EU will be extended to Estonia too. Thus, this is not a big problem taking into account that the accession of Estonia will probably occur very soon.

Answering a question from the floor if Russia would not be in a much better position after enlargement if it already will be a member of the WTO, Dr. Berglöf replied in the affirmative. But it is a far more difficult process for Russia than anyone could imagine before the talks on WTO membership were started.

H. Bandura on her part pointed out that Russia is just beginning the first steps in applying procedures which are demanded by the WTO. Russia has difficulties in this, because Russia has no experience in this area. But Russia is in the process of improving legislation on economic matters in order to bring it closer to EU legislation, especially on external trade. Using norms of the Partnership and Co-operation Agreement, the unification of Russian legislation with respective rules of the WTO ought to provide some hope in this regard.

R. Vilpišauskas indicated that despite all Russian complaints about protectionism of the EU, one should be aware that Russia is not the most liberal economy with transparent and non-discriminating trade practises. It is not very beneficial to respond with protectionist policies by demanding compensations or imposing countervailing measures. It would be much more productive to think on means to liberalise trade between Russia and the EU, not how to respond vigorously to each other's protectionist policies.

On a question from the floor on how he evaluated the work of the Kaliningrad authorities, R. Vilpišauskas answered that responses to the challenges of the Kaliningrad issue are basically on Moscow's level and are treated as such by the EU institutions for understandable reasons. There is little need to think about what is the opinion of the Kaliningrad authorities. But once there is a signal from Moscow that more autonomy could be given to the region, the attitude of local authorities would be positive. After the last elections the Kaliningrad authorities are quite constructively minded towards co-operation with the EU, but first there should be appropriate measures from Moscow.

A. Avetisyan pointed out that Kaliningrad participates in Russia's talks with the EU. There is a working group on the Kaliningrad problem, in which the Kaliningrad governor participates and all steps are co-ordinated with him. He participated also in the conference on the Northern Dimension in Luxembourg. However, talks with the EU are a prerogative of the Federal centre.

In answer to a question if a decision to enlarge NATO to the Baltic States first could change Russia's towards their integration with the EU, A. Avetisyan replied that Russia sees EU enlargement as a positive process without any additional conditions.

Session Three: New Opportunities from Enlargement as Seen by International Companies

The session was moderated by **Igor Leshukov**, Research Director of the Centre for Integration Research and Programs, St. Petersburg.

At the session representatives of Latvian, EU and Russian business communities evaluated their present working experience in the Baltic States, Russia, and the EU countries, and challenges facing their businesses after enlargement.

The first speaker, Mr. **Valdis Lokenbahs**, President of the Dati Group (Latvia) presented his company's experience in working in the EU market.

Dati Group is a group of software development companies founded in 1995. The Dati group is located in three countries – Germany, Latvia, and Russia. The main market is Germany, and in the near future it intends to start to work in Scandinavia, which is seen by the company as the most significant market since it is located very close to Latvia. Dati is the largest IT company in Latvia, which employs more than 500 specialists. The company had 200 employees in 1996, and it plans to have 800 next year. The company sees very big possibilities in the enlargement process. In 1990 it started its first project for the German government, which was the first opportunity for Latvian specialists to show potential customers that it was not necessary to reside in the country they were working for. It was an absolutely new development for the German government and a big experience for Latvian software specialists. This experience was very successful and it was declared as one of the best projects by the German government. The main problem is not having local people who speak German. In the IT sphere this is essential. Only in rare cases will outsiders be contracted. Thus the Dati Group began its new approach to work in the EU with the slogan “Think local, act local”. It established a German company located in Hamburg and employed German specialists and consultants making it the Dati outpost in Europe. This was a successful solution, but then another new problem emerged, especially important for the Dati Western clients – the question of human resources. This is why the Dati Group opened its subsidiary in Russia. Traditionally many Europeans look at Russia as a source of resources – gas, oil etc., but human resources are the most significant. Dati Group contracted specialists in Voronezh, where it opened a daughter company, and which became a big success. Even though partners in Russia may be narrow specialists, they are highly qualified and needed by Europe.

Germany tried to recruit high qualification specialists from abroad, but this attempt was not very successful in Latvia. The need was ten times higher than the number of specialists that were willing to go. The Dati company has ten years practice in outsourcing, so it knows how to organise it. It is not so important where people are working. Now the Dati company is organising an outpost in England, and planning to set up another one in Sweden.

Mr. **Dmitri Gorochkov**, Sales Director of the “Severstal” company from Cherepovets (Russia) talked about steel production. “Severstal” produced 9.3 million tonnes of steel last year and the company ranks number 17 in the world. 50 % of its production is exported to 90 countries, perhaps making it number one in the world according to this criterion. “Severstal” has been named by the Russian government as the best exporter of Russia. Product quality and customer service explain the company's success. Western Europe, Eastern Europe, and the Baltic States are key markets for “Severstal”. Exports go through different Baltic ports – Riga, Ventspils, Klaipeda, etc., however, some changes, particular in the late 1990s arising mostly from political reasons has limited “Severstal” in developing business as successfully as it would like. Therefore the company tried to find new opportunities in this region and decided to switch its activities to distribution of steel in which it has succeeded. It began by establishing a network of warehouses, then it canalising its trade in each of the three countries for specific distributors. The most successful is the holding company Fedex, which was chosen as a partner in the company's approach to the region. This year “Severstal” made the biggest investment it has ever made – 5.7 million USD into a Technopark in Riga, which has two key directions of activity, first, repair of railway cars on the basis of the former RVR enterprise in Riga, second, a service centre for steel products. “Severstal” intends to develop other projects in the Baltic region. There are very huge opportunities to expand services in such activities as vessel building and construction, especially, in Latvia.

Accession of the Baltic States to the EU confront “Severstal” with at least two challenges: 1) the status of trade within the European Union. Currently EU and Russian trade is limited by the so-called agreement on steel products, which expires this year; however, some kind of regulation will still exist in the future. The quota based system installed by this agreement, if it will not be changed when the Baltic States join the EU, may mean that steel products from Russia, Ukraine, Kazakhstan etc. will be denied access to this market. This can affect both our strategy here and our consumers' interests in this region; 2) some investment projects, especially, the building of a 400 000 metric tonnes galvanising line in Tallinn. Many galvanising lines are under construction in the EU countries, and there are three lines currently under construction in Russia, in Cherepovets at “Severstal”, in Magnitogorsk, and extending the line in Novo-Lipetsk. If this project is completed it will distort trade both in the EU and in Russia. “Severstal” will have very serious consultations with the Estonian government and it hopes that its arguments will be heard.

Mr. **Valentin Makarov**, the President of the Consortium “Fort Ross”, St. Petersburg looked at challenges of enlargement from the Russian IT business point of view. One negative consequence his business would face will be that competitors from the Baltic States – Microlink in Estonia, Dati in Latvia, etc., will come much closer to customers in the EU than Russian firms. On the other hand, for the first time former Soviet republics will become member states of the EU, and they are aware how strong Russian science is. They know that there are no risks in using Russian resources, and the advantages to be gained from this. Hence they reorient their contractual activity in the West to Russia. The EU would not need

more exports from the Baltic States to the EU; it would need exports from the Baltic States to Russia. This would stimulate the Baltic States to establish better relations with Russia, because Russia is their closest partner and neighbour. The EU will invest in developing cross-border co-operation between Russia and the Baltic States in order to enlarge economic activity and trade. If we speak only in terms of enlargement of the EU, then this is not the big challenge, much worse is NATO enlargement.

With regard to the Northern Dimension, frontiers between non-EU and EU countries are rather artificial. What really matters is the European economic space, including the Baltic Sea as a region, where St. Petersburg and the North–West of Russia are an integral part. From this point of view the EU and in particular the Baltic Sea region will become a centre for world economy in IT, competing with China, Japan, United States and other countries. The Baltic Sea region countries have invested in new technologies, in technoparks, in IT and they think globally – Nokia, Ericsson and other companies. But the Baltic Sea area could not compete in the long term if they do not have access to human resources, which St. Petersburg and the North–West of Russia have. There have been many kinds of crises in Russia, but the resources have always survived. Not everybody left for the United States or Germany. Russia's higher education produce the best engineers in the world. St. Petersburg is still the education centre, the research centre of the Baltic Sea region.

Presently the Northern Dimension is a proclamation with an odd project or two. In the longer term the Northern Dimension will become more important for the EU and for Russia than enlargement. The enlargement will possibly be limited to the present candidate countries. There will be need thus to organise co-operation with countries which will not be EU members – Russia, Ukraine, Moldova, etc.

When Westerners speak about Russia, they most often bear in mind Moscow. But Russia consists of very different regions and Russians are lucky that they have preserved differentiation of regions. Much depends on how local authorities care for investments and business. There are big differences in the investment climate in St. Petersburg and some other regions. It would thus be preferable to speak about regional co-operation of the EU in terms of the Northern Dimension. It would be very positive and beneficial for the European Union and for Russia. Kaliningrad and St. Petersburg are regions which are much ahead of other regions of Russia in the terms of economic integration with the EU. Mr. Makarov backed the idea of a pilot region for the North–West Russia and St. Petersburg, not just Kaliningrad, because it would promote the economic integration of Russia with the EU, maintaining, of course, the political integrity of Russia, the political prerogatives of central power, but economically becoming a part of the European economic space.

Mr. **George Krivicky**, Director of the Department of the Baltic States of the European Bank of Reconstruction and Development stressed that he will speak from a slightly different perspective since he does not represent private business, but rather an international financial organisation. In the Baltic States the prospect of EU accession is helping to stabilise the policy environment and to stimulate transition reforms. The enlargement will also improve the Baltic countries' long term growth prospects by pro-

viding them with an unimpeded access to a larger market and eventual free movement of people, goods and services in the EU Single Market. Russia should also benefit from the accession to the EU of its Baltic neighbours if the economic climate is favourable. With its existing cross-language and business ties in the Baltic States Russia can gain access to the larger European market when accession occurs. Enlargement can also stimulate Russia's own transition reforms further, bringing increased investment, trade and a better standard of living for the whole region. In parallel with the accession, regional integration, underlined by the previous speaker, among the countries of the Northern Dimension area needs to be further pursued. At present intra–regional trade among the Baltic States themselves and Russia still remain at the early stage of development. The further deepening of economic ties within the Northern Europe region should therefore be an important feature of the coming years' pre- and post-accession period.

While policy and institutional steps matter greatly, effective integration needs to involve a decentralised process; therefore a bottom-up project regional approach should compliment national policies. The EBRD can help to foster the accession process and further regional integration by facilitating cross-border exchanges and support capital investments involving strong complementarities for environmental externalities between the countries. The Bank can contribute its investment perspective to regional initiatives and help insure that integration concepts become effective on the ground. As a project driven financing institution, however, the extent of its involvement depends on readiness of countries of the region to cooperate with each other and on their ability to create a favourable policy climate. The Bank already has a considerable involvement in terms of projects working in the region. At the end of 2000 some 100 projects have been financed in the three Baltic States together totalling more than 1 billion Euro in terms of financing coming from the Bank. Another 100 projects have been financed in Poland for total of 1.4 billion and another 100 projects in Russia for 3.4 billion Euro. In addition financing has been provided on the Baltic investment programme, nuclear safety and on various technical assistance programmes. An international decommissioning programme for the Ignalina atomic power plant has been recently established. There is a close correlation of the objectives pursued by the accession process and the Bank's operational strategies and objectives. An important aim of the Bank has always been the promotion of regional integration. In the Baltic Sea region the Bank has invested in a number of projects with a regional dimension, for example, in the transport sector the EBRD has financed the Lithuanian project within the Via Baltica initiative, various railway projects in the three Baltic States as well as Poland and Russia, and several port and airport projects. The Bank has an important programme for improving municipal and environmental infrastructure with projects with municipalities, such as Tallinn, Riga, Kaunas, St.Petersburg, Kaliningrad, and various Polish cities. The Bank has also played a significant role in the region in the field of nuclear safety. Considerable resources have also been directed in the region supporting small and medium enterprises, including the border areas. The Bank, in addition, is playing important role in developing the regional financial sector.

The EBRD's approach to helping the accession process and fostering regional integration was aimed at supporting commercially and economically viable investments in the fol-

lowing areas: further support for development of the private sector with a particular emphasis on small and medium size enterprises and, hopefully, increasingly for cross-border investment by domestic enterprises; further strengthening of integration in the financial services sector; the restructuring, commercialisation of and participation by the private sector in infrastructure development, including the establishment of regional co-operation and markets in sectors such as energy and transport, and addressing of environmental priorities in the region. The Bank is also an active participant to launch an effort to establish the Northern Dimension and Environmental Partnership. In many of these areas the Bank will continue to co-ordinate and to co-finance its activities with the European Commission, the Nordic Investment Bank and European Investment Bank, World Bank, Council of Europe, Development Bank and other international and bilateral agencies.

The Bank expects to remain very active in the region, over, at least, the medium term. In advanced transition countries, which include the Baltic States and Poland, the EBRD plans to maintain its current business volume of some 1 000 000 Euro per annum in new investments, representing approximately 22–25 % of the overall business of the Bank.

Mr. **Bill Butler**, CEO Tele2 (Latvia) represented an international communication company active across Europe and which recently bought the Latvian mobile communications company BaltcomGSM. Tele2 has more than 12 million customers, operates in 20 countries, although not in Great Britain and in Russia. They are covered by a sister company Milicom, with whom Tele2 has some relations, but not very much on the operational level. In all countries Tele2 has a great degree of similarity, a high degree of co-operation among the people, and a high degree of movement of resources – people between these companies. The company is growing extremely quickly, focusing on three businesses: fixed telephony, mobile telephony, and Internet. Growth now is mostly focused on customer growth and revenues are growing very quickly. It is a very good situation to be in many countries, growing very consistently, there are very positive results across the board. Tele2's goal is to be the leading alternative operator in these markets – in the Nordic region, in Southern Europe, Luxembourg, Central Europe and across the Baltic region. There is a room for growth, especially in Latvia.

The main challenge for this business has to do with money. Typically, when you are building a mobile network, you have to start with capital investment. The investor has to put down a big amount of money and it takes ten years before he gets back what he started with. Competition more or less limits the amount of money the investor can make.

With regard to the Baltic States and their integration in the EU, Mr. Butler stressed that when a company does big investments which it can't get back for ten or so years, it will prefer to do them not in a small stand-alone country, but rather in a state which is integrated with the rest of Europe. Mr. Butler stressed three basic factors of the company, which will benefit from Latvia's accession to the EU.

First is the size of the market. Latvia with its 2.5 million people is interesting from the business point of view because 80 % of people don't have a mobile phone. Integration in the European market will be very easy and there will be benefits from

dealing with Russia. There is a great potential in Russia, but an economic integration of Russia with the rest of Europe is necessary.

The second is human resources. Today in Latvia the company has very well educated and very motivated employees. But there is a limited career potential for them. In the long term the company expects that Latvian employees will be integrated in bigger markets, in bigger operations on the European markets. That's one of the reasons why Tele2 is coming to this market. In this case there will be more potential for growth of their own careers.

The third factor is capital. Some sponsorship from the EBRD was very important in the development of our predecessor BaltcomGSM. But, in general, in a small unconnected country there is a very aggressive environment for business – a very high rate of return is demanded, with very short-term investments. In a more stable situation mainstream investment will arrive for the long term, including development of the infrastructure.

Regulation is the fourth and very important factor. Telecom business is regulated very strictly in Latvia; there are specific ministries just for this job. There is no certainty with regard to what legislation will be adopted; hence there is no certainty on how to invest. If there will be the same regulation in all the company's markets, it would be much easier for the company to make investments.

Latvia has done an outstandingly good job ensuring currency stability. This is very important in this business, especially for investments. But membership in the EU will provide an additional factor of stability for the business environment in Latvia.

The presentations of members of the Baltic Sea region business community sparked a very lively discussion on the prospects of the Baltic States' economies after the accession.

A. Lejinš asked, whether other arrangements like the European Economic Area could compensate for full membership in the EU, in case the people voted "No" in the referendum? Is a Norwegian option viable? B. Butler replied that Norway by itself has a much greater advantage in the eyes of investors in comparison with the Baltic States. Membership in the EU is the right answer for Latvia. He pointed out that he is for the rapid resolution of the arbitration between Lattelekom and the Latvian government.

On critical remarks from the audience on EBRD's activities in Latvia with regard to the development of local businesses, G. Krivicky said that the EBRD is introducing credit lines for local banks to back local businesses. And the Bank is also in the process of introducing leasing and other mechanisms.

The problem that by joining the EU labour costs will increase was much discussed and how this would influence local IT and other businesses.

V. Lokenbahs pointed out that a rise in salaries is inevitable. Salary differences between Latvia and the EU are already constantly decreasing. Today difference in salaries is not more than 40–50 %. Salaries have to come to the same level as in corresponding businesses in the EU. Competitiveness depends not on lower labour costs, but on quality of services. Also V. Makarov stressed that his business depends very much on the world market.

Conclusion

Mr. **Robert Nurick**, Director of the Carnegie Moscow Centre concluded the conference.

The discussion showed a rather unexpected convergence among various Western European, Baltic and Russian participants about the central issues imposed by enlargement on the region, and the need for a collaborative approach to address them. This is a very good sign. Nurick appreciated that Riga was able to provide a forum such as this where Russian officials and scholars could sit together with their colleagues from the Baltic Sea region and other places in order to discuss the issues. These questions require much more discussion and Mr. Nurick expressed hope that this was only the beginning.

Nurick noted that the challenges and opportunities that were highlighted during the conference appear to be unevenly distributed among various actors in the region. Many issues are understood and in many cases they have been addressed or will be addressed after enlargement. But the general prospect for countries once they are in the EU seems that they will have many more opportunities than problems.

Russia could potentially enjoy enormous opportunities in the wake of enlargement. But they are rather contractual, contingent and more in the long than short term. But to fully exploit these opportunities depends very much not on what the EU does but on sustained activities by Russia itself. Over the longer term the real challenge has to do with Russian policy.

Implications of EU enlargement have also to do with the question of prospects for domestic reform in Russia, particularly in three areas – security, border regimes, and trade and economic relations.

Security

Regarding EU aspirations to develop its own Defence and Security Identity, the Russian government has officially expressed its wish to participate in this process. However, Russia's ability to work with the EU developing a European Defence Identity depends very much on the success of Russia's military reform. The main task of the European Defence Identity will be to carry out the so-called Petersberg tasks, which is mostly peace keeping. Chechnya has demonstrated that Russian forces currently are not designed for such missions. If Russia is going to engage in such missions its needs to change its training system, its equipment, and its military structure. Of course, working with the EU is not going to drive forward military reform, but it outlines broader issues which Russian officials are confronting with.

Border regimes

Shengen, with particular attention to Kaliningrad, is the clearest example where the issue is visible, but the border is much longer with the EU. What happens across the bor-

der, the natural activities that take place – economic activities, movement of people etc. are the most visible signs on how the EU decides to interpret and to implement its rules. But there are also critical issues inside Russia. The main one has been identified already in the discussion – this is the amount of autonomy for regions. The current government is resolving these issues in the direction of centralisation.

Economic relations

Anti-dumping rules are the most often mentioned problem, but also this problem must be linked to the domestic policies of Russia. This problem touches upon the basic questions of how industry is organised and the state's role in the economy. Implications of the EU enlargement demand a serious strategy from Russia to deal with them in order to integrate with the EU. Comments of Russian officials today here give an impression that they are aware of these problems, but these issues are only beginning to be addressed and, perhaps, in many European capitals also. The central issue here has to do with the domestic reform challenge for Russia. An issue that raises questions also in Western institutions.

This issue is relevant not only for the EU but also for NATO. One very important factor we see in the development of economies and related policies of the EU aspirant countries and, indeed, of NATO aspirant countries have been conditioned by the prospect of membership in both of them. Membership in this sense has served both as a goal and encouragement for domestic reform. This function Russia has lacked. The prospect of membership has encouraged economic reform and served as a political rationale for political elites in justifying very painful reforms.

Looking at the broader strategic questions posed by the EU and NATO enlargement to Russia, we should be serious about finding ways of integrating Russia with these institutions. We have to find ways for substituting these institutions. In both cases it is important to keep the possibility of membership open for the long term. But if NATO and the EU respond simply by saying: well in the long run you can join us, this would not impress people. The EU and NATO have to make a decision together with Russia on how their relationships will look like. It must be a vision that is credible for Russia as well as for member countries in those institutions, which is linked to a coherent agenda of initiatives and institutions on both sides. It is not a question of large visions, but it is a vision thing, to use the words of the previous President George Bush, the need for a step by step movement. It will be vulnerable to a very narrow calculus of benefits on both sides, and the difficulties – political, economic, and moral – are going to be hard to bear. The West cannot persuade Russia to bring about changes, to create this or that structure, but the EU can help to make a structure that can make it easier for Russia to make the right choices. We should think these problems over together with Russia, and to set a political agenda for this.

Appendix

“Effects of Baltic EU Membership on Northern Europe”

Riga, 20 June 2001

Address by State Secretary Sven–Eric Söder,

Swedish Ministry for Foreign Affairs

Excellencies, Ladies and Gentlemen,

First, I would like to say that it is an honour and a great pleasure for me to be here tonight and participate in this timely conference. I would like to take this opportunity to thank all those who have participated in arranging the conference, especially the European Commission, the Ministry for Foreign Affairs of Latvia, the City of Riga and the Stockholm School of Economics in Riga, both for their financial contribution and for their personal commitments in making this event possible.

For me, this conference is a special occasion, since it brings together two key priorities of the Swedish Presidency:

First, the enlargement of the European Union and the efforts to support Estonia, Latvia, Lithuania and the other candidate countries to prepare themselves for membership.

Second, the strengthening of relations between the European Union and Russia. This conference brings both these objectives together, and I am convinced that our discussions will show that these goals are mutually reinforcing, for stability as well as for prosperity of our continent and of North Europe.

The theme and significance of this conference obviously reach far beyond the short Swedish EU Presidency, which will be over in just about ten days. For more than a decade now, Sweden, together with many other countries, has been very actively involved in promoting development and stability on this side of the Baltic Sea, and thus of Northern Europe as a whole. Today, a wide-ranging and well-developed network of regional organisations and co-operative structures exist around the Baltic Sea.

But I do not intend to speak about the things we have achieved in the past. Instead, I wish to put the central theme of this conference in focus: For many years we have seen the European Union as a key source of stability and the main factor when it comes to contributing to and promoting the democratic modernisation of Central and Eastern Europe. EU enlargement is not only about negotiating technical chapters, however important they are, but also about putting together that which belongs together. I believe that Baltic

EU membership does not mean the return of the Baltic States to Europe, because they have always been in Europe, but in a way it does mean Europe's return to the Baltic States.

EU membership also carries the firm establishment of the Internal Market in the future member states. Through the free movement of goods, capital and people, the Internal Market constitutes the engine for economic growth in the EU. The access to the EU Internal Market is especially important for smaller countries, such as ours, since Swedish industry thus gets access to a market comprising over 380 million consumers instead of just around 9. The same applies to the Baltic countries. The functioning of the Internal Market is of course a responsibility for all Member States. Therefore it is fundamental that all countries also adopt and implement the agreed legislation. This is of course especially important for the candidate countries, which was noted in Göteborg. With regard to Russia, it has been the objective of the Swedish EU Presidency to activate and intensify relations in a number of fields. Let me give you a few practical examples of what we have done. There have been two summits between the EU and the Russian President, Vladimir Putin, focusing on how to develop the co-operation further. The Kaliningrad region has been put firmly on the EU–Russian agenda. A high-level conference has been held in Moscow focusing on the benefits to Russia of WTO–membership and integration into the world economy. The European Council in Stockholm decided to open up EIB–lending, under specific conditions, to projects in the environmental field in Russia.

The Swedish Presidency has put great emphasis on developing further, and anchoring the Northern Dimension within the EU system. We have created conditions for taking concrete steps forward within areas such as the environment and nuclear safety, the fight against organised crime and the situation regarding Kaliningrad. Within the IT–area, a “Northern Dimension” has been developed to promote the development of the IT society in the ND–region. A big step forward within the environmental sector is the decision to establish a “Northern Dimension Environmental Partnership” (NDEP) between the development banks active in Northern Europe and the European Commission. NDEP is a new, innovative way of getting added value through simplifying and making more effective the financing of big projects with a focus on environment and nuclear safety in the region. This will happen through co-ordination between the development banks and also with the Commission. The financing is based on a combination of loans from the banks and donations from the Commission's Tacis–programme and other donors. A Swedish contribution to the NDEP–facility has been promised.

Other examples could be highlighted here but most important, I believe, is that all these activities point to the possibilities inherent in the region, and from co-operation. They also point to the fact that the EU and Russia are natural co-operation partners in a number of areas, and that we have a great potential of mutual benefits from close economic

and political co-operation. We hope that we have been giving this co-operation an injection during these six months and that the substance itself will carry the co-operation further. I think that integration is the key word to explain how I hope that the present and future relation between Russian and Europe will be developed. This is the vision I have for Russia and Europe – co-operation and integration into a real partnership. It is important to point out, however, and we always do that to Russia, that a full-fledged partnership has to be based on common values. The handling of the crisis in Chechnya and the present situation for independent media in Russia demonstrates that this is still not the case.

As to the accession of the Baltic States to the European Union, I believe that it is well known that it has been the ambition of the Swedish Presidency to carry the enlargement process forward considerably, to achieve a breakthrough. The reason for our focus on enlargement is simple: EU enlargement is an historical task and opportunity to unite Europe and develop the basis for peace, stability, democracy, rule of law, and prosperity in our part of the world.

Our ambition regarding enlargement for our Presidency was high: in fact so high that some believed our work plan to be far too ambitious. I do believe that we have achieved a breakthrough in the negotiations. The signal from Göteborg, talking about the irreversibility of enlargement and coupled to a timetable for the continued negotiations is strong enough. In general, it would be fair to say that the enlargement process has moved into a political phase during the Swedish Presidency. The negotiations have become tougher, not only between the Union and the candidate states but also between the member states themselves. This is a good sign, and it indicates that we are now beginning the discussion on the really important issues. That is exactly what we aimed for, nearing the end-phase of negotiations.

Considerable progress has thus been made largely thanks to great efforts primarily by the candidate countries. The Baltic states have made impressive progress in this regard, and especially Latvia's and Lithuania's progress has shown that it is possible to catch up, and that the principle that countries should be able to proceed on the basis of their own merits works. The principle of differentiation has been a guiding principle for our Presidency.

Progress in the Baltic States has been incredibly fast. Our conference is being held exactly two months before the celebration of the tenth anniversary of the restoration of the independence of the Baltic countries. These ten years are a short period of time but represent a long success story. Remember the hardships and obstacles you have overcome along the road – and be rightly proud! The first time I visited Riga was in 1990. I was an election observer to the first free and independent elections in Latvia. To see the change over all these years has been remarkable: Central Riga looks more and more like a fashionable fairytale city.

Of course, it is wise to be self-critical too, and I know that in all three Baltic countries there is an open and critical debate of lingering social and economic problems. Transition and overcoming the legacies of the past are still a painful process for many people, both here and in Russia. This is also a process that other countries in Europe either have been going through or are going through right now.

A special aspect of overcoming the past is the task of integrating the non-citizens in Estonia and Latvia. All the main pieces of relevant legislation have been adopted according to European norms and standards, and both countries fulfil the political criteria for EU-membership. The two governments have also launched ambitious programmes of national integration. There are still, however, some economic and psychological aspects, which slow down the process of naturalisation. To a large extent this relates to a number of Russian-speakers who seem to underestimate the advantages of naturalisation.

It is my conviction that membership in the European Union will give those who have not naturalised a strong incentive to do so. This will happen no later than when they realise that they also become citizens of the European Union, with all the additional rights and opportunities that follow. And when they find out that their bilingualism may give them as citizens a special niche and even a special edge within the Union, they may also find additional economic opportunities.

And then there is the potential for regional integration and development as a consequence of EU enlargement in the North. In particular, we could expect a stronger involvement not only from that great centre of talent and science which is St.Petersburg, but also from other regional centres in North-West Russia and not only in this region.

I think everyone in this distinguished audience knows about the great role that St.Petersburg played a hundred years ago as a magnet for foreign investment and a source of dynamism for the whole Northern region. I will mention an example which might not be equally well-known: in that time the governing board of the Swedish telephone company Ericsson made a decision to transfer the company headquarters from Stockholm to St.Petersburg, because that was where it saw the big markets and the opportunities of future development. The board actually made this decision, but the timing was unfavourable. It was in June 1914. A few months later, the First World War and then the Russian revolution transformed that decision into a curiosity.

But now the so-called short 20th century from 1914 to 1991 is well behind us. We have begun a new development phase which in time could bring back the role of St.Petersburg as a source of dynamism and economic attraction not only for investors in Northern Europe. After a century of violent and artificial obstacles against natural economic development, in a new climate of all-European normalisation, it is only logical

that St.Petersburg regains its regional significance. And the closeness of the three Baltic EU member states can only contribute to this. I particularly hope that ideas and visions from private companies will enrich the discussion of this perspective tomorrow afternoon. And for a faster development of Russia's overall relationship with the European Union, I can also see nothing but advantages with the three Baltic countries as members of the European Union.

Let us tomorrow also discuss challenges and apprehensions about EU enlargement. Integration and development also means adjustments, sometimes painful, but necessary. I – for one – represent a country in which the EU is often perceived as generating difficulties for its citizens. And, in Sweden, the public opinion has for a long time been quite negative towards our EU membership. But let us not lose the overall perspective: the European Union is the prime source of energy when it comes to extending rule of law, democratic values, stability and economic prosperity on our continent, and it has the capacity to contribute to that development way beyond its borders. And Baltic EU membership will further add to this capacity.

Thus, it is my conviction that we are facing not a win-win situation, but a triple win situation: for the Baltic States, for the European Union, and for Russia. That is the keynote I would like to contribute to this conference, and I am sure that tomorrow's discussions will prove it.

Thank you for your attention.