Institute for World Economics
Hungarian Academy of Sciences

The Future of Europe
Relations between the Enlarging European Union and Russia and Ukraine

Edited by
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FOREWORD

The Institute for World Economics of the Hungarian Academy of Sciences, in cooperation with a Finnish team led by Professor Urpo Kivikari of the Turku School of Economics and Business Administration, organized a seminar in Budapest on June 7–8, 2002. The seminar, entitled *The Future of Europe: Relations between the Enlarging European Union and Russia and Ukraine* took place in a Europe that has been undergoing fundamental change. It focused on some important, but rarely studied aspects shaping the future of the continent: the consequences of the European integration process for Russia and Ukraine, as well as the impacts on them of Eastern enlargement, globalization and other related issues.

This conference volume contains most of the contributions made to the seminar, by participants from Russia, Ukraine, the European Union and Hungary. The four sessions covered pertinent issues of politics, security, economics (including the presence of Russian firms in Europe) and regional cooperation.

The book makes it clear that Russia and Ukraine are looking for paths of their own in Europe. Although these paths may differ in some respects, they share the underlying goal of becoming integral parts of a democratic and prosperous continent. On the other hand, Europe and the European Union are also seeking specific ways and means of including Russia and Ukraine in Europe, rather than drawing new dividing lines across the continent. The future EU members in Central and Eastern Europe have a special function to play in developing these links with Russia and the Ukraine.

The editors trust that this volume will prove challenging and useful to those dealing with questions of EU enlargement, as well as EU–Russian or EU–Ukrainian relations.

András Inotai
Director of the Institute
for World Economics
of the Hungarian Academy of Sciences

Zsuzsa Ludvig
Convenor of the Seminar
and Research Fellow

Keynote Speech to the Conference

Hannu Halinen*

Mr. Chairman. It gives me a great pleasure to address the conference on "The Future of Europe" organized by the Institute for World Economics and my friend, András Inotai.

Ladies and Gentlemen. Europe is at an important crossroads. The future of Europe is being formed even as we sit here today: by the enlargement negotiations, by the Convention meeting in Brussels, as well as by the reforms that the EU is facing in the next few years. The EU must also decide on the Common Agricultural Policy, structural policy and the institutions, as well as on the financial framework for the period to follow 2007.

The current round of enlargement negotiations is historic in its scope. Its significance also lies in the *de facto* reunification of Europe after the Cold War. We are not only participating in a process with historical or theoretical implications. The enlargement concerns, very concretely, the economic integration of over 70 million, and soon 100 million new consumers into the internal market. This has enormous implications for the balancing of those inequalities that have existed between the present EU countries and the applicant countries, most of which have only recently had the opportunity to develop their systems into functioning market economies. With the enlargement, the European Union will become an even bigger economic and political player in the world arena. At the same time, the economic benefits of cooperation are more widely, and more equally distributed in Europe.

As we proceed with the enlargement negotiations, the European Convention has begun discussing the future of an enlarged Union. For the first time EU Treaty reform is being prepared in a transparent way by a broad-based forum, including representatives from governments, national parliaments and EU institutions. The significance of the Convention is further highlighted by the fact that Hungary and the other candidate countries participate in its work on an equal basis. This is crucial since we are now shaping our common future.

The Convention has started its work by looking at one of the most important questions: The EU's tasks and the definition of competences between the Union and the member states. Although the member states have transferred powers to the

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* Finland's ambassador to Hungary.

Union with great care, the sphere of its competence is often defined in an ambiguous manner. In practice, it rests on non-systematic Treaty provisions as a result of political compromises, as well as on the Union's general objectives. There is a need for clarification of the present division of competences.

We are also ready to consider adjustments to the present division. However, it seems that no dramatic changes are necessary. It would be more important to concentrate on using the existing powers in an appropriate manner. In the end, the real test lies in the use of shared competences while genuinely respecting the principles of subsidiarity and proportionality. As the dynamic nature of the Union is fundamental to the EU's action, we have to accept that most of the Union competence is to remain shared with the member states.

In matters in which the member states have transferred their competence to the EU, it must act efficiently and democratically. The question of the efficiency and legitimacy of the Union's action will also be addressed in the process. In this connection, we have a possibility to patch up some of the decisions made at Nice. We need to go further regarding the extension of qualified majority voting as well as consider possibilities to clarify and improve the decision-making system. This could be achieved by adopting a simple dual majority system – advocated at Nice by Finland among many others – where decisions require a majority of both members states and population.

As minister Vilén, responsible for enlargement, has stated, for Finland the approach should be pragmatic. Reaching an agreement on many important issues already at this stage might prove extremely difficult. If a genuine consensus for recommendations cannot be reached, options reflecting the variety of different views should rather be drafted. The Intergovernmental Conference 2004 will in any case make the ultimate decisions. Enough time should be left before the beginning of the Conference, so that the results of the Convention can be thoroughly debated and evaluated in the member and candidate states.

What kind of Europe will we share in a few years from now?

The work on the future of Europe provides us a valuable opportunity to examine the basic nature and development of the Union. What kind of a European Union do we actually want and what should be its tasks? How can we answer the European citizens' expectations? How could we best strengthen the EU´s role as a global actor? These are some of the questions the distinguished experts will review here today and tomorrow.

We are well aware of the Union's strengths – that is why, after all, we chose to join – and we appreciate the importance of spreading those benefits to the rest of our continent. Yet, we are by no means blind to the weaknesses in the construction of the European Union – *the imminent risk that its structures may come to a halt if we are not ready to reform the Union.* These issues need to be tackled with if the EU is to continue as a force promoting peace, security and prosperity.

In Finland we believe that the European Union should be further developed, as a close-knit community of independent member states and European peoples. The enlarging Union must be ambitious and practical in setting its goals. It must have sufficiently strong competence in matters where it has better potential to attain common goals than the member states individually. It is in Europe's interest to have an economically sound and dynamic, as well as a socially and ecologically responsible European Union. The EU must be able to act efficiently to promote its common goals in Europe and worldwide.

Ladies and Gentlemen. At the same time, we might also consider the ways to improve the participation of regional and local authorities in the national EU policy-making processes. In Finland, for example, the participation of the province of Åland is guaranteed through the constitution-level act on the island's autonomy. The neighbouring areas were set as one of the main priorities of EU's external action. The EU has created particular policies to this end. The aim should be a consistent approach as all these policies – for instance the Barcelona Process for the Mediterranean and the Northern Dimension – benefit the Union as a whole.

Cooperation with our neighbouring areas plays an increasingly important role in promoting stability and security, not only at a regional level but also on a global scale. The EU is developing as a transnational network.

Lately, more attention has been given to the specific characteristics of Northern Europe. *The importance of Russia is better understood than before. We believe that the region's significance will continue to increase. Particularly, since Russia participating in regional initiatives is a useful channel for further integration into Europe. This is a long-term but also an open-ended process.*

Vilén in Litthuania on the Europe Day on 9 May 2002:

"The forthcoming EU enlargement will change the focus of the Northern Dimension of the European Union. The new EU members, Estonia, Latvia, Lithuania and Poland will get a new instrument to enhance their Russian relations together with the other EU member states. The Baltic states and the Nordic countries have been cooperating for a number of years now. Opportunities for enlarged cooperation will now exist within the framework of the Union.

The concept of security is different for the Baltic Sea region today from what it was a decade ago. The perceived threats are no longer military. Instead we are confronted by common environmental concerns. We can also work constructively to prevent organized crime, such as drugs, prostitution, trafficking in humans, stolen cars and the spread of transmissible diseases (HIV/AIDS and tuberculosis).

With the enlargement, there is the danger of an increasing economic gap growing between the new member states, and their Eastern neighbours. This can create unstability in the region and be reflected in the whole EU area. We must work toward lessening this disparity between the new member states and their neighbours to the east. We must study arrangements that contribute to the economic and political stability of the region. We feel that the model of EU–Russia relations could be looked at. Finland has good experiences of cross-border cooperation and regional cooperation that can be useful."

Ladies and Gentlemen. Throughout the enlargement negotiations, Finland has wanted to play an active and constructive role. We continue to believe in the importance of the principles of fairness and equality. Objective criteria must be followed, and countries must be judged on their own merits. These principles, as well as that of catching up, have proven themselves to be useful tools in conducting the negotiating process, and they should be adhered to until the end. Enlargement is the most important of the European Union's present tasks. The current year will be decisive for the process. There is still much work to be done and we must not lose sight of the final goal, which is Hungary's, and the other candidate states', accession to the Union.

The enlargement will be a challenge to the functioning of the internal market, as well as to the cohesion of the Union and the entire decision making process. This is why it is crucial, that the candidate countries pay attention to the development of their administrative and judicial capacity. It cannot be emphasized enough that the ability of the new member states to function and to compete on the Union's internal market is essential for the success of enlargement.

The implementation of administrative reform will be studied at the Seville European Council in June. In October, the Commission will present progress reports on all the candidate countries. The countries that expect to conclude negotiations at the end of the year ought to be able to show developments in their administrative capacity, as well as in the implementation of their commitments.

The over-all economic impact of enlargement will be beneficial for all countries involved. According to the European Commission's estimate, the cumulative effect on growth will be positive in the current EU 15, and more so in the ten candidate countries. It is also important to remember, that already the prospect of EU membership has positively affected the economic development of the candidate countries.

The prospect of membership has already speeded up necessary reforms. According to World Bank studies, the economic impact of the transition from command economies to market economy has been much softer than for those countries that are not negotiating for EU membership. Future EU membership has helped draw foreign investments into the candidate countries. The Europe Agreements have had a positive effect on the business climate, and have lessened the risks for foreign companies. Trade between the EU and the candidate countries has grown and exports to the EU have been a major factor in improving the economies of the candidates.

Ladies and Gentlemen. Finally, I would like to say a few words about security policy.

In all the militarily non-aligned countries, a discussion is underway on how their national security policies can best meet the challenges of the changing European and global security environment.

In the Finnish case, the policy of neutrality was linked to the cold-war division and was incompatible with the EU membership. In the Swedish case, neutrality has a long historical tradition that has contributed to Swedish identity. In the Austrian case, there is a particular constitutional and legal aspect in neutrality. And the Irish neutrality has its particular roots. For Finland, the decision to remain outside of military alliances, in practice NATO, when adapting to the post-cold war situation was natural. There was no pull or push effect towards NATO membership, domestically or externally, as the Finnish doctrine was modified to comprise EU membership, military non-alignment and credible national defence as basic components. The security situation of Finland is strong at the moment. There is no big power pressure or other kind of threat against Finland.

The significance of the common foreign and security policy of the EU as guideline of our security policy has further increased. Finland's policy with regard to NATO continues to be that it remains outside of military alliances under the prevailing circumstances. This policy enjoys wide public support. At the same time, we follow closely the development of NATO, its cooperation with Russia and the effects of the US foreign and security policy on NATO's future. We want to ensure that we remain effectively involved in matters that concern our security. Close cooperation with NATO provides a solid ground for pursuing that objective.

NATO moves from a military alliance towards a political one. The enlargements of both EU and NATO are mutually reinforcing in that sense that they both involve similar political criteria and conditions.

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I.
The Future of Europe: Politics, Economics, Security Issues

The Large EU from the Point of View of Economic Growth and Regional Structure

Paavo Okko*

Introduction

The enlargement of the European Union is a fundamental strategic and political question with important economic effects. Economic issues are different from the point of view of current members and new entrants. They are also different if we look at the question from the point of view of the EU as a whole. The EU is going to undertake its greatest enlargement ever. That is why both institutional (or constitutional) and economic issues are more demanding than ever in the history of the EU. The institutional questions of the EU enlargement are very important, but now we take a macroeconomic and also a regional approach to the challenges and opportunities of the larger EU.

The main question here is, what are the growth effects of integrating very different kinds of economies. The main group of accession countries are transition economies and their income level is quite low. For that simple reason budgetary problems have been in the focus of debate. In the long run they cannot be crucial issues. The most important economic question now is, what is the impact of the Eastern enlargement to the long-term growth rate of a large EU.

The new, so called endogenous, growth theory offers an adequate approach to these questions. It points out what is important for sustainable economic progress and it also points out, how economic growth may also benefit from the fact that the EU is coming to be a heterogeneous group of economies. The basic requirement for catching-up is to enhance the development of human capital and institutional framework. For the larger EU the hope lies in the catching-up process: the average growth rate may be higher when large income differences do exist.

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The purpose of this paper is to briefly describe the new developments in growth theory and apply it to the analysis of European integration in its current stage. Some conclusions about the growth effect of integration are drawn from previous studies on European integration. In particular, an attempt is made to analyse the role of technology and human capital in this process. Some conclusions concerning economic growth and regional development of the larger EU are also drawn in this paper.

1) Convergence or divergence via integration and growth

In order to answer our questions we should know what is the impact of integration on growth rate of an integration block. Does integration enhance growth, and what is its impact on income differences? As an answer to this question we may offer some background information from the history of European integration. Empirical work on growth effects of European integration has resulted in quite considerable positive effect for EC and EFTA members (Henrekson–Torstensson–Torstensson 1997). The effect of EC or EFTA membership was around 0.6–0.8 percentage points in annual growth rate. The results also suggest that technology transfer was the main mechanism through which EC and EFTA membership affect growth. Surprisingly, there were no effects of membership on investment. Even if it is not possible to draw direct conclusions from earlier experiences it seems quite obvious that new members starting from quite low relative income level compared to incumbent members will have even stronger growth impetus from their membership.

The regional convergence hypothesis has been in the focus of the debate between the neoclassical and the endogenous growth theory approaches. If the neoclassical assumption of diminishing returns holds, then we should have narrowing regional income differences (convergence) via growth. Romer (1986) argued that the absence of convergence across economies throughout the world represents strong evidence against the neoclassical model and works in favour of his theory of endogenous growth.

The new theory of economic growth differs from the neoclassical theory especially in respect to the endogenous treatment of technological change. According to Romer, technological change – improvement in the instructions for mixing together raw materials – lies at the heart of economic growth and that change arises in large part because of intentional actions taken by people who respond to market incentives (Romer 1990a, p. 72). The growth of human capital is the result of purposeful actions for increasing it, but the technological progress as an input factor is a public good. The production function may even contain increasing returns in respect to the inputs. Human capital is a special input because it affects not only current production but also accelerates long-term technological development. Human capital has both direct and indirect or external effects. Technological advance is an endogenous phenomenon and it may create increasing returns. Integration is adding to this a new option. It means an increase in ideas that can be used in each country in producing goods.

Also in the case of Eastern enlargement of the EU a key economic issue is whether low income countries or regions grow faster or more slowly than rich ones, *i.e.* are there automatic forces that lead to convergence over time in the levels of per capita income? Romer (1986) argued that inequalities across the world show no sign of narrowing over the years. Barro (1991) produced an impressive battery of regressions showing that a negative correlation between the initial income level and the growth rate could be observed when this correlation was taken conditionally upon a set of variables, the most significant of which was the level of school enrolment.

Sala-i-Martin (1994) presented an extensive empirical convergence analysis from the United States (48 states; 1880–1990), Canada (10 provinces; 1961–1991), Japan (47 prefectures; 1955–1990), and Europe (73 NUTS II regions/7 countries; mainly 1950–1990). The basic result was that there is evidence of strong forces leading to regional convergence. The estimated speeds of convergence are surprisingly similar across data sets: economies tend to convergence at a speed of about 2 per cent per year. However, the catching-up process is quite slow: one forth of the original income differences are predicted to remain after a long period of 70 years! The slow speed of convergence suggests that technology does not instantaneously flow across countries, but integration is supposed speed up the process.

The evolution of regional disparities within the EU seems to contain convergence among countries but not necessarily convergence among regions. There are some new empirical evidence on that (Giannetti 2002). If international knowledge spillovers affect certain sectors only, integration and greater exchange of knowledge among countries whose regions have heterogeneous specialization spur growth and bring convergence among regions specialized in high-tech sectors, but create greater disparities within individual countries. As a result, differences in income levels among countries are decreasing, just like in the EU, because the value added of the technologically advanced regions is a rising share of GDP.

Putting it in brief, the economic integration is in favour of economic growth and growth is in favour of narrowing income differences among countries. But all this requires adjustment, which will change the relative position of sectors and regions within countries.

2) Integration and regional concentration of economic activities

The main hypothesis about effects of integration on regional structure has normally been concentration. Larger markets mean larger concentrations has been the way of thinking. Even if the basic tendency has been into that direction the issue is not so simple. There are both centripetal forces and centrifugal forces functioning in the integration process causing regional adjustment. The new economic geography models have offered new interpretations to these questions (see *e.g.* Brulhart 2001).

Economies of scale and positive external effects of concentration (agglomeration economies) are main reasons for centripetal forces. There is a home market effect meaning that the larger the home market the more attractive it is. But because of integration, peripheral areas may also benefit from the demand coming from foreign markets. There are immobile resources and there are transportation costs and trade barriers, too. Cost competition is also willing to use cost advantages of peripheral areas and this creates centrifugal forces via foreign market effect.

Empirical work on the European integration (Brulhart 2001) has resulted in some interesting results. The strongest concentration appears in traditional, low-technology industries. The technology-intensive industries are least geographically concentrated, but concentration in those industries has been increasing. Surprisingly, the scale-intensive industries are not strongly concentrated. Employment concentration has been strongest in sectors protected by high non-tariff barriers.

General conclusions drawn by Brulhart (2001) are also interesting from the point of view of accession countries and the expected effects of EU enlargement. The three main conclusions were the following. First, industrial specialization has been increasing slowly but steadily. Second, the single market project boosted this process. Specialization accelerated after 1986 in those industries, which were strongly affected by the abolition of intra-EU non-tariff barriers. Yet, the single market did not affected sectoral concentration in general. Third, on the whole, specialization process reflects neither concentration in core countries nor movement towards peripheral countries; for most industries the importance of the centre-periphery dimension seems to have diminished in recent years.

This all may be interpreted that comparative advantage considerations continue to be relevant for the evolution of specialization patterns even in a relatively homogeneous area like the current EU. For the accession countries the traditional argumentation may even be more relevant. The finding that the spatial concentration of technology-intensive sectors has started to increase since the mid-1980's, however, may mean that agglomeration economies are coming to be more important in the EU.

3) The larger EU as a growth potential

The enlargement of the EU means a change in the basic set-up of growth conditions. In this sense it is surprising that the debate on the enlargement has been concentrating to a large extent on short-term budget issues. The budget of the EU is a bid over one per cent of the total GDP. A small reallocation in the budget cannot be a crucial matter in a process in which the annual growth rate of the GDP may increase about to the same extent. It is not now a question of a one-shot change but a change of the growth rate. For these issues the new growth theory is capable to offer adequate insight.

The new growth theory means contributions both to the problems of economic integration and labour mobility. *E.g.*, these models suggest that what is important for growth is integration – not into an economy with a large amount of people but rather into one with a large amount of human capital. According to Romer (1990a) growth seems to be correlated with the degree of integration into worldwide markets but not closely related to population size or density. Integration means interaction of "idea sector" and "goods sectors". If there is a difference in the initial endowment of countries in the level of technology the flow of goods means an extra gain in the increase in ideas that can be used in each country in the production of goods. An increase in the size of the market or in the trading area in which a country operates increases the incentive for research, and thereby increases the share of investment and the rate of growth of output, with no fall in the rate of return on capital (see also Romer 1990b).

These models permit a distinction between a one-shot gain (a level effect) and a permanent change in the growth rate (a growth rate effect) that is important in making of estimates of the benefits of economic integration (see Rivera–Batiz–Romer 1991). The results by the neoclassical model and the new one may differ strongly. *E.g.*, it is not obvious – like in the old theory – that a permanent increase in the investment rate could result only in a temporary change in the growth rate. Actually the opposite might be true: a temporary increase in the investment rate linked with the increase in the human capital may have a growth rate effect.

In the case of mobility, it is very crucial whether the effects of human capital are entirely internal or whether they have external benefits that spill over from one person to another. In the latter case the wage rate of labour at any given skill level will increase with the wealth of the country in which he is employed (Lucas 1988). Not at all surprising conclusion is that labour will move from poor regions to wealthy ones. But the result is interesting enough in the sense that it offers an explanation within the rigorous theory to the question why labour mobility is not equalizing wage levels. It has been a difficult question to the static neoclassical theory.

The traditional and the new growth theory also give different answers in respect of growth effect of integration. The traditional theory predicts no permanent effect of integration on the rate of growth. The new approach makes understandable the possibility of permanent change in the growth rate because of the change in the dynamics of economies. The evaluation of the creation of a European single market was an interesting example about the issue. Richard Baldwin (*e.g.* 1989) was the first one to show medium-term effects of integration in addition to static efficiency gains reported by the Cecchini Report on the single market.

From the point of view of transition economies the main message is that economic progress requires investment both into physical and human capital and institutional framework is a crucial factor (see also Okko 2001). Investments into human capital need both public and private activities because market incentives are not effective in a case in which external effects are important but not compensated via markets. Transition economies have typically large investment needs. That is good for growth if investments are realised. Foreign direct investment is one way of organising that. Actually, FDI has an important role in the growth process of the accession countries integrating into the EU. Trade flows and FDI have been in EU integration more complements than substitutes (Widgren 2001). Eastern enlargement of the EU will create a union with large income differences. Countries have access to the same technology, but many of them are lagging behind. This means that the steady state income levels are near to each other but actual levels have a large variation. The crucial thing is how soon these differences will be narrowing. That will also determine the growth rate of the larger EU.

4) The real convergence as the final end

If these predictions also hold for the new members of the EU, it would mean that the income gap will be narrowing but it will be an issue for a long time in the future. The current gap between the per capita GDP of Poland and the EU 15 average is about 60 per cent. If the convergence rate would be only 2 per cent a year, the difference would be still about 15 per cent after 70 years! It is reasonable to think that members of a single market are capable for faster convergence. Actually, the latest observations (1995–99) show that the accession countries have a higher growth rate (3,4%) than the EU 15 (2,4%) (see, *e.g.* Prime Minister's Office 2001). And it is supposed to remain so in the future.

According Armstrong (1994) the convergence rate in Europe is lower if more peripheral regions are included into the analysis. This is in accordance with the original results by Romer that in the global sample including countries of very different income levels no clear overall convergence is found. Catching-up hypothesis works only in certain circumstances. Cumulative causation may work into both directions; there are convergence and divergence going on alike. In this respect it is very interesting that according to Barro (1991) those poor countries tend to catch-up the rich countries, which have high human capital per head (in relation to their level of per capita GDP), but not otherwise. The debate continues, but it reveals that the law of motion of human capital has a crucial role in the process of growth and convergence.

The prediction is that low-income countries having the access to the same technology and investing strongly into human capital are capable to catch up high-income countries. The new members of the EU are supposed to be that kind of economies. This will mean that the Eastern enlargement is going to be growth-enhancing from the point of view of the EU. The low income entrants are often considered to be a burden to the EU budget, but the main impact is on the real side of the economy. The fact that the EU is coming to be a heterogeneous group opens up new opportunities for growth. If new members are capable to catch up, the average growth rate will increase. Transition economies entering into the EU market have urgent needs for investment and they offer new possibilities to combine new ideas and new production.

Integration is a long-term process, which tends to abolish income differences, but they will never disappear entirely. According Charles Kindleberger (1968) factor price equalisation is the ultimate measure of integration, but it is like the absolute zero point in low-temperature physics: it will be never reached! Income differences fuel economic growth, and an integration process will not come to an end until considerable differences still exist. This all means that regional integration – as well as global integration – is an organic part of economic growth.

We have also learned to know convergence criteria in the case of EMU. Those requirements deal with monetary and nominal conditions imposed on economies entering into EMU. The real convergence means different growth rates, and different growth rates tend to mean different inflation rates (Balassa–Samuelson effect). EMU may mean problems to fast-growing, low-income countries showing real convergence but having problems with nominal convergence. That means a challenge to EMU, which was established actually for a final stage of a very deep integration.

Conclusions

The coming Eastern enlargement will be a fundamentally different step in the history of the European integration. It will create a new situation in which growth conditions of Europe are going to change. The theory of economic growth and regional structures has developed recently in an interesting way. Especially the endogenous growth theory and the models of the new economic geography offer relevant approaches for interpretations.

The market-driven integration benefits from large income differences. There is a strong tendency towards factor price equalisation and income convergence. The large EU and especially the new entrants are in the front of a challenge. They must be capable to create an endogenous growth process by investing into physical and human capital and maintain high growth rate, even if there are strong pressures of new competition and adjustment. The endogenous growth theory points out that it requires effective transformation towards an innovation-driven economy. Accession countries have also high marginal returns of physical investment. That requires capital flows within the larger EU, too. By this way the investment rate both into physical and human capital will remain high. That is the ultimate guarantee of a high growth rate. This will also contribute positively to the competitiveness of the large EU.

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SPECIAL CHALLENGES AND TASKS OF "EASTERN" ENLARGEMENT OF THE EUROPEAN UNION

András Inotai*

In various aspects, the approaching "Eastern" enlargement of the European Union is different from the pattern of previous enlargements. Western European experts attribute these differences to two basic factors. First, the large number of candidate countries is emphasized, since up to ten countries have justified hopes for concluding negotiations by the end of 2002 and joining the EU by 2004. Second, the relatively low level of economic development is stressed, which, as measured in per capita GDP terms, lags behind the average of the present EU and, in most cases, also behind the corresponding indicator of the least developed present member countries as well.

Too many...

It is difficult to contradict the first statement. One can only add that the large number of candidates is the direct result of the lack of a clear enlargement strategy of Brussels and the member countries over a decade. This is in sharp contrast with all other strategic developments of the integration process which possessed a clear timetable from the very beginning: the common commercial policy between 1969 and 1974, the implementation of the internal market from 1985 to 1992 or, and most recently, the economic and monetary union between 1993 and 1999. There can hardly be any doubt that some countries that form part of the Eurocurrency zone today, would have been unable to make the necessary (but still not always sufficient) domestic adjustments without a detailed road map, which both forced and encouraged them to follow the prescribed path. Despite the solemn declarations which emerged time and again concerning the historical importance of "Eastern" enlargement, the latter missed such a road map in the nineties. No wonder, that each candidate considered

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this hesitation as general uncertainty and a unique window of opportunity, both. Thus, once a partial road map has been created (for the Swedish Presidency and just for part of negotiations, and by far not for the whole process of accession), there were already twelve countries negotiating on joining the EU. The consequence is that, despite substantial differences among the candidates, at the rather advanced stage of negotiations, the EU has practically no evaluation instruments or a political leverage to reject the application of any of the currently negotiating countries (excepting Bulgaria and Romania). The number of the countries joining in 2004 seems to depend exclusively on the internal political and socio-economic developments of the candidates and on the outcome of referenda. While self-disqualifications cannot be ruled out, EU-driven differentiation, which could have been possible in case of a clear road map of the enlargement strategy in the 1990s, has run out of time, and any such initiative at the present stage would be politically extremely risky and counterproductive.

... and too poor?

Certainly, the candidate countries have a generally lower level of economic development than the present members. However, the general view became victim of an incorrect, oversimplified and therefore dangerous homogenization among the candidates. In case of a large group consisting of highly different countries from historical, political, economic, social and other aspects, any “average” should be avoided. The differences within this group are much higher (in GDP per capita terms one to three) than the “development gap” between the more developed candidates and the EU average. Moreover, some candidates are nearer to the less developed EU member countries than the latter to the EU average (let alone to the more developed member countries). Slovenia's GDP per capita is similar to that of Greece or Portugal, and the Czech Republic's or Hungary's lagging behind to Greece or Portugal is much less than their difference to the least developed candidate countries.

It is, however, more important to emphasize that the GDP per capita term, certainly a comprehensive one, must not be considered as the exclusive indicator of differentiation among countries. As a static figure it misses the dynamic aspects of catching up, which have always been expected to become more important elements once a country joined the EU. Some of the less developed present member countries (mainly Ireland but also Portugal and Spain) could substantially approach the development level of more advanced member countries following their accession to the integration. The main factor of catching up was, however, not the difference in growth rates but the sustained (and sustainable) appreciation of their national currencies to the ECU (or the DM). (Only part of the difference in inflation rates was compensated by nominal devaluations against the DM.) The same process can be observed today in some of the candidate countries (most notably in the Czech Republic or Hungary, where the national currency appreciated by 12 per cent against the Euro in the last 12 months). Adding to this fact the obvious difference in growth rates, the catching up process can be much more dynamic than expected by part of the experts and observers, provided, of course, that the appreciation of the currency does not undermine the competitiveness of the economy.

Second, the "Eastern" enlargement, in contrast to previous enlargements, is not a narrow-minded European issue but part of shaping Europe's position in the global context. Therefore, the strategic question is whether, and if yes, to what extent, the coming enlargement will be able to improve Europe's political standing and economic strength in the world. Two different answers, but with the same outcome, can be given to this question. Many experts argue that "Eastern" enlargement will not only help the EU to become a more important global player (largest domestic market in the world, additional resources, additional economics-of-scale advantages) but this factor may become the basic driving force of integration, particularly in those areas which used to be characterized by reform deadlock in the last decade (common agricultural policy, institutional reforms, decision-making process, move towards a more federal structure, *etc.*). Others argue in a negative way, saying that nobody knows whether the enlargement will result in a better global position of the EU, particularly not in the first years after enlargement (partly due to the "heavy" financial costs of such a step). Nevertheless, delaying or postponing the enlargement by new "Eastern" countries would be much more costly, both in security, economic and financial terms.

Third, in a changing world, in which the relative weight of the different production factors is also rapidly changing, static indicators have to be dealt with extremely carefully. Much more attention should be devoted to the question, to what extent the candidate countries possess those elements (or production factors) which belong to the driving forces of development in a technology- and information-driven economic and social system. A cross-country comparison of such factors as the general level of education, availability of human capital, innovative and creative environment, institutional and social flexibility, level of social tolerance or cohesion, *etc.* would certainly offer a rather differentiated picture (ranking), in which some of the present candidate countries are at least as "developed" as some (or most) of the present member countries.

Fourth, considering the economic structure and competitiveness of the less developed member and the more developed candidate countries, the latter seem to be much more adjusted to and integrated into the EU division of labour than the former at the moment of their accession. Even in a contemporary comparison, some of the candidates reveal a higher share of intra-EU trade than most of the member countries (*e.g.* 75 per cent of Hungary's exports are directed to the EU, while only two EU member countries have a higher level of intra-EU export shares, Portugal and the Netherlands). Also, the structural development of production and exports, mainly driven by privatization and green-field investments carried out by international (and within it, to a large extent, by EU-located) companies, seems to be at least as advanced as in many EU countries (again, a Hungarian example: two-thirds of exports to the EU consist of technology-intensive products, or, one ton of Hungarian exports of final manufactured goods to Germany, the major market of almost all candidate countries, is 30 per cent higher than the corresponding data for Austrian or Spanish exports to Germany). At first glance, there is only one area where the candidates still have to catch up considerably, namely the quality of public administration. Otherwise, most of the visible differences derive from the fact that some countries are members and some others are would-be members (starting from the flow of transfers to the participation in and influence on the decision-making processes within the integration framework).

A key issue: new geography of Europe

Perhaps the most relevant difference between the coming enlargement and the previous ones is in its geographic implications. During the last decades, in four "waves", altogether nine countries joined the founding "core group" of the European integration. Not less than seven of them are located at the geographic periphery of the continent (excepting Denmark and Austria). In the North (excepting Norway), in the West and in the South (excepting Malta and Cyprus), Europe has reached its well-defined geographic boundaries. The next enlargement (or enlargements) will bring into the enlarging Union the continental core of the continent, even if, for understandable reasons, the new Eastern borders of the EU will not reach the rather unclear Eastern borders of Europe. The consequences will be (partly are already) felt in the shifting geo-political balance, and, in a positive scenario, in the emergence of a new growth centre (or centres) in Europe (Central Europe and the Baltic region). More importantly, all of the new member countries will be transit countries, with clear and positive consequences for (two-way) trade and capital flows, more economical investments into the physical infrastructure, more efficient use of national and community resources available for the development of infrastructure, the cleaning of environment and the formation of human capital. Last but not least, the new borders, some of them temporary, due to the gradual and further extension of the EU, some more lasting, clearly require a long-term strategy of dealing with the new neighbours.

The day or the years after (enlargement)

Looking at the current stage of negotiations, the Commission's plans (even if they are only reluctantly shared by some member countries) and, not less importantly, to the autonomous political dynamism of the process of enlargement, within less than 20 months, up to ten new countries may join the present EU. Evidently, the decision of enlarging will be, as in the case of all previous enlargements, fundamentally motivated by political considerations. It is very much telling that the really hard Copenhagen criteria are also political. Although there are some economic, legal and institutional criteria as well, they can hardly be applied in such a strict sense as the political criteria. Just the opposite, even in case of evident structural differences, different levels of competitiveness (which can easily be measured with statistical figures), and not less obvious differences in the economic, social, legal, institutional absorption capacity of the individual candidates, the Commission proved to be extremely cautious in stressing them. The political intention of the enlargement (or the lack of political courage and of strategic thinking in the early period of the process) has always overlapped economic and other considerations and concerns. As a result, the EU (and the candidates) are facing a "big-bang enlargement", which, of course, does not offer only advantages but gives birth to some serious challenges as well. In order to make the coming enlargement a success, which is absolutely necessary to maintain the openness of the integration/enlargement process for countries which are expected to join later, the potential setbacks have to be reckoned with already now. Not with the purpose of slowing down the enlargement process, which would be extremely risky and politically unviable, but in order to identify the necessary elements of counteracting potential negative developments and avoid any kind of "bad surprises".

And just in this field one can find a basic difference between the enlargement by Greece, Spain and Portugal, on the one hand, and by the "Eastern" Europeans, on the other. Two decades ago, everybody had been aware of the fact that a politically motivated enlargement has some economic consequences, for which, the integration has to be prepared in time. Thus, a generous set of financial (and other) instruments has been designed and put into practice (regional and structural policies). The coming enlargement, also mainly politically motivated (at least as far as the size of the group is concerned), is not based on the same solid financial fundament which may make the success of the process less predictable (or, in a less over-optimistic formulation, it may lead to serious negative impacts).

The three challenges, the enlarging Union has to be prepared for, are the following. First, the minimum level of the critical mass of internal cohesion of the Union has to be maintained after the first wave of "Eastern" enlargement. Second, the enlarged Union in general, and (some of) the candidate countries, in particular, have to be prepared how to face and treat eventual adverse developments after membership, in case it turns out that their adjustment capacity is not sufficiently developed and their hopes for membership will not materialize immediately (or not even in the medium term). Finally, and most importantly, the enlarging and the enlarged EU has to have a clear road map for a second, and potentially also a third wave of enlargement in the next decade (one still in this decade and another one in the first half of the next decade). The sustainability of European stability on the one hand, and the successful implementation of community policies in such vital areas as foreign and security policy, justice and home affairs, *etc.* on the other, need a clear strategy covering present, first-wave and later members alike.

There is no reason any more for deploring which kind of other scenarios, less costly or less risky ways of the "Eastern" enlargement could have been imagined or enforced. We should look at the current situation, identify the chances and risks and make full use of the former, and face with adequate, in-time designed and efficient strategies and instruments the latter. This is the only way how the “Eastern” enlargement can become not only a success story for the present and future member countries but how it will rightly deserve the label of the most important “historical project” of the continent in a rapidly changing and globalizing environment.

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The Future of Europe EU Enlargement and Ukraine

Youri M. Matseiko*

1) To the future of Europe through competitiveness and sustainable development

Talking about Europe's future one has to take into consideration two major strategic challenges calling for (i) the maintenance and preferably the increase of competitiveness, and (ii) the support and strengthening of sustainable development.

The Council of the European Union in its decision on 25 January 1999 made a very important pronouncement: "Competitiveness and sustainability are the keys to the long-term future of the Union's economy: creation of the wealth and jobs, enhancement of the quality of life, and preservation of the environment and the natural resource base.".

Europe has a major role and responsibility in global efforts to achieve sustainable development. In their ministerial statement to the World Summit on Sustainable Development, members of the UN Economic Commission for Europe stated: "We reaffirm the Rio Declaration and our strong commitments to sustainable development, our support of the Rio process." The problem now is to launch a concrete mechanism to carry forward objectives of sustainable development. Europe has to do its best to contribute to this important aim. Poverty eradication will remain a crucial issue for sustainable development.

Today knowledge is perhaps the most critical competitiveness factor. Accordingly, in formulating the objectives of Europe's sustainable development strategy the priority must be the invention, dissemination and utilization of technologies needed to produce those high quality products that will be competitive on tomorrow's market.

Competitiveness and sustainability require a "system approach" in which research activities support the development of coherent interconnected and eco-efficient industrial and social systems responding to both market and social needs.

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That is exactly what the EU does rather successfully. And this may be well seen in formulating and realizing the special RTD Programmes – the so-called Framework Programmes. The EU is fulfilling now the Fifth RTD Framework (1998–2002). This programme has a clear target of increasing economic growth and creating new jobs in Europe by sustaining the innovation efforts of European industry towards improved competitiveness. And what is more important, the programme supports research activities contributing to competitiveness and sustainability particularly where these two objectives interact.

The programme tries to meet socio-economic needs by stimulating the best possible approaches including strengthening the innovative capacity. The major courses set by the EU programme to competitive and sustainable growth are as follows:

* innovative products, processes and organizations;
* sustainable mobility and intermodality;
* land transport and marine technologies;
* new perspectives in aeronautics.

However, having all this in mind, we should not forget that Europe still lags behind its major competitors, inasmuch as it is less able to translate its scientific results into innovation. Currently only 1.8 per cent of Europe's aggregate GDP is invested in research compared with 3 per cent in the USA and Japan. And the gap is increasing. Therefore it is vital to distribute efforts and goals at both the national and European levels to promote innovation and competitiveness. Private investments in research are very essential. Industry constantly has to be orientated towards new and innovative production processes which maximize resource use and, at the same time, minimize environmental impacts.

The knowledge-based European economy will develop further by the realization of the next – the Sixth Framework Programme (2002–2006). As we understand, the basic principles of this project are:

* concentration – on selected priority research areas;
* structuring effect – through a stronger link with nations, regional and other European initiatives;
* coordination – simplification.

There are seven thematic priorities in this programme, including (i) genomes and biotechnology, (ii) information technologies, (iii) multifunctional materials, (iv) aeronautics and space, (v) food quality and safety, (vi) sustainable development and (vii) citizens and governance in the European knowledge-based society.

We have acknowledged with pleasure that this programme envisages participation of third countries in the above-mentioned thematic priorities. We are glad to note that Ukrainian scientists participate in the EU's Fifth Framework Programmes. Approximately 1200 Ukrainian teams have been linked to EU research projects. Ukraine has repeatedly expressed its wish to establish a closer relationship with the EU in the field of science and technology. In October 2001 the European Council authorized the European Commission to negotiate an S and T agreement with Ukraine. We hope that it will help Ukraine in a more active participation in the Sixth Framework Programme.

We found rather promising the idea of creating the European Research Area, which is supposed to strengthen the capacity of European scientists contributing to economic competitiveness, sustainable development and a better quality of life.

The four basic categories of ERA activity are being planned in the following areas:

* research and innovation;
* human resources and mobility;
* research infrastructure;
* science and society.

We believe that the future of Europe lies on the path of maintaining competitiveness and sustainability. The production sector will remain essential and strategically important not only for the EU but for the whole of Europe. This requires a more integrated and effective policy which takes into account the economic, environmental and social dimensions. The highest priority has to be given to research, technology, development and innovation.

While assessing the undeniable progress in what we may call the European system of production, one cannot claim that this system is already sustainable and that competitiveness has already been achieved. European production is not in a state of sustainability, yet.

The Working Group of the EU Commission on "Competitive and Sustainable Production and Related Service Industries in Europe" made the following pertinent conclusion: "This vision requires a more integrated view of the arena of innovation, with focus on sufficiency. Integrated view brings together economic, environmental, social and scientific concerns." We have not achieved this approach in Europe. We have not achieved it in the world. This conclusion is contained in the report of the UN Secretary General in connection with the Johannesburg Summit. Progress in the realization of Agenda 21 was slower than expected and in some respects conditions became worse than they were 10 years ago. Writing and talking about competitiveness and sustainability is an easy matter. But doing something about it is quite different. Sometimes we hear success stories but they are fragmented. Some improvements reported in economic, social and environmental issues sound nice. But they often cause other problems. And after all, they do not mean sustainable development, which still seems elusive.

Europe and the USA are supposed to be in the lead of formulating and realizing national strategies of sustainable development. It must be noted that the problems faced by the developing and developed countries in the preparation of national strategies for sustainable development are quite different. Most developing countries are occupied with economic development, poverty alleviation and social investment. Developed countries face problems caused by high levels of industrial activity and consumption.

There is also a third group of countries, the transitional economies, closer to developing countries. The North tries to act in the spheres of institutional orientation and integration, regulatory and voluntary standards, and environmental controls. The South is busy with creating new institutions and development projects. One thing is undeniable: all these three groups of countries have much to learn from each other's experiences. Johannesburg would have to contribute to the important process of the realization of Agenda 21.

Of course, for success political will must be generated. This political will, as we see it, may be found in the ministerial meeting of the UN Economic Commission for Europe. The statement adopted on 21 September 2001 stressed that the European region has a major role to play and the responsibilities in global efforts to achieve sustainable development. The European ministers promised to contribute effectively to achieving the agreed international development goals and meet the commitments of the UN Millennium Declaration. The meeting expressed its determination to deal with the economic, social and environmental policies in a balanced and mutually reinforcing way for the benefit of present and future generations. The forum stressed that poverty eradication, and economic and social progress are crucial to sustainable development. At the same time, the European ministers appealed for a better understanding of the linkages between the environmental, poverty, trade and human security issues.

We have to take into serious consideration that there are substantial challenges to sustainable development in Europe. The "Enlargement Future Project" prepared by the Expert Panel categorized these challenges as the following:

* misunderstanding of the principles and the significance of sustainable development on high executive levels;
* poor environmental understanding;
* meagre social involvement, which impedes the implementation of sustainable policies;
* weak confidence in institutions dealing with sustainable development;
* lack of structures which can be used in the mediation between interest groups and decision makers;
* low income of the population, which reduces the priority of sustainability criteria in the light of daily needs.

Europe has to perform better to make globalization work for sustainable development for the benefit of all people and especially the world's poor. Europe is supposed to contribute to such a vision of the global system in which every country has its place and shares the common wealth.

2) The EU enlargement process in the context of future reforms

The European Union during its rather long history contributed to resolving international conflicts, strengthening peace and security, and the well being of peoples. The Union is in a constant process of enlargement which helped accomplish political stability, economic progress and social justice.

In Ukraine we follow this historical process with concern and sympathy. The skills of the EU in building stable institutions, changes of governments on the basis of free and democratic elections, protection of basic human rights and market economy principles – all these mean a lot for Ukraine as an indispensable experience. The simple truth is that EU enlargement will benefit not only old and new members but also neighbouring countries, including Ukraine.

Enlargement means the sweeping away (not in a speedy way) of all dividing lines across the continent. This process is not an easy going one. Sometimes it even looks like building something which reminds new dividing lines. But let us not forget that each new member state brings to the EU its own political, economic, cultural, historical and geographical values. This, in its final result, makes member states draw near each other. We have to add that some present-day challenges (like the terrorist attacks of 11 September) contribute to a more intense and fruitful cooperation between European countries. As we understand, this year will be crucial for the successful completion of the ongoing accession negotiations and for the candidates' preparations for membership. The accession negotiations will be concluded by the end of this year with those countries which fulfil the accession criteria. On this basis, these countries will be ready to become members of the EU in 2004, in accordance with the objectives set by the European Parliament and by the European Council. We wish a successful completion of this important process for all candidates. Of course, for Hungary too, which is one of the most successful candidates. Hungary achieved remarkable results in fulfilling the accession criteria. We hope that EU enlargement will contribute to realizing that only peaceful and concerted action can make our continent stronger and more prosperous. As we remember, in the beginning it was more of an economic and technical cooperation. Then the construction of a political union followed. And cooperation today includes practically all aspects of life.

As it is known, the conditions for membership were set by the Copenhagen EU summit in 1993. They have remained valid ever since. Evaluating the accession process, it is worthwhile to stress one important aspect, the implementation of the criteria and their transposition into law. This is extremely essential for the process of Ukraine's preparation for membership.

The second point which deserves the most serious attention of future candidates is the cooperation in justice and home affairs. That is important in view of the fight against international terrorism and organized crime, and the possible creation of common border control arrangements also. Ukraine, having in mind its geopolitical and geographical position, has a special interest in the above-mentioned cooperation.

As it is reflected in official EU documents, all negotiating countries continued to fulfil the political criteria including the strengthening of democratic institutions, enhancing the rule of law and protecting human rights. The situation has improved since last year. We have noted that the EU Commission paid special attention to the need of accelerating the judiciary reform. The Commission also pushed for vigorous measures in fighting the growing problem of trafficking women and children.

Corruption, another major problem, has to important aspects: low salaries in the public sector and an extensive use of bureaucratic controls in the economy. Anti-corruption bodies will have to be strengthened. There is an urgent need of effective legislation. Some positive developments have been taken place in Ukraine, but much greater efforts should be made. Corruption, fraud and economic crime remain widespread in our country, as well as in other countries. All this testifies that candidate countries achieved overall progress in consolidating and deepening democracy and respect for the rule of law, human rights and the rights of the minorities.

The progress has been assessed by testing the fulfilment of economic criteria. The EU Commission testified the existence of a functioning market economy and the capability to withstand competitive pressures and market forces within the Union. It means that prices and trade are liberalized. An enforceable legal system, including property rights, is in place. A stable macroeconomic framework exists in practically all candidate countries. It must be noted that accession requirements have been enlarged since the Gothenburg summit in June 2001. Accordingly, sustainable development has become an overriding objective of the EU. It means that the accession countries must therefore commit themselves to sustainable development within the context of the Lisbon process.

The process of accession is taking place simultaneously with another important process, the transformation of the EU. Europe cannot but change being confronted with a fast changing globalized world. Our continent has to play a stabilizing role in a new world order. The world today seems to be unstructured, which means an absence of strong world organizations and the actual existence of monopolarity when the United States acts as a single superpower. At the same time, today's world is economically deregulated, which means the weakness of the world market and the absence of effective forms and mechanisms of regulation.

What is to be done in this globalized, yet highly fragmented, world? One of the avenues leading to the governance of globalization is the strengthening of the role of international organizations, building a new world political and economic structure, which will construct a multipolar world based on stability, democracy and respect of human rights. The strengthening of international organizations means their cooperation. It must be a system of international bodies embracing the EU, the NATO, the OSCE, the Economic Commission for Europe, the European Council, the OECD. We cannot but agree with the opinion on this score expressed by the NATO Secretary General, Lord Robertson: "Cooperation between international organizations is no longer just a good idea. It's the only way forward."

The Laeken Declaration rightly stressed that "Europe needs to shoulder its responsibilities in the governance of globalization." This highly important document proposes to resolve three basic challenges:

(1) how to bring citizens closer to the European design and European institutions;

(2) how to organize politics and the European political area in an enlarged Union;

(3) how to develop the Union into a stabilizing factor and a model in the new, multilateral world.

As we understand the dialogue on the future of Europe, it touches four basic issues: (i) the precise definition of the competencies of the Union, (ii) the simplification of the Treaties, (iii) the legal status of the Charter of Fundamental Rights of the EU and (iv) the role of national parliaments in the integration process. There are many other ideas and suggestions being discussed at the special Convention in Brussels. We, in Ukraine, are following these discussions with great interest. It is quite possible that by the time Ukraine prepares for accession, the European Union will be a quite new, substantially transformed international entity. Having this in mind, it may be a good idea to grant to Ukraine, and to other applicant countries, an observer status at the Brussels Convention.

There is one more issue that attracts our special attention. The debate on the EU future is being broadly based. A special Forum is opened for organizations representing civil society (social partners, business world, non-governmental organizations, *etc.*). This evidently shows how indispensable is real democratization in decision making.

3) Ukrain's partnership with the European Union

Relationship between Ukraine and the EU is being regulated by the Partnership and Cooperation Agreement (PCA) signed on 14 June 1994 (entered into force on 1 March 1998). This document provides a framework for political relations based on democratic EU values. The agreement embraces goods, services, labour and capital. The PCA is an important instrument in bringing Ukraine closer to the single European market and the GATT/WTO system. The PCA envisages the prospects of a free trade area. The document provides a framework for wide-ranging cooperation in the commercial, industrial, scientific and administrative areas.

Ukraine was the first of newly independent states to sign such an agreement. The trade in steel and textiles between the EU and Ukraine is regulated by the separate agreements of 1995 and 1993. In July 1999 the European Atomic Energy Community and Ukraine signed agreements on cooperation in the fields of nuclear safety and controlled thermonuclear fusion. Finally in December 1999 the Helsinki summit adopted an EU common strategy on Ukraine. This document aims at developing a strategic partnership between the EU and Ukraine. In accordance with the above-mentioned document the European Union has proclaimed the following strategic goals with regard to Ukraine:

(1) to contribute to the emergence of a stable, open and pluralistic democracy governed by the rule of law, underpinning a stable functioning market economy for the benefit of all the people of Ukraine;

(2) to cooperate with Ukraine in the maintenance of stability and security in Europe and in the wider world, and to find effective responses to common challenges facing the continent;

(3) to increase economic, political and cultural cooperation with Ukraine, as well as cooperation in the field of justice and home affairs.

Two important points have to be stressed here:

1) The EU supports the democratic and economic transition process in Ukraine.
2) The EU considers that the rule of law is a prerequisite for the development of a functioning market economy in Ukraine.

To our conviction we have to address ourselves specifically to the second point in order to explain why the progress in the functioning of the market economy in Ukraine is so slow and sometimes even elusive. The Country Strategy Paper 2002–2006 describes the situation in Ukraine with the following terms: "Weaknesses and uncertainties still characterize the political, economic and social situation in Ukraine in spite of recent economic recovery after almost 10 years of GDP decline." We cannot but agree with this somber assessment. A lot must be done for the consolidation of democracy, the rule of law and public institutions in Ukraine. Ukraine has to double its efforts to reform the legal system, to make the independent judiciary function properly, to organize a professional police force, and to set up a well-trained public administration at all levels. Ukraine has to do much more in order to improve the efficiency, transparency and democratic character of its public institutions, including the development of a free media. Only by accomplishing all these will Ukraine be able to assure success in economic and social development, for the building of a modern civil society.

The European Union encourages Ukraine to intensify its efforts to create a functioning market economy through greater structural, economic and administrative reforms. This should include the establishment of clear property rights, further privatization, the liberalization of prizes, the restructuring of businesses, and the support of small and medium-size enterprises. The situation in Ukraine has somewhat improved in certain spheres, in others – not much has been done. As is known Ukraine suffered a drastic economic decline in connection with the dismantlement of the USSR. Consequences for the production level were very negative. The standard of living sharply decreased. The financial crises in 1998 exerted grave impacts on Ukraine. At the same time the return of growth to the Russian economy and the depreciation of the hryvna in 1999 positively influenced Ukraine's economic performance. In 2000 Ukraine's GDP grew by 5.8 per cent, compared to 9 per cent in 2001. But let us not forget that the volume of Ukraine's GDP in 1999 was 2.5 times less than in 1990. It means that over the last two years we came close to the 1995 level, which was around 48 per cent of the 1990 performance. So we cannot describe this situation as a stable economic development. A GDP growth of 6 percentage points a year would mean that Ukraine needs 13 years to reach the level in 1990. Industrial growth in 1999 was 4 per cent (in 2000 and 2001 it was 12.4 and 14.2 per cent, respectively). At the same time only a very modest movement might be seen in producing energy materials (0.2%), electric energy, gas and water (2.6%) and metallurgy (4.9%). Military industries have decline radically, and so it happened to light industry.

Agricultural growth is rather stable. But again, let us not forget that in 2001 the volume of agricultural production was 1.7 times less than in 1990. It is worthwhile to note that the most stable and substantial growth was assured by the private sector (the growth in 2001 was 21%). At the same time public sector performance (the former *kolhoz*es and *sovhoz*es) showed a dramatic decrease. The share of private sector in agricultural production was 66 per cent in 2000 compared to its 1990 level of 29 per cent.

In the social sphere nominal income for the 11 months of 2001 increased by 25.5 per cent compared to the same period in 2000. Real income including inflation increased by 8.7 per cent. Real salaries from January to November 2001 increased by 19.2 per cent compared to the same period of previous year. Unemployment in 2000 was on the 11.7 per cent level according to ILO methodology.

Assessing the economic and social situation in Ukraine, in general terms, it has to be pointed out that Ukraine urgently needs the reform of the energy sector, the speeding up of privatization and an improvement in tax collection. It is absolutely necessary to bring about serious reforms in the operation of the judiciary and financial institutions so as to create a business environment that attracts foreign investments, badly needed for the modernization of the Ukrainian economy's obsolete infrastructure and technological standards.

Ukraine has to develop its own competition policy. This would mean the working out of the legislative framework and the full enforcement of the rules in both anti-trust and state aid. This must include the alignment of incompatible aid schemes in particular fiscal aids. Around 20 per cent of Ukraine' foreign trade is with the European Union. In recent years Ukraine has recorded a steadily increasing trade deficit with the EU. After a steep decline in 1999, imports and exports in 2000 increased by approximately a third each. Ukrainian exports consist mainly of crude materials (22%) and heavy industry products (44%) while EU exports consist of manufactured goods primarily (72%).

The low competitiveness of Ukrainian goods are well demonstrated. A very substantial industrial restructuring with an inflow of foreign investment may be the only perspective to remedy this situation. Foreign direct investment in Ukraine rose in 2001 by 18.4 per cent totalling to almost USD 4 billion, which remains very low compared to the amounts received by other Central and Eastern European countries. So, all this testifies the rather modest reform progress. Of course the main responsibility for Ukraine's future lies with Ukraine. But we hope that the European Union will intensify its economic efforts in working with Ukraine at national, regional and local levels in order to support a successful transformation. In our view the Union has to introduce new programs and institutions, which might continue and strengthen the Tacis activity in Ukraine.

Ukraine has achieved some progress in establishing a democratic political system. There is a wide acceptance of political pluralism and freedom of opinion, although autocratic tendencies are rather strong and civil society is practically absent. Still, the country has moved ahead to legal and institutional reforms. The judicial reforms include the question of pre-trial and court system. The administrative reforms remain to be solved. They specifically concern the relationship between the center and the regions. The management continues to be very centralized. Regional bodies still do not have a due role in the economic reform process. The fulfilment of the privatization program cannot be described as satisfactory. The problem here lies not only in slowness but in the creation of oligarchical structures in the economy. There are many examples of inter-enterprise arrears, barters, tax exemptions, which are detrimental for market development. The positive feature is the emerging consensus on the significance of entrepreneurship as a driving force to the market. There is also an urgent need for restructuring the banking sector. Further agricultural reforms are needed. The key problem here has always been land ownership. Ukraine must have a market oriented long term energy strategy, too. The macroeconomic situation shows signs of improvement but the movement cannot be labelled stable and sound. Economic recovery after 10 years of independence needs to be substantially strengthened by sustainable development. It presupposes structural reform, particularly in the energy and the agricultural sectors. The established legal environment should be conducive to domestic and foreign investment, as well as joining WTO, and restructuring the banking sector and the social security system.

The crux of the matter, as we see it, is as follows: competitiveness and sustainability have not yet become the highest priority in the process of Ukraine's transition to a market economy. Ukraine has not yet worked out its national strategy on sustainable development. It is a pity that actually there is not even a preparatory work on the strategy so far. Existing plans of national development are rather far from sustainability and compatibility. The development plan for 2000–2004 is based on economic and social dimensions only. Such a vitally important dimension as environment is practically absent. The document keeps silence on institutional reforms in Ukraine, without which a sustainable development is simply not possible. Finally the above-mentioned document says nothing about the essence of the whole idea of sustainability: interaction, integration, harmony and the balance of the economic, social and ecological components.

Sustainable development is not a panacea but it would offer a good chance and Ukraine cannot afford to miss it. A lot of valuable experiences were accumulated in the modern world. They have to be carefully studied and used in the best possible way. The national strategy of sustainable development in Ukraine will have to have an orientation which is both global and European, and of course integrated. Its basic character must be founded on science, technology and innovation. Naturally, while looking for this uneasy but so indispensable path, Ukraine is supposed to find its own, original and promising approaches. The EU pursues a well-defined economic policy strategy containing sound macroeconomic policies and comprehensive structural reforms. The Lisbon summit provided a key impulse for these policies – dynamism and competitiveness. Sustainable development had been integrated into EU economic policy strategy. However, it is exactly what Ukraine needs today: national strategy of sustainable development in order to foster a knowledge-based economy.

The idea of Ukraine's accession to the EU is not taken for granted. There are those in the country who support, and there are others who disapprove of joining. The discussions on this score are intensive and sometimes harsh. But it must be noted that masses are still not involved in these controversies. Ukraine's accession to the EU is a subject for politicians, academics, some NGOs, *etc.*, at least for the time being.

Some people in Ukraine say that many branches in our economy are not compatible with the world market and draw the following conclusion: we are not to include ourselves into the world and the European economic system; on the contrary, we have to keep away from it. This conclusion is, of course, false. Such an approach of self-isolation will lead us to a dead end. As is well known, closed economies simply cannot be effective. Only whole integration into the world and regional economy will lead the country out of economic difficulties and backwardness. We know what self-isolation meant for the Soviet economy. At the same time the success of Hungary, Poland and the Baltic countries, that were under the same conditions ten years ago, proves the necessity of opening-up. We count on some problems arising from meeting the EU on our borders. We hope that these difficulties will turn to be only temporary, and believe that our neighbours are interested in the partnership with Ukraine. Let us not forget that Ukraine, for a number of years, has a positive saldo in trade with its partners in Central and Eastern Europe. Of course, nobody is going to cherish us in the European market. The laws of the market are in force for centuries. Ukraine has to fight for its place under the sun.

Ukraine's future accession to the European Union should not and certainly will not in any way create difficulties in its relations with the Russian Federation. As it is known, the Partnership and Cooperation Agreement is directed at strengthening the strategic partnership of the EU with Russia. It addresses common challenges in Europe. Ukraine is also interested in such important activities as socio-economic reforms, the building of the legal, institutional and administrative framework through private initiative and market forces. Ukraine is interested in a close cooperation with Russia for the resolving of all political and security issues in Europe. It would be better if Russia became a member of the EU some time in the future. But, of course, that must be decided by Russia itself. In any case, both Ukraine and Russia strive to facilitate transition to a fully fledged market economy, founded on the core principles of democracy, the respect of human rights and the rule of law. Both countries want to be the most stable, cooperative and friendly partners for the security and prosperity of the European continent.

The EU enlargement process creates a rather new situation for Ukraine. The simple question arises: what actually should we do in order to be acceptable not to the old, but to the new, enlarged and transformed EU. We find some clarification on this score in the document "Country Strategies Paper 2002–2006. National Indicative Program 2002–2003, Ukraine". The document contains a rather important conclusion: "Enlargement is bound to make the EU more sensitive to "soft" security threats from Ukraine which need to be addressed." They mean the environment, justice public health and home affairs.

So far, our general impression on the reforms in Ukraine and the EU are as follows: The EU train is making headway faster and faster. The Ukrainian train moves sometimes slowly and timidly, sometimes it even stops and waits (waits for what?). As a result, the distance between these two trains is increasing. The Ukrainian economy remains vulnerable and unstable. The way out is evident: speeding the reform process. Ukraine must ensure that its development moves forward on all three fronts: economic, social and environmental. They are mutually reinforcing. Only an integrated approach will guarantee Ukraine's success: sustainable growth and competitive economy based on knowledge. EU accession and transformation processes give a good stimulus for reforming Ukraine. The country has to follow this path. There is no other sound option.

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BEYOND EU ENLARGEMENT: THE CHALLENGE OF PREVENTING A NEW DIVIDING LINE

Iris Kempe*

Introduction

EU Eastern enlargement is a success story for Europe's role in providing security and stability beyond its borders. The reasons for success are related to the combination of norm-setting from the outside, supporting the transition process and offering a clear perspective of membership. This very strategy is also being applied to the post-conflict zone of South-Eastern Europe. The EU is providing intensive transition support and signaling its openness to this region.

The countries with a more or less direct neighbourhood to the enlarging European Union, Russia, Ukraine – but one should not forget Moldova and Belarus – are in a much less clear position. The EU so far has not provided a clear perspective on cooperation that goes beyond the perspective of the partnership in the cooperation agreements, which came into force in 1997.[1] Furthermore, the European Union also shapes its foreign and security relations with Russia and Ukraine with the EU Common Strategy for the Russian Federation and Ukraine. The Common Strategies are an instrument of the EU's Common Foreign and Security Policy, which has to be applied to post-Soviet countries as well as to the Mediterranean.[2] From an analytical point of view, these strategies are first and foremost internal EU instruments. In shaping external relations, it can be characterized as "a public policy paper".[3] The common strategies do not include any perspective of future mem-

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[1] http://europa.eu.int/comm/external_relations/ceeca/com_strat/index.htm

[2] Common Strategy of the European Union on Russia, 4 June 1999, (1999/414/CFSP), Common Strategy of the European Union on Ukraine (1999/877/CFSP) http://europa.eu.int/comm/external _relations/ceeca/com_strat/index.htm.

[3] Ralph Genetzke, 'The First Common Strategy. Added Value or Added Confusion? ' in *Les re-alations entre l'Union européene et la Fédération de Russie*, ed. Tanguy de Wilde et Laetitia Spetschinsky, Louvain-la-Neuve, 2000, p. 161.

bership. Considering the current EU policy towards its Eastern neighbours, the success story of enlargement seems to come to an end after integrating the current accession states in the first "big bang" and the Balkans in a second one.

So both the future neighbouring countries as well as the EU are challenged to think beyond the current strategic approach of "simply" continuing EU integration and enlargement. The official aim of shaping relations beyond EU enlargement towards Eastern and South-Eastern enlargement is to avoid new dividing lines between East and West. This is indeed an ambitious as well as a positive concept, but its benefit depends highly on strategies of operationalizing normative aspects into policy. Furthermore, these very concepts have to consider highly asymmetric relations between relatively stable and prosperous EU candidate states on the one side, and the future neighbouring states muddling through the transition process on the other side. As a negative side effect of EU enlargement, dividing lines that already exist will strengthen. The introduction of the Schengen *acquis* has already become the number one symbol for creating a new iron curtain between Poland and Ukraine by terminating the necessary preconditions for good neighbourly relations.

The concept of preventing new dividing lines for the future neighbouring countries cannot be limited to declarations. It has to be defined by a three-pronged approach: (i) security issues, (ii) transition problems and (iii) European cooperation.

1) Security issues

The tragic events of September 11 also had an impact on EU external relations. Against all previous assumptions, Russian President Putin has been fulfilling a very positive role in cooperating with the West. This, to a certain degree new and unexpected cooperation started with Putin declaring solidarity with the US from the very first moment when he kept the hotline warm by saying "We are with the Americans against the international terrorists," includes closing wire-tapping installations and listening stations in Norway and Cuba, supporting the Central Asian successor states to the Soviet Union in their cooperation with the anti-terror coalition, and has not ended with the recent signing of the US-Russia strategic arms redaction treaty during President Bush's visit to Russia.

Apart from military and strategic action, Putin has been opening new windows of opportunity for relations between Russia and the West. Russia's short-term signals surprised the international community, but in the half year that has followed, the long-term tasks have come increasingly into focus. Putin's most significant foreign address on both short and long-term developments was his speech given in the German Bundestag on September 25th in Berlin.[4] He started by highlighting the worldwide background to the tragedy of September 11 and continued with the need to build a new security architecture. In doing this, he suggested strengthening European integration but also thinking in a wider, *i.e.* pan-European, security context.

Russia's clear support for the US and Putin's declaration of the end of the Cold War surprised the Western world. At the same time, most of the Russian political elite is critically astonished about Putin's current position. One has to ask how far and by whom the President is supported. Whether he is expressing his own power over other actors and influence groups, or whether he is under serious pressure from his opponents? Furthermore, the immediate cooperation on strategic aspects, such as providing the air corridor, is no guarantee of a strategic and sustainable partnership. Some doubts should be considered about the support for Putin among the Russian elite and public opinion. The strongest criticism is formulated by communist and/or nationalist representatives, who are comparing Putin with Yeltsin or Gorbachev. Beyond radical positions, even analysts and politicians, who usually support Putin, are much more skeptical now. Even if they do not criticize, they have started to brick up the new windows of opportunity with wish lists for compensation. The list starts with understanding Russia's military action in Chechnya. The bombing of apartment buildings in Moscow and other Russian cities in summer 2000 is once more propagated as a terrorist attack from the Caucasus, even if any kind of official proof is still missing. The intervention in Chechnya is portrayed as fighting against terrorism, and the West should support it instead of constantly criticizing Moscow.

Other analysts assess the close cooperation between Russia and the West as a tactical policy, which will not lead to any new medium-term strategic alliances. For instance, the journalist Alexeij Pushkov argues that the window of opportunity for new cooperation is already closed, since the US pulled out of the ABM treaty and Tony Blair's proposal to install a new NATO-Russia institution was blocked.[5]

Even if Putin's position is not shared by all members of the Russian elite, he is supported by reform-oriented representatives, such as the member of the Russian State Duma Vladimir Ryshkov, or Dmitri Trenin, deputy director of Carnegie Moscow.[6] They mostly share the position of a new window of opportunity of Russia's external relations and internal development. Under this assumption, the EU is

[4] "Wortprotokoll der Rede Wladimir Putins im Deutschen Bundestag am 25.09.2001", http://www.bundestag.de/blickpkt/2001/putin_wort.htm, Download 4.12.2001.l

[5] "Ein Neues Verhältnis zwischen Russland und dem Westen?" Presentation given by Alexej Pushkov, Conference „Russland und der Westen – Neue Implikationen für Sicherheit und Stabilität nach dem 11. September", Bertelsmann Stiftung, Friedrich Naumann Stiftung, Centrum für Angewandte Politikforschung, Moscow, 13.12.2002.

[6] Dmitri Trenin, 'Vladimir Putin's Autumn Marathon: Towards the Birth of a Russian Foreign Policy Strategy', *Brifing Mosckovskogo Centra Karnegi*, Issue 11, November 2001, http:// pubs.Carnegie.ru/English/briefings/2001/issue01-11.asp. Download 8.1.2002.

of growing importance for Russia, and the events of September 11 have an impact on almost all areas of cooperation between Russia and the European Union.[7]

This recent development changed Russia's role in the framework of international security from a former super power losing its influence, and being first and foremost a soft security risk, into a partner for Western security and defense cooperation. From this, it follows that Russia has to be considered in Western security cooperation. In Russia's case, NATO has already responded to the new requirements by creating the new NATO–Russia council.

Ukraine also supports the war against terrorism rhetorically and by offering military support. In the shadow of the Russia-NATO rapprochement, Ukraine maintains the possibility to stop its muddling through between Russia and the West by formulating a clear Western orientation. This orientation can be seen in Ukraine's official declaration of its intention to become a NATO member state, which was made by the Council of Foreign and Defense Policy in May 2002. On the one hand, one has to welcome the country's Western orientation; on the other hand, one must take into consideration that Ukraine's integration into Western structures has to be decided in Kiev and not in Brussels, meaning that membership criteria cannot be limited to declarations but has to be based on internal reforms.

Even if Russia and the other Western CIS states have an increasing function in security cooperation, they are at the same time difficult and risky partners. The successor states of the former Soviet Union harbour open as well as frozen conflicts, ranging from violent escalations in Chechnya, Nagorno-Karabakh, Abkhazia, *etc.* to instabilities and unclear status question in Kaliningrad and Transdniestria. As a tragic twist of fate, only one month after the attacks on the US, Ukraine gave a very critical example of potential risks caused by internal conditions, when on October 4th a civilian airplane coming from Israel was accidentally shot down over the Black Sea by a Ukrainian missile.

Conflicts within the former Soviet Union are almost all based on two factors:

1) Regional problems caused by ethnic and economic legacies of the Soviet past.
2) Insufficient commonly accepted mechanisms for conflict resolution and weak institutional structures.

The more both factors apply to a regional conflict, the more the conflict threatens the West. These soft security risks might have a negative impact on the West because of uncertain border demarcation and control, and an administration which does not fulfil Weberian standards of a modern administration. Due to their geographic locations, Russia and Ukraine are transit countries between East and West, located between weak states in Central Asia, including Afghanistan and prosperous countries of the enlarging European Union. As a consequence, Russia and Ukraine are a good breeding ground for illegal migration, international crime,

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[7] Ljudmila Romanova, 'Rossija I ES dogovarilis pothschti obo vsem', *Nezavisimaja gazeta*, 2.10.2001, S. 2.

corruption, organized crime, smuggling and weapons proliferation.[8] These risks will not stop at the outer border of Russia and Ukraine. On the contrary many of these activities are directly addressed to the West. These very factors lead to assessments such as the following, made by *The Economist* in June 2002, "For the time being, however, the squalor on Europe's Eastern frontiers poses a dismal prospect for the West. Both Ukraine and Belarus are weapons supermarkets for the worst sort of customer and provide transit for just about everything the West wants to keep at bay."[9]

Overall, internal weakness and transition problems cause a potentially long list of soft and hard security risks that might threaten the West. The prevention of these very risks includes special requirements for the EU as a potential provider of risk management and stability. At the same time, the consequences of September 11 require cooperation with Russia in order to prevent security risks from the outside. Thus, the West is challenged to develop security cooperation with an asymmetric partner, which might at the same time be a potential threat by itself.

2) Transition problems

In comparison with the candidate states, the neighbouring countries lack a transition process, but nevertheless it would be narrow-minded to reduce their position to losers who are unable to solve transition problems. This very image stops constructive discussion of options for preventing new dividing lines, for example, with the argument that Ukraine is too corrupt, a center of organized crime and a destination for illegal immigration. Effective strategies need more differentiation and should also consider both the success and shortcomings of European influence in shaping the transition process.

After nearly ten years of economic decline, Russia and Ukraine have been showing economic growth since the year 2000.

The economic stabilization is partly related to developments after Russia's financial collapse in 1998 and to world energy prices, but also to some structural changes.[10] In 2001, Russia made some remarkable progress on reform by introducing a new tax system, based on a personal income tax of 13 per cent, unification and reduction of social security contributions, reduction of turnover tax and elimination of a number of smaller taxes. Due to the new land code adopted in

[8] Transparency International Corruption Perception Index 2000/ 2001, http://www.transparency.org/cpi/2001/cpi2001.html. Todd S. Foglesong and Peter H. Solomon, Jr. Crime, Criminal Justice, and Criminology in Post-Soviet Ukraine, Washington 2001, James O. Finckenauer and Yuri A. Voronin. The Threat of Russian Organized Crime, Washington 2001

[9] *The Economist*, June 1, 2002, p. 30.

[10] *Transition Report 2001*, European Bank for Reconstruction and Development, London 2001.

2001, Russians and foreigners are allowed to purchase, trade and mortgage urban and industrial land. Furthermore, the Russian government has succeeded in breaking away from the old Soviet pension system. Since the beginning of 2002, pensions are no longer based on the latest salary but on a much more differentiated system built on three pillars. Pensions are now regulated with a minimum state pension, a second state-funded element depending on the length of employment, and a third saving component including contributions from employees and employers. Similarly, Ukraine has achieved progress by adopting a new land code, sale of six power companies to strategic investors and a remarkable increase in the activity of small and medium seized enterprises, whose total number rose by more than 10 per cent.

Table 1
Rates of growth of real GDP, 1992–2002
(annual percentage change)

Country	1993	1994	1995	1996	1997	1998	1999	2000	2001 (est.)
CIS and Mongolia	-12.6	-14.6	-5.5	-3.3	1.0	-2.8	4.6	7.8	4.4
Latvia	-14.9	0.6	-0.8	3.3	8.6	3.9	1.1	6.6	4.75
Lithuania	-16.2	-9.8	3.3	4.7	7.3	5.1	-3.9	3.3	3.5
Poland	4.3	5.2	6.8	6.0	6.8	4.8	4.1	4.1	4
Belarus	-7.0	-12.6	-10.4	2.8	11.4	8.3	3.4	5.9	2
Moldova	-1.2	-31.2	-1.4	-7.8	1.3	-6.5	-4.4	1.9	5.0
Russia	-13.0	-4.2	-3.4	0.9	-4.9	5.4	3.3	8.3	4.0
Ukraine	-14.2	-22.9	-12.2	-9.8	-3.3	-1.9	-0.2	5.8	2

Source: IMF, 2001, p. 195, 205; data obtained from ECE, 2002, World Economic Situation and Prospects, p. 16. Transition Report 2001, European Bank for Reconstruction and Development.

In contrast to the positive economic development, the social and political transition is lagging behind Western standards. One has to consider a gap between formal and informal reforms.[11] For instance, presidential as well as parliamentary elections in Ukraine and Russia with some minor exceptions fulfil the OSCE criteria of being free and fair. But political power is still less distributed by elections than through the influence of individual actors and groups; political and economic power are insufficiently separated; and civil society is a state-organized institution.[12] The balance of power is mostly driven by economic and political influence groups. Political parties are organized from above, concentrating on the leading person in order to run elections. It is symptomatic of former socialist countries in

[11] Douglas C. North, *Institutions, Institutional Change and Economic Performance*, Cambridge, 1990.

[12] Hans Henning Schröder, 'Mächte im Hintergrund: Die Rolle von „Familie„ und „Oligarchen„ im politischen Kräftespiel', in *Russland unter neuer Führung. Politik, Wirtschaft und Gesellschaft am Beginn des 21*. Jahrhunderts, Münster, 2001, pp. 67 – 77.

transition that political parties are not program but actor-driven. The only exceptions are the Communist Parties. Closeness to or even pressure from different levels of the state administration restrict the parties' social independence. The weakness of civil society and the absence of checks and balances are also reflected in international rankings.

Table 2
Freedom House: comparative measures of freedom, 2001

Country	Political Rights	Civil Rights	Freedom Rating
Poland	1	2	Free
Slovakia	1	2	Free
Hungary	1	2	Free
Romania	2	2	Partly Free
Moldova	2	4	Partly Free
Ukraine	4	4	Partly Free
Russia	5	5	Partly Free
Belarus	6	6	Not Free

Source: The Survey of Freedom 2001/2002. Survey of Press Freedom 2002; Freedom House;
Note: 1 (most free) – 7 (least free)

Table 3
TI 2001 corruption perception index

Country	Rank	Score
Belarus	n.a.	n.a.
Hungary	31	5.3
Moldova	63	3.1
Poland	44	4.1
Romania	69	2.8
Russia	79	2.3
Ukraine	83	2.1

Source: http://www.transparency.org/cpi/2001/cpi2001.html
Note: Survey by business people, academics and risk analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).

It is no surprise that Ukraine and Russia bring up the rear in Transparency International's annual corruption perception index. In a ranking of 91 countries, Russia is at position 79 and Ukraine 83.[13] The gravity of the situation tempted George Soros to say "Ukraine gives corruption a bad name."[14]

Another important factor for civil society development in Russia and Ukraine is the weakness of the independent media. Although both countries' constitutions guarantee freedom of the press, this right is not enforced. The media strongly depends on the state, and regional executives put pressure on journalists and editorial boards. Methods range from administrative pressure, such as the old Soviet methods of interventions by tax inspectors or fire inspectors, through shortages of paper and distribution problems up to physical violence.[15] In the 10 years since the breakdown of the Soviet Union, several journalists have been killed. Numerous media outlets have been shut down by administrative means. Russian President Vladimir Putin as well as Ukrainian President Leonid Kuchma received the dubious honour to be nominated by the American Committee to Protect Journalists to be among the ten "Enemies of the Press 2001."

Table 4
Press Freedom 2002: Ukraine and its neighbours

Country	A	B	C	Total	Rating
Poland	6	6	6	18	Free
Slovakia	10	5	7	22	Free
Hungary	2	8	13	23	Free
Romania	11	24	24	35	Partly Free
Moldova	22	20	17	59	Partly Free
Russia	13	30	17	60	Partly Free
Ukraine	23	26	11	60	Partly Free
Belarus	26	31	25	82	Not Free

Source: Survey of Press Freedom 2002; Freedom House;
http://www.freedomhouse.org/pfs2002/pfs2002.pdf
A = Laws and regulations that influence media content; scale 0-30
B = Political pressure, controls and violence that influence content; scale 0-40
C = Economic pressure and controls that influence content; scale 0-30
Rating: Free: 0-30; Partly Free 31-60; Not Free: 61-100

[13] *The 2001 Corruption Perceptions Index*, Transparency International, 2001.

[14] George Soros (The New Republic, April 15, 2002),
http://www.rferl.org/corruptionwatch/2002/04/15-190402.asp.

[15] *Media Reponses to Corruption in the Emerging Democracies: Bulgaria, Hungary, Romania, and Ukraine*, A Freedom House Assessment Report, Key Findings and Recommendations, May 1999.

Thus one might characterize the state of affairs of the transition process as reforms from above lacking the necessary social background. But beyond all necessary criticisms, the interest in ongoing economic reforms is a potential driving force for further modernization at all levels. At this point Western actors, including the EU with its experience in supporting transition processes, are also challenged.

A significant difference between the transition process of EU candidate states and the future neighbouring states is related to the EU's impact. The perspective of EU membership, the orientation on the *aqcuis communautaire* and annual progress reporting provide a frame for transition. Because of the Union's own interest, the candidate countries are highly supported with technical advice and technical programs. Since 1991, the Central and East European countries received € 11,880.7 million, the Balkans received € 6143.8 million while the EU's technical assistance provided to the CIS countries was limited to € 4206.1 million.

Table 5

EU assistance to Eastern Europe, 1991–2000

Region	€ mn
*Total TACIS payments to the CIS countries**	*4,206.1*
Russia	1,274.0
Ukraine	460.8
*Total PHARE payments to the candidate countries***	*11,880.7*
*Total payments to the Balkan countries****	*6,143.8*

Source: * 1991–1999 without the Baltic States;
Source: http://europa.eu.int/comm/external_relations/ceeca/tacis/figures.pdf
** 1990–2000;
Source: The PHARE Annual Report 2000;
http://europa.eu.int/comm/enlargement/pas/phare/pdf/phare2000.pdf
*** 1991–2001;
Source: http://europa.eu.int/comm/external_relations/see/index.htm

In order to overcome dividing lines, the EU has the option of strengthening its function of supporting transition processes in the future neighbouring countries.

3) European cooperation and integration

In general, the European Union is a very attractive partner for East European countries. By providing a unique combination of norm setting from the outside and membership perspective for candidate countries, the Union has a strong influence on shaping transition processes. In the same way, the EU is also very attractive for the neighbouring countries. The EU forms its policy towards Ukraine and Russia on the basis of a three-pronged approach. The Partnership and Cooperation Agreements are supposed to build the overall framework for political dialogue on various levels, as well as economic and social cooperation. Stabilization of the transition process should be reached through the technical assistance program TACIS. With the Common Strategies for Russia and Ukraine the European Union tries to weave the countries into its security and defense policy. Even if the approach contains a broad spectrum for cooperation, it does not go further in the direction of offering a perspective for membership. In comparison with South Eastern Europe and the East European candidate states, technical assistance to Russia and Ukraine is relatively low. By not conditionalizing technical assistance through membership criteria the assistance is less efficient and less effective. Among the latest EU documents, the Country Strategy Papers 2002–2006 and the National Indicative Program for Ukraine and Russia include a detailed analysis of the state of affairs, but once more restrict the framework to cooperation, and without a membership perspective.[16]

Russia's and Ukraine's positions towards the European Union are based on three modules. First of all, the countries' self-definition of belonging to Europe. Secondly, progress and problems of transition processes. In this sense the question is not up to Brussels but to Kiev and Moscow. Finally, the consequences in the aftermath of September 11 point up the significance of first and foremost Russia but also Ukraine as both partners and, at the same time, risk for Western security.

There is a significant difference between Russia and Ukraine on the first module. Russia has an internal debate about whether the country belongs to Asia or to Europe, which has been conducted since the period of Peter the Great. The discourse of intellectual history is also related to different paths of modernization, the Asian versus the European one. If one takes Putin's Western orientation after September 11 seriously, and if it is sustainable, the long debate should be decided in favour of Western modernization.[17] Nevertheless a potential turn towards the West did not go so far that Russia has declared its interest in EU membership. Since 1991, when Ukraine declared its independence, the country has been trying to consider Russian as well as Western interests. Sometimes this caused an unclear orientation in internal development and foreign relations. Nevertheless, Ukraine has declared its intention to become an EU member state. This very process began in 1996–1997 before being developed in "The Strategy of Ukraine's Integration into the EU" in June 1998 and further developed in "Ukraine's National Program on the Integration into the European Union" in September 2000.[18] The declarations describe of how Ukraine could meet EU criteria in order to gain EU accession. So one has to consider different expectations between the EU and Ukraine on how to

[16] *European Union Country Strategy Paper 2002–2006, National Indicative Program, Russia, Ukraine, 2001*.

[17] Dmitri Trenin, 'Vladimir Putin's Autumn Marathon: Towards the Birth of a Russian Foreign Policy Strategy', *Briefing Mosckovkogo Centra Carnegie*, Issue 11, November 2001.

[18] *Strategy of Ukraine's Integration into the European Union*, Decree No. 615, 1998.

shape mutual relations. Even if the Ukrainian requirements are not responded to by the EU side, some Western decision makers, for instance German Chancellor Schröder in December 2001 during his visit to Ukraine, have publicly opted for Ukrainian accession to the EU.[19]

On all three modules – transition, security and European orientation – developments within Russia and Ukraine go beyond the current EU policy. The European Union has not formulated an option of accession, because of the Union's limited capacities and capabilities, and also because of a lack of political will. Insofar as the overall aim is to avoid a new dividing line as a negative side effect of EU Eastern enlargement, an active neighbourhood policy has to be developed.[20] A new neighbourly policy should be based on the state of affairs of all three modules. In shaping security, the EU has to take Russia in particular but also Ukraine as a serious partner. The Union also has to develop mechanisms in order to prevent and reduce (soft) security risks within the neighbouring countries. The Joint Declaration on stepping up dialogue and cooperation on political and security matters, adopted at the EU-Russia summit in October 2001 in Brussels, is another step towards security cooperation. The document defines Transdniestria, the Balkans and the Middle East as areas of common security interest and opens possibilities for joint EU-Russian peacekeeping operations in these regions, under the important presumption that the EU will fulfil a new function in regional peace keeping. At this very point European integration has also to make up its deficits in the European Defense and Security Policy. The European Union Country Strategy Paper 2002–2006 makes a differentiated analysis of the current state of affairs in the Ukrainian and Russian transitions. The resulting programs continue the previous approach of supporting single reforms without having an overall master plan. On the one hand, this provides for high degree of flexibility, but on the other hand, it restricts the EU's influence. All in all, an increasing influence in Russian and Ukrainian reforms very much depends on the budgetary framework, which the EU is willing and able to offer for the neighbouring countries. The Union should also consider that stabilizing the transition decreases soft security risks, an important step towards a reliable security partnership between East and West. Active neighbourly policy would go beyond paying lip service to a Common European Economic Area.[21] An active neighbourly policy should be based on programs including funding for cross-border cooperation along the future EU border, an EU monitoring system on transition developments within Russia and Ukraine, implementing European standards through technical assistance, defining areas of coop-

[19] 'Schröder für Assozierung der Ukraine mit der EU', *Frankfurter Allgemeine Zeitung*, December 7, 2001.

[20] Iris Kempe – Wim van Meurs, 'Strategic Challenges and Risks of EU Eastern Enlargement', in *Beyond EU Enlargement*, ed. Iris Kempe, Gütersloh 2001, pp. 11–43.
Catherine Guicherd, 'The Enlarged EU's Eastern Border. Integrating Ukraine, Belarus and Moldova in the European Project', *Stiftung Wissenschaft und Politik*, Berlin 2002.

[21] EU–Russia Summit, Brussels 3.10.2001. EU–Russia High-Level Group charged with elaborating the concept of a Common European Economic Area.

eration but also of common decisions including, for instance, pan-European energy, transport and communication networks.

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II.
EU Enlargement and Contacts with Russia

EU ENLARGEMENT AND RUSSIA EXPERIENCE AND EXPECTATIONS

Urpo Kivikari*

We have no reason to doubt that future enlargement of the European Union, based on free will and decision making, is not a win-win situation to current European Union members and candidate members. But what can we presume about its implications to Russia, the most conspicuous third party in this process? What can we learn from recent history?

1) The enlargement in 1995: positive expectations and experience

In an interview published in a Finnish economic newspaper on fifth of August 1991 I expressed opinion that Finland's membership of the EC would be beneficial to our trade with the Soviet Union. The embarrassment caused by this interview was tackled in some TV programs. Also the then Prime Minister of the Soviet Union Mr. Pavlov's opinion was asked by Finnish TV. Prime Minister Pavlov agreed with me. The Soviet standpoint came as a great surprise to Finnish people. Was he right or wrong? I think we were right.

In 1995 Finland – as well as Austria and Sweden – joined the European Union. Of course, it is impossible to provide indisputable results of a comparison between reality and a fictional alternative. Nevertheless, a few remarks on actual development could be relevant.

In most years in 1990's Russian foreign trade was overshadowed by declining GDP and worsening competitiveness of domestic industries. By contrast, the Finnish economy benefited from EU membership and this was reflected in economic relations with Russia. Finland's total turnover of trade with Russia increased after acceding the EU strongly, excluding a temporary drop caused by ruble's deprecia-

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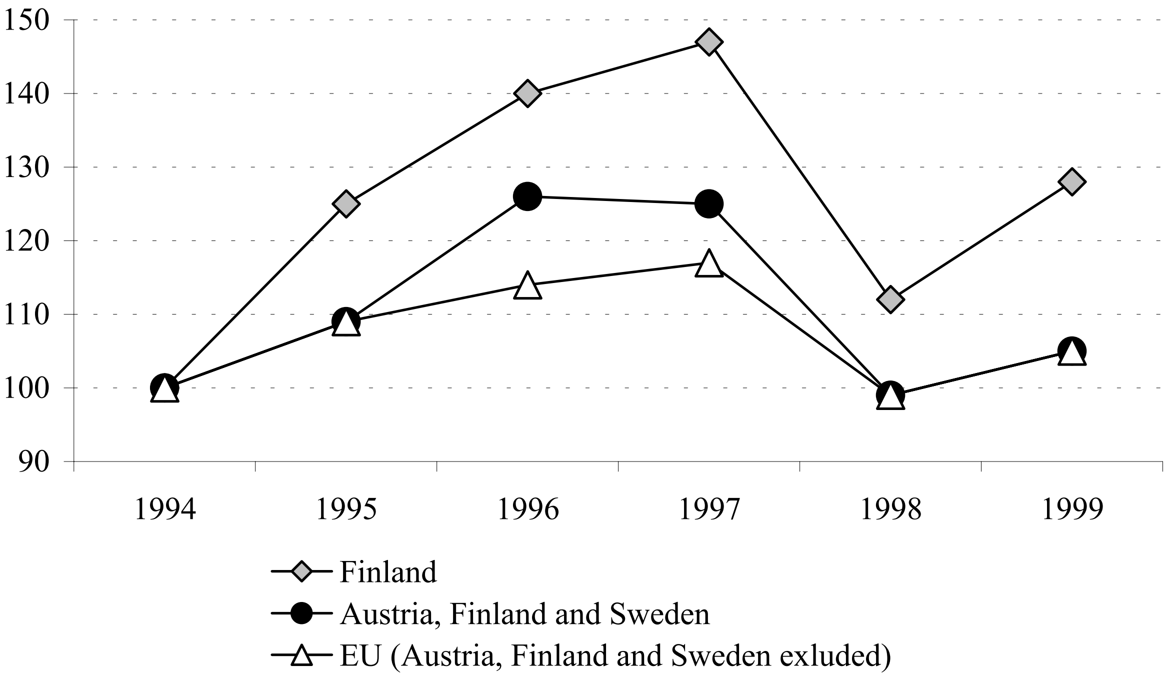
tion in 1998. Now only a small part of exports from Russia to Finland is bearing custom duties. They totalled in 1999 about 20 million FIM compared to the value of 12,7 billion FIM imports from Russia.

In the first years after Finland's joining the EU, Russia's exports to Finland developed much better than its exports to other EU member countries. The Russian exports to Austria, Finland and Sweden jointly developed quite similarly to its exports to other EU member countries (*Figure 1*).

Figure 1

The USD value of Russian exports to Finland, Austria and Sweden, and the rest of the EU, 1994–1999

(1994 = 100)



Source: Goskomstat Statistics

All three new EU member countries have been active participants in Tacis-program. They have committed themselves to promoting trade and investment and harmonious economic relations with Russia. On Finland's initiative the European Union has adopted the Northern Dimension policy, which opens ambitious vistas for cooperation between Russia and the European Union.

There is no evidence to support the view that Russia has suffered from the EU membership of Austria, Finland and Sweden.

2) The enlarged EU – a good partner for Russia

In many respects the future enlargement of the EU will be different from the previous one. But it is significant that its experiences do not raise expectations of adverse implications of EU enlargement to Russia. Even more important is that many relevant factors of coming process look beneficial to Russia:

* As an outcome of expected enlargement the European Union becomes geographically closer to Russia, as happened in 1995 when Austria, Finland and Sweden acceded the EU. While Finland is now Russia's only current EU neighbour, as many as four candidate countries (Estonia, Latvia, Lithuania and Poland) have border with Russia. The growing proximity and common border with the EU will decrease transaction costs between Russia and its most important economic partner and market area.
* Russia's economic foothold in the EU market will be reinforced and expanded by accession of countries, which are traditionally important trading partners to Russia.
* The expected economic strengthening of new EU member countries will enhance their potential as partners and markets to Russian companies.
* As a result of Eastern enlargement the cooperation with Russia in trade, investment and development of transportation and energy networks becomes more important to the whole EU.
* Market access of Russian goods and services to new member countries will be regulated by the Partnership and Cooperation Agreement (PCA) provisions. The average customs tariffs these countries charge for imports from Russia (with the exception of agriculture) will be lowered to the EU level, which will increase demand for Russian goods.
* Unification of rules and regulations in the enlarged Union will benefit Russian business interests in the entire region.

3) The Baltic Russia deserves special attention

Of course, besides benefits the EU enlargement process creates challenges for Russia to adapt to a new situation. Certainly all changes are not welcome to Russia and questions will arise, which will require detailed discussion and settlement. Trade diversion presumably will effect adversely on new EU member countries' trade with Russia.

Particularly, certain border areas deserve special attention. After Estonia's future accession to the EU, the St. Petersburg region, factually Leningrad oblast, will share a border with two EU member states. Respectively, in the future the Kaliningrad region as an enclave will be separated from the mainland Russia by forthcoming EU countries, Lithuania and Poland. People living in the Kaliningrad region visit Lithuania and Poland much more often than mainland Russia. The implementation of the Schengen system at outside borders of Lithuania and Poland, if justified and effective in the fight against crime, might cause a substantial obstacle to legal dealings, too. (*cf.* The Kaliningrad Economy at the Edge of EU Enlargement, 2002).

An integral part of the preparation for EU enlargement should be a deeper integration of the Kaliningrad region and St. Petersburg region with their neighbouring areas.

An instrument successfully implemented in Eastern Asia for international cooperation between adjoining regions is called “a growth triangle”. A growth triangle is a specific form of international cooperation, an economic zone exceeding national boundaries, and including areas from three or more countries. The experience gathered from Asian growth triangles suggests that their success is determined by the different factor endowment and geographical proximity of the participating regions, the political commitment and coordination at national and regional levels, as well as the need for common infrastructure development. A growth triangle remains an empty shell without a core unless companies are interested in the opportunities it provides.

In a close study of the preconditions and advantages a growth triangle would seem to be an appropriate instrument for further integration of the St. Petersburg region and the Kaliningrad region with their neighbouring areas. A growth triangle could be beneficial *e.g.* for lessening the friction caused by the border, deepening the international division of labour within production processes, facilitating the access to EU market, accelerating the two-way transfer of technology, attracting foreign direct investment and developing infrastructure. Naturally, the real possibilities of the growth triangles will be determined, simply, by whether all the parties involved believe that the project will yield significant benefits compared to the situation without a triangle. (*cf.* Kivikari 2000).

4) Russia as an agent in integration

The EU enlargement should not be understood only as the accession of candidate countries to the EU (*Table 1*). Besides this process, in which Russian role is to be an adjusting outsider, Russia can be an active insider in a project like the growth triangle and also in some other dimensions of enlargement, too.

Table 1
EU integration and Russia

* New members	→	EU closer to Russia
* “Growth triangles”	→	A hinge between the EU and Russia
* PCA, the Northern Dimension	→	Deepening integration
* Application of *acquis communautaire*	→	Integration “from inside”
* Euro as CIS clearing currency	→	Continental integration

Source: Kivikari 2001

Further fulfilment of the PCA between Russia and the EU promotes integration according to European standards. The Northern Dimension is part of the EU’s external and cross-border policies with a specific aim to raise the Union’s profile in Northern Europe. Under examination are the prerequisites of a new vision, namely the Common European Economic Space of the EU and Russia.

Russia, like other non-EU countries, Norway and Switzerland, could promote integration “from inside” by applying nationally EU’s *acquis communautair*e on the basis of political, economic, social, and human values, which it shares with the EU.

Another dimension of EU enlargement might be the introduction of the euro as a multilateral clearing currency in mutual trade of (some) CIS countries. After the disruption of the Soviet Union no arrangement established within CIS has been capable of fully reviving trade relations between these independent states. The decline in mutual trade, caused largely by the absence of a required payment system, has caused serious damage to all CIS national economies.

The shortage of international purchasing power was successfully solved in Western Europe by the European Payments Union in 1950–1958. The ideas of the EPU, incidentally, were subsequently successfully used within the frameworks of the Central American Clearing House, the Latin American Integration Association, the Asian Clearing Union and other organizations of multilateral trade and settlements.

The situation in Western Europe in 1950's had certain features in common with the present state of affairs in the CIS. So, the experience of the EPU could be helpful in finding a working system for the CIS.

A tentative draft and preliminary calculations for proposed clearing scheme have been developed (Shagalov–Kivikari–Brunat, 2001). The designed system could widen the international use of a new, nationally neutral European currency for the benefit of the whole of Europe.

Conclusion

The positive expectations about the impacts of previous EU enlargement in 1995 obtained an affirmation from the success of Russia's exports to the three new EU member countries experienced in the second half of 1990's. We have good grounds for assuming that economic integration will continue in Europe on a win-win basis. In many respects the expected Eastern enlargement of the EU appears advantageous to Russia, too.

Not being a candidate country itself, Russia does not have a share in the decision making regarding new members. But Russia has much room for action and reaction, initiative and innovation in finding content and dimensions for the enlargement of integration in Europe. Russia should have an important role as an agent and middleman in pan-European, factually Eurasian, integration.

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THE EURO AS A BRIDGE CONNECTING THE EU, RUSSIA AND THE CIS

Gregory Shagalov*

1. The prospect of EU enlargement to my mind does not contradict Russia's strategic political and economic interests. From a political point of view, the process of EU enlargement can be welcome by Russia since it is understood that Russia will have a reliable neighbour on the continent to the west of its borders and that the EU will be encreasingly able to adopt policies independently of the USA. It is worthy to mention that at the end of his visit to Italy, to hold talks with the Italian President (November 2000), Vladimir Putin stated particularly that Russia had a positive attitude towards EU enlargement. From an economic point of view EU enlargement in the long run will bring positive results for Russia, provided that mutual intensification of economic cooperation will be fuelled by a self- enforcing mechanism of growth and structural changes in the country.

2. In the long run Russia can be the candidate for EU membership as well as Ukraine and some other CIS states. The cooperation in the framework of the Partnership and Cooperation Agreement and the possible realization of the concept of Common European Economic Space might bring Russia closer to that membership. But before that Russia should develop its cooperation with CIS countries. That cooperation can help Russia to enhance its economic growth and productivity in the medium term.

3. Economic cooperation between Russia and CIS states has curtailed dramatically during the reforms years. The share of mutual trade between CIS countries in total CIS trade decreased from approximately 60 per cent before the start of the reforms to 30 per cent by now. Meanwhile more intense mutual economic cooperation might be the important factor of economic growth of CIS countries. CIS markets render for Russia the opportunity of increasing exports of industrial goods, which might be the factor of sustainable growth and a means of "hedging" it in a situation when energy commodity prices and world demand for oil, gas and other raw materials exported by Russia would go down.

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CIS countries have shown economic growth in recent years. According to the Interstate Statistical Committee, average GDP growth in CIS countries in 2000 was 7.5 per cent, while industrial production increased 10 per cent. CIS countries could buy considerable quantities of industrial products from Russia. Traditional ties between markets of former Soviet republics, technological similarity, and the need for spare parts and components for equipment installed in the Soviet era are all factors enhancing demand for Russian-made products in CIS states. However, still unresolved problems related to establishing a mechanism of economic integration between CIS countries impede growth of Russian exports to these countries.

In 2000, total Russian exports to CIS countries were 11 per cent lower in dollar terms than in 1997 (*i.e.* prior to the crisis), while machinery exports were 70 per cent of the 1997 level. Established economic cooperation mechanisms make it hard to overcome the long-standing stagnation of trade and economic relations between Russia and other CIS countries, since these mechanisms have failed to provide a workable system of mutual payments and settlements.

4. In our view, Russia and other CIS countries have underestimated the role of the payments system in fostering their economic relations. In particular, they failed to achieve the timely development of a mutual payments and settlement system using national currencies. This might have been due to reliance on the market to form appropriate systems on its own, without government intervention. After the break-up of the rouble zone in 1993, CIS countries agreed in September 1993 to establish an economic union, which was followed by the agreement on a free-trade zone in April 1994. However, these documents could not work without a reliable payments system.

To give them their due, CIS countries did sign an agreement on the establishment of a payments union in October 1994, a year after the rouble zone was defunct. But, in effect, this had little in common with a conventional payments union.[1] Despite a declared aim of improving the payments system, the agreement in fact brought no new features to the inefficient system, which had developed in an ad-hoc manner, effectively without intervention from CIS national banks.

The inefficiency of the system has been clear in the seven years since 1994. The current system of payments uses hard currency as well as the rouble and, to some extent, national currencies of other CIS countries. Up to 40–50 per cent of payments are in barter. Given the shortage of hard currency and roubles faced by most member countries, the weakness of the majority of national currencies, and the economic flaws of barter, it is clear that such a system is incapable of providing efficient maintenance and development of trade and economic relations between the Commonwealth countries. Nor can it secure essential expansion of Russian exports to the former Soviet republics. The established system of payments effectively hampers development of economic cooperation between Russia and other CIS countries.

[1] An example of a classical payments union is the European Payments Union, the operation of which is described in *European Payments Union* (1953). See also Kaplan J. *et al.* (1989).

5. Our analysis shows that there is a need to replace the current system of payments by a multilateral clearing system. Such systems have been successfully used as part of the European Payments Union (EPU) and payments unions employed by developing countries in Latin America, Asia and Africa.

Such payments unions, past and present, have been based on the concepts of J. M. Keynes, who recognised the need for government involvement in regulating international payments and settlement systems.[2]

Now is probably a more favourable time to introduce a system of multilateral settlements, than, let us say, in 1994, when the agreement on establishing the CIS Payments Union was concluded. Relatively tight financial and monetary policies pursued by most CIS countries since 1995–1996 resulted in substantial deceleration of inflation, which made trade of CIS countries more balanced.

6. A few years ago some Western experts viewed excessively soft monetary policies in Russia and CIS countries as the main obstacle to a multilateral clearing system, modelled on the EPU (see for example Eichengreen, 1993). But in recent years a number of Western experts have supported a system of payments based on EPU concepts as suitable for CIS countries (see Daviddi R. *et al.*, 1996). In their view, the use of such a system could pave the way for addressing long-term issues, such as restructuring of the national economies of CIS countries.

In our view, a system of multilateral mutual payments for CIS countries should draw on the experience of the EPU and the payments unions of developing countries. Such a system would be based on multilateral clearing and a system of partial crediting of the clearing balance.[3] A multilateral payments system (MPS) between CIS countries could be used for several years, after which the countries could adopt a new system of payments based on national currencies or extend the MPS for a number of years, basing their decision on economic conditions and mutual cooperation.

Such a system should, firstly, reduce the cost of handling trade between CIS countries, which is extremely important given the lack of roubles and hard currency in these countries. Secondly, it would be more beneficial than the current system, both for countries with a trade surplus and those with a negative trade balance. The new system would enable the former countries to automatically receive a portion of their trade balance surplus in hard currency, whereas under the current system the trade surplus is entered in the accounts as a credit. The latter countries would automatically obtain a credit on a portion of the negative balance. Thirdly, such a system would allow national currencies to be used in trade. Fourthly, by eliminating the need for bilateral balancing of merchandise flows, it would secures

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[2] Keynes J. M. (1943). The prominent J.M. Keynes's follower R. Triffin participated in the elaboration of regional payments unions in Latin America and Asia. See Triffin R. (1966).

[3] Originally, the idea of the MPS was proposed by the Market Research Institute of the Russian Academy of Sciences (N. Petrakov, G. Shagalov *et al.*). The project is being developed by Russian, French and Finnish experts.

the multilateral nature of settlements between CIS countries, substantially enhancing their ability to develop mutual exports and imports. For all practical purposes, national currencies would become mutually convertible within the framework of multilateral trade settlements.

7. The first question to be answered, if payments union principles are to be used for clearing between CIS countries, is which currency will be used as the accounting currency. The reliability and workability of the entire system depends on the right answer to this question. In principle, either national currencies, specially selected hard currencies, or a basket of currencies constructed from national currencies could be used.

Given the weakness of all, without exception, CIS currencies, the most acceptable option is the use of a hard currency and, in our view, the most acceptable convertible currency is the euro. The euro is the currency which is used for trade in the greater part of Europe. EU countries are the most important trade partners of Russia and most other CIS countries. Besides, the economic development strategies of Russia and several CIS countries will be determined by closer cooperation with the EU or accession to it.

It has been argued that the Russian rouble should be used as an accounting currency for the CIS. However, a thorough analysis refutes this view. First, the rouble has no long-standing history of financial reliability: only three years have passed since the financial and banking crisis in Russia. Second, the currency of a country with 20 per cent annual inflation cannot be regarded as stable. Such a currency cannot serve as a store of value.

8. After deciding on the accounting currency, the following mechanism of settlements within the CIS could be used: exporters and importers in CIS countries deal directly with national currencies. Importers who wish to buy goods in a particular CIS country use their national currency to buy national currency of the exporting country via the banking system. And, *vice versa*, exporters from a particular CIS country sell their goods to other CIS countries for their own national currency, which the importer has bought on the currency market in his home country.

Based on the results of mutual exchange for a certain period (let us say a month or two weeks) mutual claims and liabilities are offset to the greatest possible extent according to the principle of a clearing pool. Under the clearing pool arrangement, bilateral claims and liabilities of each country with respect to all other countries are totalled for a net balance to be calculated. Each country has one balance *vis-à-vis* the MPS system.

To calculate a net balance is to identify the settlement position of each country with respect to all other members of the system, *i.e.*, with respect to the MPS as a whole. So the single net clearance balance (whether it shows surplus or deficit), calculated for each member, is settled between the balance-holder and the MPS rather than with each individual country.

9. The procedure for each individual member's settlements with the MPS could use a special limit or a quota, which is set for that member country. Quotas would be assigned as a percentage of the volume of each MPS member's trade with all the other member countries and calculated in the accounting currency.

A concrete procedure for settlement of the balance would be determined depending on the ratio between the quota and the balance calculated as a total. The general principle according to which the balance is settled is that a part of the deficit of a country is covered by credits from the MPS, and the remaining part by hard currency. Similarly, a part of any surplus is settled with the proceeds of loans extended within the MPS, and the other part by hard currency.

10. For the MPS to operate smoothly, a special currency reserve fund, similar to the one that existed within the EPU and other payment systems, should be established to regulate relations between individual creditor and debtor countries, on the one hand, and the system as a whole, on the other hand. In our view, the establishment of such a fund would be crucial for multilateral settlements to succeed in stepping up integration between CIS countries. The first priority here is to determine the size of such a fund. This would in many respects predetermine the procedures for its accumulation.

11. The mechanism of trade balance settlement could operate as follows: If the balance is negative, 80 per cent of a portion of the balance equal to the first 20 per cent of the quota (first tranche) is settled using loans from the MPS, and the remaining 20 per cent of the balance is settled using payments in hard currency. As the negative balance is settled further, the share covered by credit decreases, while the share of hard currency payments increases. Thus 60 per cent of the second 20 per cent of the quota (second tranche) is settled using loans from the MPS and 40 per cent is settled in hard currency paid to the MPS. As a result, when the quota is used in full, 60 per cent of the balance is settled in hard currency, while the remaining 40 per cent is entered in the accounts as a credit. If a negative balance exceeds the quota assigned to a given country, the entire amount in excess of the quota is paid in hard currency to the MPS. The system of settling a negative balance, by which the share paid in hard currency augments, should put a lid on excessive growth of an MPS member country's negative balance and encourage this country to develop exports, while restraining imports.

Conversely, any surplus is settled using a procedure, where the share paid in hard currency rises with an increase in the surplus. Hence, 80 per cent of the first 20 per cent of the quota is covered by a credit from the MPS surplus holder, while the remaining 20 per cent is settled in hard currency. Then 60 per cent of the second 20 per cent quota is entered in the accounts as a credit from the MPS, with 40 per cent settled in hard currency. When the quota is used in full, 40 per cent of the settlement balance is covered by credits with the remaining 60 per cent settled in hard currency. The mechanism for settlement of deficits and surpluses used in our experimental calculations is shown in *Table 1*. Of course, other mechanisms could also be used. In particular, the EPU used somewhat different mechanisms.

Table 1
Mechanisms for balance of trade settlement in the proposed CIS multilateral payments system

Quota portion	Settlement portion	
Creditors	Paid to the creditor in euros by the payments union	Credit provided by the creditor to the payments union
First 20% portion of the quota	20%	80%
Second 20% portion of the quota	40%	60%
Third 20% portion of the quota	60%	40%
Fourth 20% portion of the quota	80%	20%
Fifth 20% portion	100%	-
When the quota is exceeded	60%	40%
Debtors	Paid by the debtor in euros to the payments union	Credit extended to the debtor by the payments union
First 20% portion of the quota	20%	80%
Second 20% portion of the quota	40%	60%
Third 20% portion of the quota	60%	40%
Fourth 20% portion of the quota	80%	20%
Fifth 20% portion	100%	-
When the quota is exceeded	60%	40%

12. According to our estimates, the size of the reserve fund that would be needed for the settlement is about 900 million euros (*i.e.* about USD 800 million). Finding sources of financing for the reserve fund is a problem. In our view, 50 per cent of the required amount could be provided by CIS countries, while the remaining 50 per cent could be loans from the European Union. In this case Russia would have to contribute about 250 million euros to the fund over the whole period of its operation, which it can cope with. It seems that other countries could also find funds to make contributions to the MPS. For example, Ukraine would have to contribute 70 million euros and Kazakhstan about 17 million euros (if EU countries support the project, some CIS countries would be likely to obtain certain amounts by signing bilateral credit agreements with the EU).

13. It should be emphasised that Russia's contribution to the MPS reserve fund would be an efficient tool for expanding Russian exports to CIS countries. The use of a multilateral settlements system would give an additional impulse to Russia's economic growth and substantially promote demand for Russian industrial products from CIS countries.

In principle, the use of a multilateral settlement system would be most beneficial for countries with the greatest potential for production and export of industrial products, or of so-called soft goods (*i.e.* goods not easily saleable on the world market). It should be noted that CIS countries spend their limited hard currency and rouble reserves to buy fuel and raw materials, which they lack, and other hard goods (*i.e.* goods easily saleable on the world market). There is little foreign currency left to buy soft goods, and in most cases these countries are unable to buy any goods for their national currencies. The multilateral settlement system would make purchases for national currencies possible.

14. The proposed system would be most beneficial for countries that could secure a considerable share of industrial products, primarily machinery, in their exports. Hence, it can be assumed that such countries as Russia, Ukraine and Belarus, which traditionally supply considerable quantities of industrial products to the markets of the former Soviet republics, would benefit most of all. Machinery represents 17–18 per cent of total Russian exports to CIS countries. For Belarus this figure exceeds 30 per cent and for Ukraine it is approximately 16 per cent.

Exporters of metal products, chemicals, clothing, footwear, food and agricultural products would benefit from increased demand, while importers would be able to buy these products for their national currencies. The system would also offer more efficient settlements to exporters of energy and raw materials. In this case only a small share of goods within the established quotas would be explicitly supplied on credit, while the rest of the goods would have to be paid in full.

It should be noted that in principle this system could also be used in a truncated form, applicable only to soft goods. In this case the size of the reserve fund would decrease drastically.[4]

15. The proposed system of payments and settlements for Russia and the CIS involves many different actors with their own interests and, though beneficial for all participants, its implementation would obviously require strong political will and support from all participating countries. We think that it would be no tragedy if some of the 12 CIS states failed to participate in the MPS, but the inclusion of core countries such as Russia, Ukraine, Belarus, Kazakhstan, and some others is crucial.

16. This system would not only benefit CIS countries, but could also provide certain economic advantages to EU countries. First, the use of the euro in the huge Eurasian space would strengthen the position of the European currency in the world monetary system. Second, the development of mutual trade between CIS countries could influence possible pressure on Western markets from Russian exports and other CIS countries. Third, geopolitical considerations provide additional arguments for expanding economic ties between CIS countries. Development of mutual trade and economic relations would pave the way for stabilisation of the

[4] Such a clearing system was used within the Asian Clearing Union. The possibility of using a truncated form of MPS for soft goods was pointed out in the article of Sitaryan S. *et al.* (1999).

social and economic situation in these countries, *i.e.* in the region adjacent to the European Union. This is why we believe that the idea of the MPS deserves EU support.

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A RUSSIAN VIEW ON HUNGARY'S ACCESSION

Ruslan Grinberg*

From the end of the 1960s Russian scientific community followed with a lot of attention and much sympathy how their Hungarian colleagues implanted market mechanisms into a planned economy first and later carried out a systemic transformation. That is why Hungary is something more than just another transitional economy for us. In connection with this I would like to divide my speech into two parts. First, I will discuss the most recent state of Russian–Hungarian relations in the light of Hungary's accession to the EU. Second, I would like to share my ideas with you about the qualitatively different ways of Hungary and Russia participating in the globalization and regionalization of world economy.

1) Russian–Hungarian relations in the light of Hungary's accession to the EU

In the 1990s, after the transformation, the flow of goods between Hungary and the developed countries, first of all the EU, was the most dynamically developing area of foreign trade while the share of former socialist countries, including Russia, was steadily declining. For example, in 1989 the latter amounted to 44 per cent of Hungarian exports (more than 50 per cent in the 1970–1980s), and the share of Western countries was 49 per cent (40 per cent in the 1970–1980s), including 27 per cent of the EU. By the year 2000 the situation dramatically changed: the share of the developed countries reached 84 per cent, including the 75 per cent of the EU, and the share of former socialist countries (without the former USSR) dropped to 13.8 per cent. The members of the CIS accounted for 2.5 per cent (without Russia only 1.6 per cent).

After signing the accession agreement for the period of 1993–2000 the total amount of exports increased 3.1 times, and exports to the EU 5.2 times. The rapid integration of Hungarian economy with the EU was reflected in the higher rates of

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trade growth as compared to other countries, in the increasing share of manufactured goods as a result of developing cooperation with the leading EU companies and in the big inflows of foreign capital, which contrasted sharply with Russian–Hungarian trade turnover dynamics: between 1990 and 1999 it declined almost twofold, let alone the Soviet times. It can be explained by the decay of the Soviet Union and the crisis in Russia.

Table 1

Trade turnover between Russia and Hungary, 1990–2000

(USD mn)

	1990	1993	1995	1999	2000
Turnover	5500	3342.6	2662.6	1987.7	3044.0
Russian Exports	2490	2399.3	1839.8	1631.1	2588.6
Russian Imports	3060	945.0	822.8	356.2	455.4
Balance	570	-1452.6	-1017.0	-1274.9	-2133.2

Source: Russian and Hungarian foreign trade statistical yearbooks for respective years; Magyarország Külgazdasága 1999 és 2000.

In the beginning of the 1990s when the relations between Russia and Hungary broke down Russia was preoccupied with its domestic problems. Decay of the Soviet Union and the economic crisis that followed objectively limited our links with Hungary. Hungary, too, experienced an economic crisis, after which it decisively shifted its policies towards the Western countries. There was a certain euphoria in the country in connection with such a reorientation.

As to Russia, apart from the economic problems, there were a number of factors that hampered the development of Russian relations with East and Central European states, our former main allies, including Hungary. Namely the lack of a clear concept of developing relations with these countries in the new circumstances, taking into account the long-term economic and political interests of Russia in the region, is in question. Working out such a concept could help create conditions to secure Russian interests more consistently in Eastern and Central Europe in general, and in Hungary, in particular, at the same time showing our partners the prospects of our relations.

The political reason of our loosening links with Hungary was its joining the NATO and – *de facto* – the EU (the share of the EU in Hungarian trade is higher than its share in the trade of EU members) –, the fact that for a long time was negatively evaluated by Russia. Now, when the Russian President declared that the EU occupies the first place in the system of Russian foreign and economic relations priorities, Russian cooperation with Hungary could and should be built on new realities to develop in a more positive way. Increased technological potential and the coming of leading transnational companies to Hungary can be of interest to Russia as well. On the other hand, Hungary today – the country that has the most successfully adopted to the new conditions and where the considerable inflow of foreign capital helped modernize the structure of industry – is more cautious in assessing the prospects of its relations with the West. It was believed for long that all problems could be solved with the help of Western resources. Now it is stressed that the bias of production and trade in favour of one group of countries (as it was the Soviet Union before, now the EU) leads to a certain dependency. This is why recent Hungarian documents devoted to foreign economic strategy declare the necessity to diversify foreign trade, including paying more attention to adjacent countries. At the same time, Russia is slowly emerging from the crisis and this creates economic prerequisites for a more active development of Russian–Hungarian relations. The political climate has warmed as well: the meeting between the Russian President and the Prime Minister of the new Hungarian liberal government showed that there is a political will in this respect on both sides.

Taking into account all the above, the relations between Russia and Hungary in the context of Hungary's accession to the EU should be developed in the following way. First, it is necessary to work out a concept of relations between Russia, and East and Central European countries, including Hungary. It should take into account new realities, such as the increasing role of the EU in Europe and Russian long-term interests, both political and economic, in the region. Politically, it would improve our position in relation to the EU and eliminate the remaining annoyance of East and Central European countries about Russia's negative attitude towards their accession to the EU and the NATO.

Second, as far as economic issues are concerned, two main trends of our cooperation with Hungary should be noted. On the one hand, it is important to establish links with multinational companies operating in Hungary. Considering that enterprises with foreign capital account for 80 per cent of Hungarian exports and the majority of them function as branches of large multinationals, three-party cooperation with Western firms actively operating in Hungary seems to be a viable perspective. Especially when their long-term strategy is to enter not only the East and Central European but the Russian market as well. Some of those companies could – with the stabilization of political and economic situation in Russia – invest into the Russian economy (supply from Hungary might include *e.g.* Audi motors, Siemens energy equipment, IBM components for computers, *etc.* for assembly in Russia).

On the other hand, the interests of purely Hungarian businesses (especially in traditional industries such as meat processing, pharmaceuticals, *etc.*) to strengthen their position in the Russian market before joining the EU should be used. They could invest into establishing trade houses in Russia (for consignment and wholesale trade). There are already examples of such cooperation available. Gedeon Richter, the famous pharmaceutical firm, has established a network of consignment warehouses, concluded agreements on direct links with pharmaceutical departments in a number of Russian regions, and opened a joint enterprise in Egorievsk (the largest Russian–Hungarian enterprise).

In order to promote Russian manufacturing in the Hungarian market it is necessary to implement an active marketing strategy. For example, there are certain interests in Hungary in some types of Russian products subject to a proper price policy (Gazel cars, tractors, metal-cutting lathe, instruments, *etc.*).

During the meeting between Russian President Vladimir Putin and Hungarian Prime Minister Péter Medgyessy the desire to expand cooperation between Hungary and Russia was expressed. But in order to implement it there is a need for a day-to-day thorough work of both parties concerned to create real conditions for developing such a cooperation in production, trade and finance.

2) The Hungarian and the Russian way of integration into the European and the world economy

Let us discuss now, why the Hungarian way of integration into the European and the world economy is different in principle from the Russian one. As for the regionalization of the world economy, which can be regarded as a specific way of its globalization, it is appropriate to emphasize the significance of the European Union in this matter. No doubt, over the next ten years the majority of countries in Central and Eastern Europe will become full members of the Union. It means that even now, adjusting themselves to the EU requirements concerning various aspects of life, they participate in globalization, so to say, on a collective basis. This circumstance qualitatively distinguishes their position from that of the countries of the CIS in general, and Russia in particular.

What I mean is that due to the oligopolization of market structures and in connection with the factual adoption of the norms of the powerful geoeconomic and geopolitical centre by the CEEC (Central and Eastern European countries), their destiny is actually predetermined – in the sense that their economies are already built in firmly enough within the European integration processes with more or less definite prospects. Experiences of Spain, Portugal and Greece testify the fact that in general these prospects are favourable. Firms of the CEEC will have to act only as objects of the oligopolization of market processes. In other words, structural shifts in these countries' economies will be determined by decisions made in the headquarters of transnational corporations. National firms become parts of transnational corporations with all ensuing consequences for employment, economic growth, structure of foreign trade, *etc.*

In this context it seems to me possible to single out the specific "Hungarian variant" of integration of post-socialist national economies to the European economic space. I mean Hungary's evident advancement on the attraction and use of foreign direct investment, as well as the participation of non-residents in the privatization of the bank and real sectors of the country's economy during the last 2–3 years. The share of foreign capital in the Hungarian economy exceeds average

West European standards, amounting to about 60 per cent in the manufacturing industry and almost 70 per cent in the bank sector (see M. Usievich, 'Hungary: Decade of Reforms', *Modern Europe*, 2000, No. 4, p. 76.). Apparently, there is a direct link between these developments and halting the tendency towards de-intellectualization of labour and primitivization of production. For the first time in the years of system transformation in Hungary the share of finished goods in aggregate exports has been increasing and the share of high-technology production growing notably, which is almost completely due to the local branches of transnational corporations and enterprises where foreign capital prevails.

In my opinion, all the Central and Eastern European applicants for accession to the European Union follow suit, with national firms becoming parts of transnational industrial complexes. I am far from either idealizing or demonizing the Hungarian variant of involvement in international integration processes. Its implementation might be rather painful even for Hungary which, due to different factors, appeared to be better prepared than others to structural shocks connected with transformation of a command economy into a market one. But, *ceteris paribus*, there is no guarantee that this method of modernizing economies of post-socialist countries in Central and Eastern Europe will allow these countries to catch up with the desirable West European standards. Anyway, they have made the step that determined their strategic orientation.

Though with a risk of simplifying the situation, I would like to note that it is somewhat similar to the "dissolution" of the GDR, where the vacuum of institutional "systemlessness" was almost in a moment filled with the legal and organizational norms of a more viable civilization. Certainly, there are some differences. In the countries of Central and Eastern Europe this process will take a longer time and will always manifest itself in a considerably milder form. It is well known that the European Union, unlike Germany which was interested to achieve the country's unification as soon as possible regardless of all costs, demonstrates no eagerness to accept new members fast merely for economic reasons. Besides, it is necessary to take into account the difference between the outcomes of the adoption of one country's institutions (like in the case of Germany) and the norms of an intergovernmental association, however integrated it might be. It is clear that in the first case the effectiveness of reforms is unambiguous and easily predicted, while in the second, one has to deal with the "zigzag" tendency.

Nevertheless, this analogy is essentially justified. In both cases reforms are planned in details and their mainstream is definite. If we compare the CEEC to trains, we can say with certainty that we know not only their destination but also their schedule. Most likely these trains are not to be running exactly according to schedule, but the course will remain unaltered. Growing inertia, the support of the EU authorities and the responsibility the CEEC assumed will not let them deviate from their course, and inevitable difficulties and failures of national policies "on the way to Europe" will be compensated somehow by the universal "Brussels" norms, which gradually take root in Eastern Europe.

Situation in the independent states formed on former Soviet territory, first of all in Russia, is essentially different. Russia's integration to the world economy now in the process of globalization is going on intensively enough. But this process is developing almost absolutely spontaneously for the time being.

General statistical indicators are the evidence of the fact that in the course of system transformation Russia has seriously advanced the internationalization of its economy, as a sharp increase in its foreign trade quota proves. The striking fact is that nowadays Russia surpasses the USA as to the country's involvement in international trade. In 2001 more than one third of Russia's GDP was realized through the export sphere, while in the USA this figure did not exceed 10 per cent. By the way, in the USSR the export quota never exceeded 10 per cent, also. The same is the situation in the sphere of imports: in 2000 in Russia the import quota amounted to about 20 per cent, while in the USA it always makes up 12–14 per cent.

However, one should not be misled by these figures. The point is that in 1990s GDP in Russia declined much faster than foreign trade turnover. Given an abrupt reduction of home production and consumption, the country's foreign trade turned into a determinative of economic activity only due to the unprecedented export orientation of extractive industries (20–80 per cent of extracted fuel and raw materials are now being exported). They account for more than three-quarters of Russian exports, while the share of finished goods is small and keeps on decreasing. For instance, today the share of machinery and equipment in Russian exports is only 10 per cent.

What are our nearest prospects? To all appearances, the present Russian authorities adhere to the view that the positive tendencies of economic development in 1999–2000 (when the country's GDP increased by almost 10 per cent) can be maintained exclusively by the means of normalizing the investment climate and pursuing the course of the state's withdrawal from the economy.

First, it means that in addition to the realization of principles of the Washington Consensus the government should concentrate on completing the reforms in legislation adequate to a civilized market economy. Secondly, the state authorities should take measures aimed to suppress the so-called informal, *i.e.* illegal economic relations and accordingly to create conditions for equal application of legal norms to all physical and juridical persons. Special attention should be paid to the observance of property and contract rights, as well as to the significant limitation of the "economy of preferences and privileges" blossoming in Russia. Thirdly, according to the view dominating Russian authorities, special importance is attributed to the measures directed to reduce the tax burden imposed on investors in combination with the course for gradual individualization and privatization of the social sphere.

If the concrete policy is limited to these tasks – from my point of view, they are absolutely reasonable except for the antisocial orientation of the "social" policy – and, if we assume that besides an almost five-fold devaluation of the rouble and a sharp increase in world oil prices, certain factors (in my opinion, only mystical ones for the time being), independent of these unexpected stimuli, contribute to the long-awaited economic growth, the Russian economy will undergo a process only slightly resembling the Hungarian variant of integration to the world economy.

The only thing in common is that the Russian economy will also be structured spontaneously and partly according to the interests of transnational corporations, provided that the present degree of its openness is preserved.

The spontaneity of shaping the economic structure in Russia has no limitations, for, as distinct from the CEEC, Russia is not likely to adopt the institutional norms of the European Union. It is necessary to understand that its economy, like other post-Soviet countries' economies, becomes an object for other, more powerful economic players – without any chances for the EU institutional and legal framework to root there. Even Ukraine, let alone Russia, is too big to fit into this framework, whatever the attitude towards it might be – hatred, admiration or cold indifference.

This results in a number of circumstances hindering the formation of a desirably civilized market economy. I would only like to note that the tendency of primitivizating the Russian economy under the circumstances becomes irreversible, even if a great progress is made in the observance of laws and the stabilization of conditions for business activities. Even if the positive economic dynamism is maintained, the decisive contribution to it will be made by the extracting industries, having an export potential, while a significant part of the manufacturing industry will lose all its chances of survival.

There is still a real alternative to this scenario. It is based on the activization of available research-and-production potential in order to achieve and maintain an acceptable international level of competitiveness in selected branches and sectors of the economy. It is clear that progress in this direction implies the development and implementation of an appropriate structural and innovation policy. I believe that only under these conditions is there a chance for the conscious structuring of post-Soviet space or at least most part of it. In other words, the real preconditions for transformating the amorphous CIS into a viable regional block will arise only when the pleasing dreams of reintegration are replaced by concrete tasks, arising from a concrete collective interest.

If Russia initiates a comprehensive programme of restructuring the post-Soviet economy on a basis of carefully chosen priorities and the wide spreading of modern technologies, this interest will spring up without any coercion. I would designate the creation of a group of concerned CIS countries with the purpose of organizating and developing their own competitive transnational corporations or financial and industrial groups (now virtual), able to participate in globalization as subjects, not objects, as a collective interest.

I shall not undertake to predict which scenario will develop in Russia. For the time being the chances of both variants can be considered equal. However, time is not on the side of the second one, because the country is still at the crossroads, making no headway, while the chances for implementating this scenario are continuously worsening.

* * * * *

III.
Russian Firms in the European Space

Development and Integration Processes in Eurasia, and the Role of Hungary

László Kapolyi*

1) The integration process

Inhomogeneity represents one of the main motive powers in the world economy. It is manifested in the parameters of the different countries in Europe and the world, for example in the location of natural resources, the density of technological development, the population, food production – just to name a few. This inhomogeneity underlines the importance of the integration process in terms of transfer and transport processes, for example energy policies, and especially the importance of economic integration. The international division of labour and cooperation will promote the development of the world economy.

There is no other alternative to the rational integration of national economies if political cooperation and peace is to be promoted. Economic integration based on economic interests is much more important than disintegration based on political slogans.

1.1. The "Eurasian trio": the EU, Russia and China

The past ten years have brought significant changes in the geopolitical situation of the world. The once bipolar structure of the cold war followed by the unipolar US-centred formation has turned into a multipolar world with the development of the European and Chinese economies and identities. We have witnessed rapprochement between Russia and China, Russia and Europe, and between some European countries and China leading to the evolution of a "Eurasian trio" of Europe, Russia and China. In the aftermath of the tragic events of 11 September, the United States realised that the traditional unilateral approach should be replaced by multilateral politics.

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China is already a member of the WTO; Russia is soon to become one, which would facilitate the integration processes in Eurasia and encourage foreign investments in Russia and China. The unification of energy and information systems in Eurasia would not only provide the technological background of integration, but it would also become the motive power of the process.

1.2. The enlargement of the EU

Certain very important dilemmas and questions need to be clarified. Whether to apply merely the Copenhagen criteria *i.e.* the strict implementation of the *acquis communautaire* or political criteria as well; should candidate countries be considered on the basis of individual merits or should the EU go for the "big bang" approach; should enlargement take place with or without Romania and Bulgaria? How to moderate the gap (economical, social, technological) between the first and lucky group of the enlargement, the other candidate countries and the "outsiders"? EU enlargement will certainly require strengthening cross-border cooperation, regional integration and infrastructural development.

The role of Ukraine is another important consideration. It will serve as a bridge between the European Union and Russia (Corridor no. 5).

2) The EU–Russia relationship

The tragic events of 11 September and the perspectives of enlargement have brought a new quality of relationships between the EU and Russia. A stable, democratic and prosperous Russia anchored in a united Europe free of new dividing lines is essential to lasting peace on the continent. Therefore Russia is to be integrated into a common European economic and social space (the Union is already Russia's main trading partner and Russia provides a significant part of the Union's energy supplies). Improved cooperation between the EU and Russia will ultimately strengthen stability and security in Europe and beyond.

A closer relationship between them is all the more important as they are faced with common challenges on the European continent:

Their geographical proximity and growing interdependence calls for more intensive exchanges between the Union and Russia. They share common interest in the development of their energy policies to improve the exploitation, the management and the sustainable use of natural resources, the security of supplies and the management of nuclear waste.

All this can be supported by regional and cross border cooperation (*e.g.* in Kaliningrad – in the view of EU enlargement) and infrastructure development (working towards linking the Russian transportation system – road and rail – with the Trans-European corridors). A free economic zone at the meeting point of the Subcarpathian region, North-East Hungary and North-West Romania (Transylvania) can also play an essential role.

The EU supports Russian efforts to meet the requirements for WTO accession.

2.1. The EU–Russia energy dialogue

Let me move on to a specific aspect of EU–Russia relationship, *i.e.* the EU–Russia energy dialogue which started at the EU–Russian summit in Paris, on 30 October 2000, and is based on the recognition of long-term and mutual interdependence of the EU and Russia in the energy sector.

The commitments achieved through this dialogue in the energy sector could serve as a model for other sectors.

Four thematic working groups have been set up:

* The first group focuses on energy strategies and balances. It is to give an overview of the energy situation in Russia and in the European Union up to 2020; the EU's experience of gradually building an internal energy market provides a useful pool of knowledge appreciated by the Russians.
* The second group works in the domain of technology transfer and energy infrastructure: the objective is to facilitate technology transfers by European energy companies, concentrate on the upgrading of the existing energy transportation network, the production technologies for hydrocarbons (Northern Russia), coal and electricity, with particular emphasis on clean technologies and environment; consideration needs to be to the development of interconnections between Russia, the EU and the candidate countries given in the electricity sector.
* The third group deals with investments. Facilitating technology transfers by European energy companies is in the focal point; huge investments are needed in the energy sector at approximately 600 billion used up to 2020.
* The fourth group is concerned with energy efficiency and environmental issues.

I would now like to present a few statistical facts that lie in the background to this evolving dialogue:

(1) The EU currently imports 50 per cent of its energy requirements. This dependence is expected to increase to 70 per cent over the next 20 to 30 years. It will mean an increase in the imports of:
   * oil from 76 to 90 per cent;
   * gas from 40 to 70 per cent; and
   * coal from just over 50 to more than 70 per cent.

It is not likely that this global picture of the EU's growing energy dependence will change after the enlargement.

(2) The energy sector in Russia offers ample opportunities for foreign investment estimated at 460 billion to 600 billion used up to 2020 including:

* 100 billion used in the gas sector;
* over 150 billion used in the oil sector;
* 200 billion used in the electricity sector;
* 60 billion used in the nuclear sector.

(3) Russian energy exports account for 45 per cent of the total value of exports to the EU:

* 53 per cent of Russian oil exports were to the EU (1999);
* 63 per cent of Russian natural gas exports went to European countries (2000); 56 per cent of the natural gas exported to Europe was made to the EU.

(4) In EU imports:

* 21 per cent of total net EU oil imports in 1999 came from Russia representing 16 per cent of total EU oil consumption;
* 41 per cent of EU gas imports in 2000 came from Russia accounting for 19 per cent of total EU gas consumption.

3) The role of Hungary in the Eurasian integration processes

And last but not least, what role can Hungary play in the Eurasian integration process? This question can be answered in the light of the double inhomogeneity that exists between the East and the West:

* In the East there are significant surpluses of natural resources whereas the West has to face big deficits compared to the demand in this field.
* At the same time the West has accumulated a wealth of capital resources looking for investment opportunities as well as know-how enabling modernisation; while in the East the entire energy system has to be modernised and it requires enormous capital investments.

Integration has affected the energy systems and the information systems alike, providing the technological background for the information society in the 21st century.

In both respects, its geographical position and geopolitical conditions destine Hungary to play the role of a transit country: significant potentials lie in our infrastructure, especially our transmission systems, national grids, crude oil and natural gas pipelines, railways and highways.

* * * * *

Conclusions

What conclusions can we draw for the triangle of the EU, Russia–Ukraine and Hungary?

Cooperation between the EU and Russia is essential to build up a competitive energy market in Russia and Europe in compliance with international standards. Prices are to be gradually normalised and reduced on a consolidated market.

It is important to improve Russian exports potentials to Japan, China, the Balkan area and Europe.

Neither Europe nor the industrialised far East can satisfy their growing energy demand unless cooperation enables them to rely on Russian energy sources.

Hungary and Ukraine can play a key role as transit countries offering their infrastructure potentials, their transmission systems, national grids, oil and gas pipelines, railways and highways, thus facilitating cooperation between the EU and Russia.

Figures

Figure 1

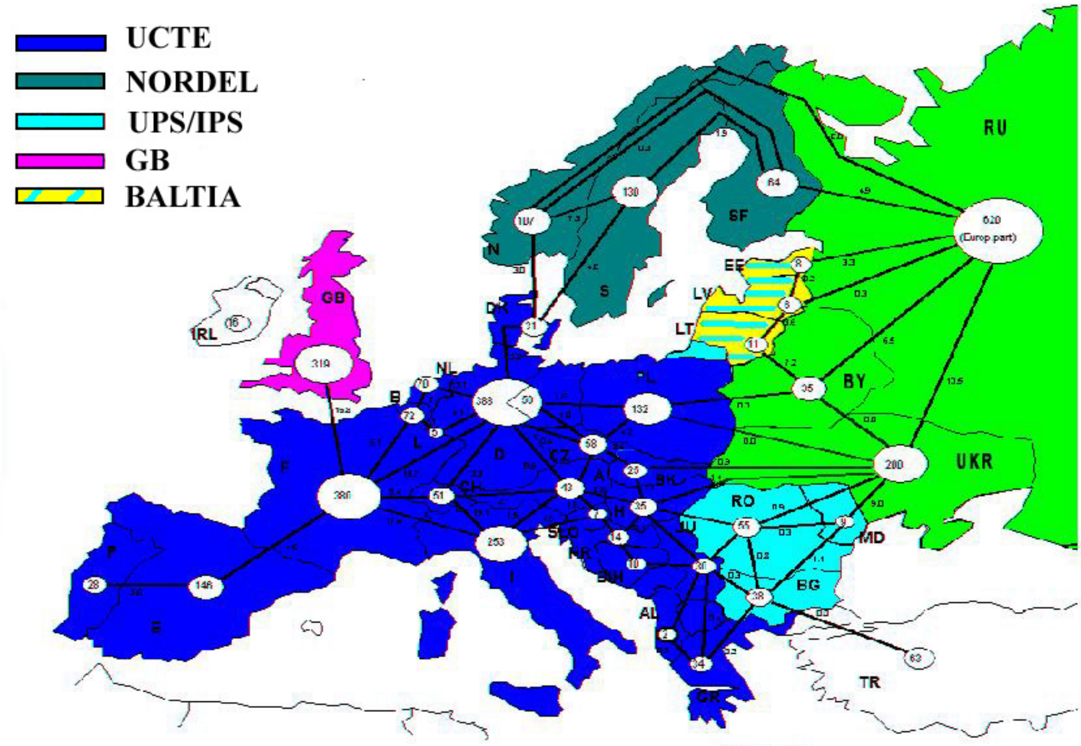


Figure 2

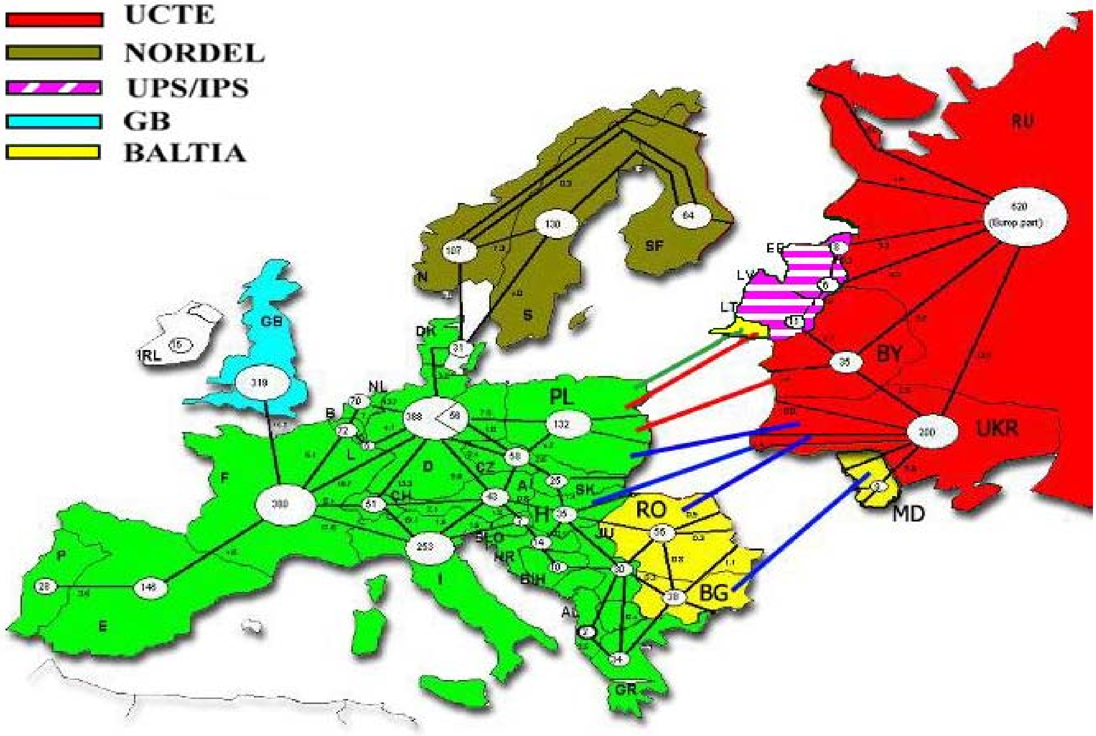


Figure 3

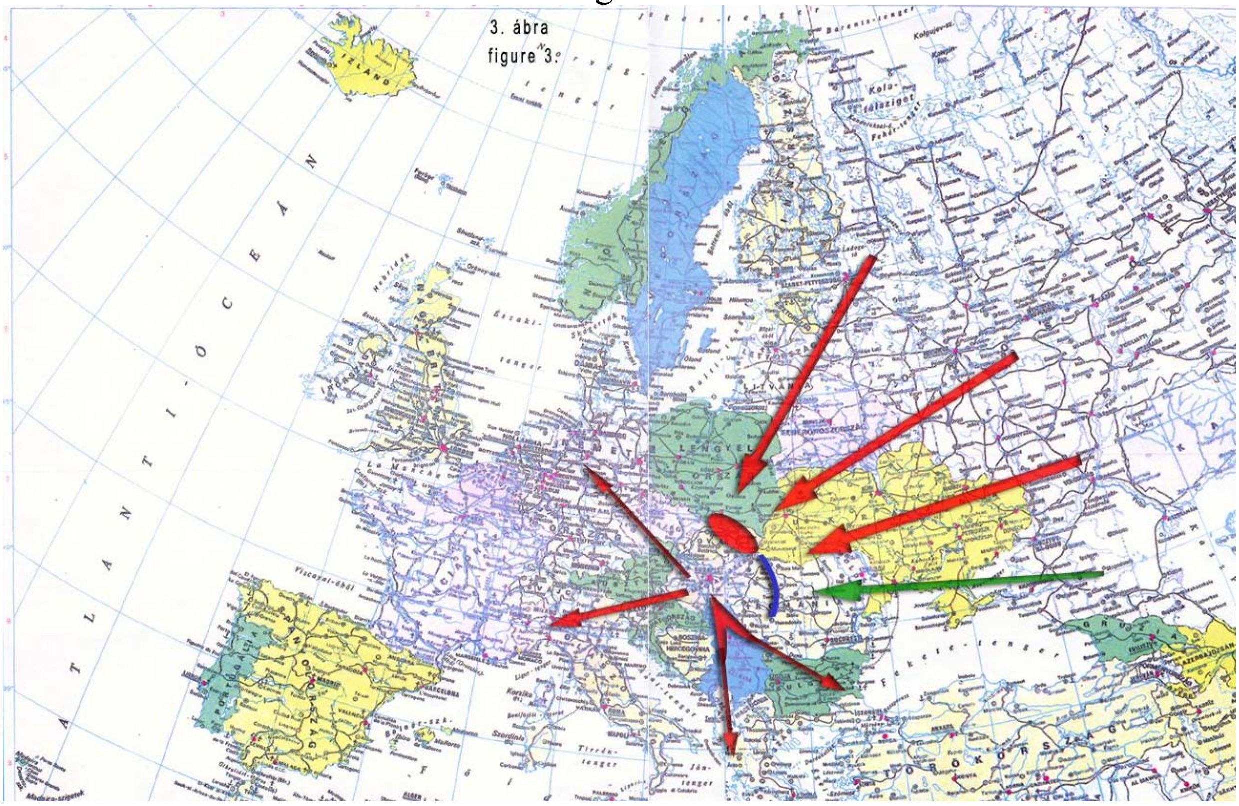
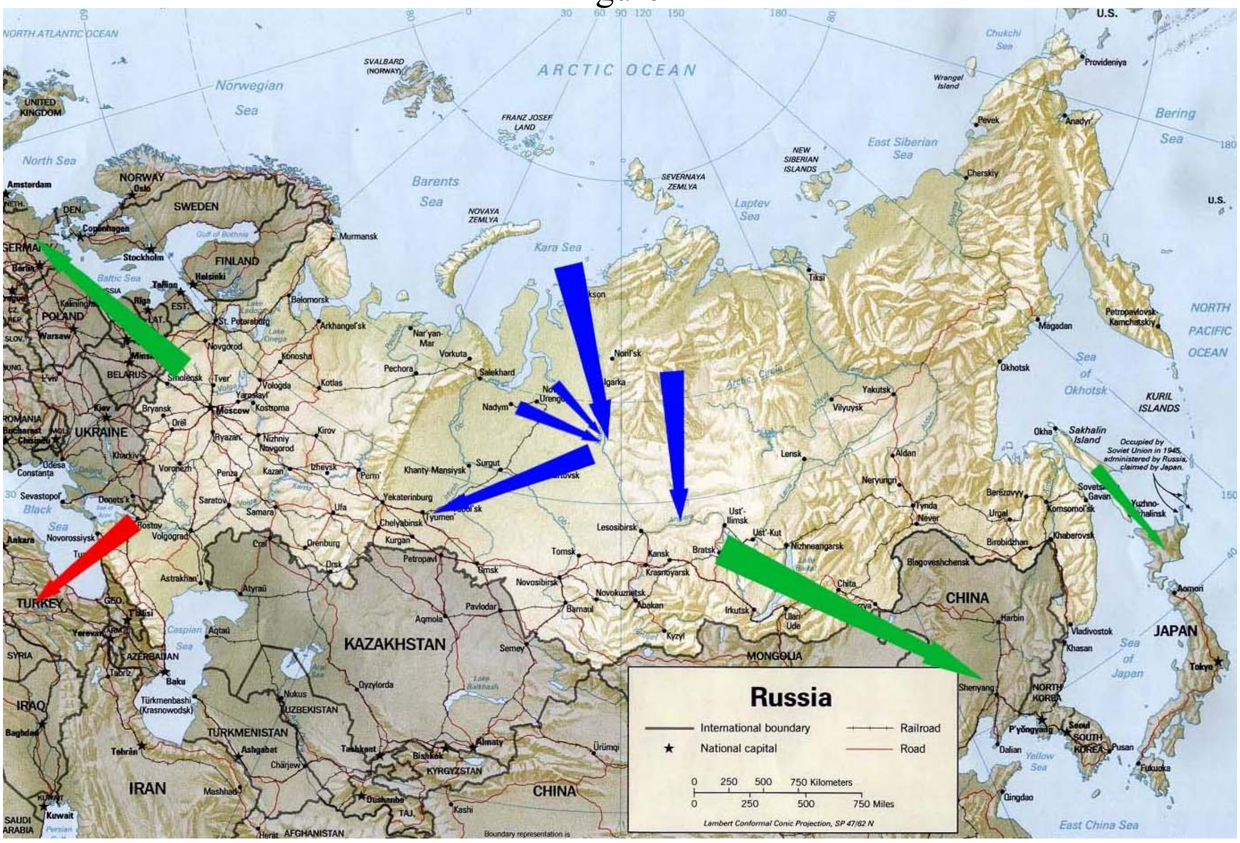


Figure 4



Russian Corporations Expand Abroad
International Activities of Russian Banks, Energy and Metal Companies

Kari Liuhto – Jari Jumpponen*

1) Foreign direct investment flows to and from Russia

Foreign firms have clearly become more active in their operations in transition economies (TEs) since the mid-1990s. According to UNCTAD (2001), foreign direct investment (FDI) inflow to all TEs was USD 7 billion in 1994, whereas six years later FDI inflow exceeded USD 25 billion. By the beginning of 2001, the inward stock of FDI in former centrally planned economies amounted to over USD 150 billion.

Poland, Hungary and the Czech Republic cover a half of the stock of FDI in transition economies. Russia with her huge natural resources and a population of 144 million, *i.e.* approximately 2.5 times the combined population of these three Central East European countries (CEEC), has been able to garner FDI worth less than USD 20 billion, only as much as Hungary with its 10 million citizens and modest natural reserves has.

The FDI per capita figures are even less flattering for the CIS, and Russia in particular. According to EBRD (2001), the cumulative net FDI inflow during 1989–2000 to Russia was only USD 70, whereas the corresponding indicator for the CIS was USD 170 and USD 500 for all TEs. The most attractive TEs in terms of cumulative net FDI per person are the Czech Republic, Hungary, Estonia, and Latvia. All of them have managed to collect over USD 1000 per citizen; the Czech Republic over USD 2000 (*Graph 1*).[1]

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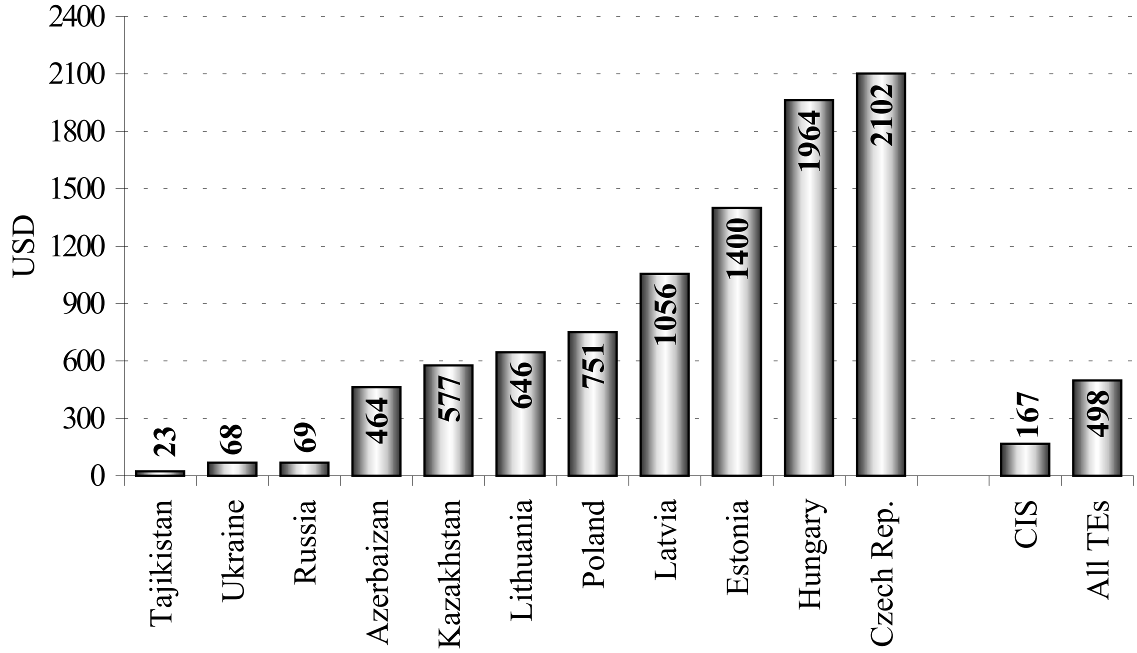
[1] EBRD gives the FDI stock data on a net basis, and hence, its figures are considerably lower than data offered by UNCTAD or the Vienna Institute for International Economic Studies (WIIW). According to EBRD, the cumulative FDI inflow to Russia is some USD 10 billion, whereas UNCTAD indicates that the FDI stock in Russia is some USD 20 billion. WIIW suggests that the FDI inward stock of Russia is USD 23 billion. Russian sources sometimes report

Graph 1
Cumulative net FDI per capita in selected transition economies



Source: EBRD

FDI inflow analysis suggests that foreign companies have not penetrated Russia and the CIS to the same extent they have the CEEC. So, if Western corporations have not entered Russia and the CIS as intensively as the CEEC, then what happened the other way round to FDI flows *i.e.* to what extent investments have flown from the East towards the West?

Direct investment outflow from transition economies abroad is still modest compared to investment inflow towards TEs. The outward FDI stock of transition economies amounts to USD 20 billion, which is less than 15 per cent of the inward FDI stock. This ratio is highest in Russia – 60 per cent. The outward FDI stock of Russia almost reached USD 12 billion at the beginning of 2001. With this figure, Russia clearly makes up over half of the transition economies' total outward FDI stock (*Table 1*).[2]

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even higher FDI figures than WIIW due to fact that they misleadingly include portfolio investments and foreign loans into FDI inflows.

[2] The outward direct investment flows from transition economies are still modest compared to developed Western economies. For example, the outward direct investment stock of Ireland, the least active investor among the EU countries, is USD 16 billion. Correspondingly, the UK is the most active investor with her outward investment stock totalling USD 900 billion. The USA has the biggest outward direct investment stock in the world, almost USD 1250 billion *i.e.* over 100 times bigger than the respective figure for Russia (UNCTAD, 2001).

Table 1
Outward and inward FDI stocks of transition economies by the beginning of 2001
(USD billion)

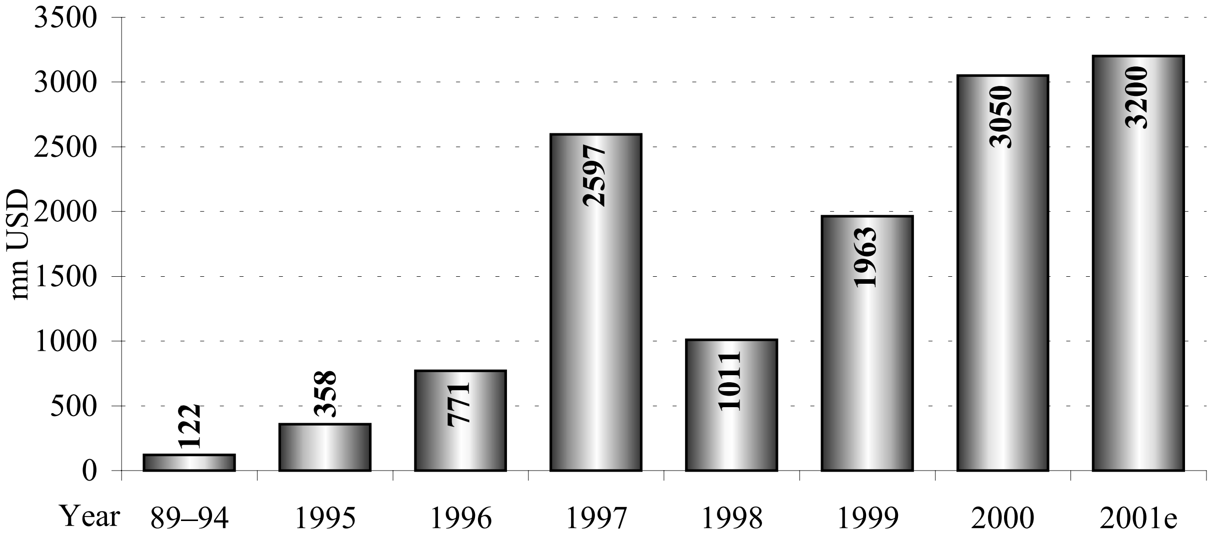
	Outward FDI stock	Inward FDI stock	Outward/Inward FDI stock ratio (%)
All transition economies	*19.8*	*150.3*	*13*
Commonwealth of Independent States (CIS)	12.5	41.9	30
Central and East European countries (CEEC)	7.3	108.4	7
Some selected transition economies (ranked by the amount of the outward FDI stock)			
Russia	11.6	19.2	60
Hungary	2.0	19.9	10
Poland	1.5	36.5	4
Croatia	1.1	4.9	22
The Czech Republic	0.8	21.1	4
Slovenia	0.7	2.9	24
Azerbaijan	0.7	4.5	16
Estonia	0.4	2.8	14
Slovakia	0.3	4.9	6

Source: Authors' calculations on the basis of UNCTAD (2001) data.

The recorded FDI outflow from Russia has multiplied since the mid-1990s. In fact, FDI outflow in 2000 was almost tenfold of the mid-1990s amount. The growing FDI outflow suggests that the financial position of some Russian companies has significantly improved, making them increasingly interested in expanding abroad. The outflow is expected to increase further along with an ever growing Russian stake in global business (*Graph 2*).

It should be stressed that recorded FDI covers only a small part of the total capital outflow from Russia: capital flight, that represents the core of Russian capital outside the country, has to be taken into account in trying to reach an accurate estimate of outflows. A rough calculation shows that during the period 1994–2001 recorded annual FDI outflow was approximately 10 per cent of all capital flight (*Table 2*).

Graph 2
Recorded annual FDI outflow from Russia



Source: UNCTAD

Table 2
Recorded FDI outflow, capital flight and Russia's exports
(USD bn)

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Recorded FDI outflow	0.1*	0.1	0.4	0.8	2.6	1.0	2.1	3.0	3.2
Capital flight	n.a.	15.0	7.5	26.0	11.0	21.0	21**	25**	21.6**
Exports	59.7	68.1	81.3	88.4	86.7	73.9	74.3	105.2	105.1
FDI outflow/capital flight	...	0.7%	5.3%	3.1%	23.6%	4.8%	10.0	12.0%	14.8%
FDI outflow/exports	0.2%	0.1%	0.5%	0.9%	3.0%	1.4%	2.8%	2.9%	3.0%

*1988–1993 annual average. **EIU, 2001/2002.
Sources: IMF (2001); UNCTAD (2001); Bank of Finland (2001/2002); authors' calculations.

This article aims at answering the following two questions: (1) where has the Russian FDI landed, and (2) which corporations are behind the FDI outflow from Russia? In order to answer these questions, this research describes the foreign operations of Russia's most internationalised corporations, and discusses the role of their foreign activities in integrating Russia into the global economy.

2) Where has the Russian eagle landed?

At the end of the 1980s, less than 500 Soviet enterprises operated abroad. A decade later, a multitude of Russian companies had been established beyond Russian borders (Jumpponen, 2000; Liuhto and Jumpponen, 2001).

Goskomstat data indicates that the overwhelming majority of Russian direct investment in 1999 went to the USA and the EU, especially the UK. Goskomstat offers much lower figures for Russian investments in ex-socialist countries than some Western sources. For example, the PlanEcon Report (2001) suggests that at least one-third of Russian FDI has landed in the former socialist block (*Table 3*).

According to a preliminary investigation, some USD 1.3 billion of Russian capital has been placed in Poland. Russia with its 3 per cent stake is the tenth largest investor in Poland. The five biggest foreign companies in Poland are: (1) France Telecom (USD 3.2 billion), (2) Fiat (1.64), (3) Daewoo (1.55), (4) Citibank (1.3) and (5) Gazprom (1.28).

Gazprom has equity investments at least in two Polish companies: Gas Trading and Europol Gaz. The overwhelming majority of Gazprom's investments in Poland have been placed in Europol Gaz. Gazprom holds a 48 per cent stake in Europol Gaz. This company owns the gas pipeline, Yamal-Europe, inside Poland.

Bulgaria and Ukraine have attracted an aggregate of almost USD 500 million. The biggest single investments in these countries were made in the gas and oil industry. For example, Lukoil, the biggest Russian oil company, has bought an oil refinery in Bulgaria as well as in Ukraine.

Russian investments in the Baltic States exceed USD 150 million. The Russian eagle has found the most comfortable nest in Latvia, where Russian capital has landed the most. Russian corporations have invested approximately USD 100 million in Latvia. The three biggest Russian investments in Latvia are: (1) Latrostrans (Investor: Transneftprodukt; Investment: USD 62 million; Field of operation: transit of oil products), (2) Latvijas Gaze (Gazprom; USD 19 million; gas supply), and (3) Lukoil Baltija (Lukoil; USD 15 million; the transit of oil products and their trade). These three investments cover over 90 per cent of the Russian FDI in Latvia. Russian energy companies have also been active in Lithuania. Lukoil is the biggest Russian investor in Lithuania. It has invested some USD 25 million in Lithuania through Euro Oil Invest, an investment company based in Luxembourg. In addition to Lukoil, Yukos aims at acquiring a stake in the Mazeikiu oil refinery. Should one of them be able to acquire a 27 per cent stake in the Mazeikiu oil refinery, total Russian FDI in Lithuania would jump from the current level of 20 million close to USD 100 million. Energy companies are behind the majority of Russian FDI also in Estonia. The biggest Russian investor is Gazprom, which holds almost one third of the Estonian gas company, Eesti Gaas.

Besides equity shares in the Baltic States, Gazprom is eyeing gas companies all over Central Eastern Europe and the CIS. Gazprom aims at buying new stakes of Central East European gas companies (for example, Bulgargas in Bulgaria, SPP in Slovakia, MOL in Hungary and petrochemical companies in Romania) or increasing its share in companies where it already possesses a foothold.

Table 3
Russian FDI stock in selected transition economies in 2000

Target country[3]	Russian FDI stock (USD mn)	Share(%)	Rank among investor countries
EU candidate countries			
Poland	1286	2.8	10.
Bulgaria (as of Sep./2001)	205	4.7	9.
Latvia	100	7.3	5.
Hungary (as of 1999)*	53	0.6	12.
Estonia	39	1.4	10.
Lithuania	23	1.0	16.
Czech Republic (as of 1999)	18	0.01	25.
Slovakia (as of Sep./2001)	9	1.6	
Romania[4] (as of Sep./2001)	4	0.05	
Slovenia (1996-2000)	1	0.04	28.
Other transition economies			
Kazakhstan[5]	>500	>5	
Ukraine	314	8.1	4.

* The figure comprises FDI inflow from all ex-USSR countries.
Sources: Hunya and Stankovsky (2001); Liuhto (2002b); national sources.

As the research is at its initial stage, the researcher is not able to provide a comprehensive picture on the foreign nests of the Russian eagle. A further study concerning Russian investments in the CIS might contribute to the knowledge of Russia's outward FDI. Such an investigation might reveal that significant Russian investments can also be found in Azerbaijan, Belarus, Kazakhstan and Turkmenistan. Moreover, a closer investigation of Russian business expansion in the current EU member states and the candidate countries would show to what extent the Rus-

[3] Russian companies have also indirectly invested to many transition economies. Russian corporations may sometimes be detected behind significant investments from Cyprus, Panama or Luxembourg to transition economies.

[4] The amount of Russian FDI stock in Romania seems to be rather modest, taking into account that Lukoil owns a controlling position in a refinery there. This fact leads to an assumption that acquiring the refinery was made through some of the Lukoil's foreign units.

[5] "Lukoil has invested about USD 500 million into oil projects in Kazakhstan over the last six and a half years ... Lukoil is producing just over one million tonnes of oil per year in Kazakhstan but intents to raise that to 3.5-4 million tonnes annually ... Lukoil has a five per cent interest via LUKArco joint venture in the Tenghiz deposit, 50 per cent in the Kumkol deposit, 15 per cent in the Karachaganak oil and gas condensate field and 12.5 per cent, again via LUKArco, in the Caspian Pipeline Consortium" (NE, 2002).

sian enterprises have already been integrated into the enlarging European single market.

3) Who are behind Russian business expansion abroad?

3.1. Oil and gas corporations

UNCTAD (2001) provides a list of the largest non-financial transnational companies based in Central and Eastern Europe. Three Russian companies, namely Lukoil, the Primorsk Shipping Company and the Far Eastern Shipping Company are on the list. In fact, Lukoil was ranked the largest transnational corporation, based in ex-socialist countries, by its assets abroad. Its assets abroad exceed USD 3 billion. The foreign assets of the other two Russian companies are considerably smaller, less than USD 300 million (*Table 4*).

Lukoil, the largest Russian oil company, has been purchasing stakes in foreign oil fields, especially in the Caspian Sea region and in Egypt. Besides participating in the development of oil fields, Lukoil has acquired controlling stakes in foreign refineries (in Bulgaria, Romania, and Ukraine). Lukoil has also been involved in retailing petroleum outside Russia. At the end of 2000, Lukoil acquired the US company, Getty Petroleum Marketing. This was the first step by Lukoil towards US expansion and also the first time when a Russian firm acquired a publicly traded US company. The acquisition of Getty shows that Lukoil not only orients towards post-socialist markets. In July 2001, Lukoil acquired a Canadian exploration and production company, Bitech Petroleum, which has operations in Colombia, Egypt, Morocco, and Tunisia.[6] Currently, Lukoil is eyeing, for example, the Talara oil refinery in Peru and Rafineria Gdanska in Poland with Rotch Energy.

According to UNCTAD, the Primorsk Shipping Corporation is the second most transnational Russian firm after Lukoil. The Primorsk Shipping Corporation has a fleet of 45 tankers (and one dry-cargo vessel), 30 of which are registered in Cyprus and Singapore. The third most international Russian enterprise, the Far Eastern Shipping Company, has around 100 vessels, registered both in Russia and abroad. The company has agencies in Australia, China, New Zealand, North America and the UK.

[6] In March 2002, Lukoil made a press release in which it was indicated that the company aims at selling its assets in Morocco.

Table 4

The 25 largest non-financial transnational corporations based in Central and Eastern Europe

(ranked by foreign assets, 1999)

Corporation	Country	Industry	Assets (USD mn)		Sales (USD mn)		Employment (employees)	
			Foreign	Total	Foreign	Total	Foreign	Total
1. *Lukoil Oil Co.*	*Russia*	*Petroleum & gas*	*3 236.0*	*8422.0*	*4642.0*	*10903.0*	*10000*	*120 000*
2. Latvian Shipping Company	Latvia	Transportation	459,0	470,0	191,0	191,0	1124	1748
3. Hrvatska Elektroprivreda	Croatia	Energy	296,0	2524,0	10,0	780,0		15877
4. Podravka Group	Croatia	Food & pharmac.	285,9	477,1	119,4	390,2	501	6898
5. *Primorsk Shipping Co.*	*Russia*	*Transportation*	*256,4*	*444,1*	*85,3*	*116,5*	*1308*	*2777*
6. Gorenje Group	Slovenia	Domestic applian.	236,3	618,1	593,3	1120,6	590	6691
7. *Far Eastern Shipping Co.*	*Russia*	*Transportation*	*236,0*	*585,0*	*134,0*	*183,0*	*263*	*8873*
8. Pliva Group	Croatia	Pharmaceuticals	181,8	915,9	384,7	587,6	2645	7857
9. TVK Ltd *	Hungary	Chemicals	175,4	553,2	248,9	394,3	927	5225
10. Motokov	Czech Rep.	Trade	163,6	262,5	260,2	349,1	576	1000
11. Skoda Group Plzen	Czech Rep.	Diversified	139,1	973,4	1507	144,5	1073	19830
12. Atlanska Plovidba	Croatia	Transportation	138,0	154,0	46,0	46,0		509
13. MOL Hungarian Oil & Gas	Hungary	Petroleum & gas	126,3	3131,0	582,4	3129,6	833	20684
14. Krka	Slovenia	Pharmaceuticals	120,7	447,0	209,0	283,0	429	3218
15. Adria Airways	Slovenia	Transportation	116,3	129,2	103,4	104,6	19	597
16. Petrol	Slovenia	Petroleum & gas	90,4	574,9	105,7	924,4	75	2356
17. Slovnaft *	Slovakia	Petroleum & gas	82,8	1367,1	627,5	1035,7	119	7540
18. Zalakeramia	Hungary	Clay product	69,0	125,0	39,0	64,0	2022	3066
19. Matador	Slovakia	Rubber & plastics	51,9	305,0	34,0	203,4	5	3878
20. Malev Hungarian Airlines	Hungary	Transportation	43,3	206,3	274,1	367,5	49	3162
21. KGHM Polska Miedz	Poland	Mining	34,0	1266,0	265,0	1155,0	25	28300
22. Croatia Airlines	Croatia	Transportation	29,9	288,6	60,2	77,9	39	842
23. Elektrim	Poland	Diversified	21,0	1228,0	42,0	874,0	62	26475
24. Petrom National Oil Co.	Romania	Petroleum & gas	19,0	2970,0	211,0	2041,0	67	82054
25. Intereuropa	Slovenia	Trade	16,0	168,0	17,0	136,0	511	2103

* TVK and Slovnaft have been taken over by MOL.

Source: UNCTAD (2001).

It is likely that more Russian corporations would appear on the list if they disclosed all their assets abroad. The biggest Russian company missing from the list is indisputably Gazprom. The company has equity investments in approximately 20 countries (*Table 5*).

Table 5
Major equity stakes of Gazprom in Europe

Country	Joint venture	Stake (%)	Activities
Austria	GHW	50	Gas trading
Belarus	Belgazprombank	35	Banking
	Brestgazoapparat	51	Gas equipment manufacturing
Bulgaria	Topenergo	50	Gas trading and transport
Estonia	Eesti Gaas	31	Gas trading and transport
Finland	Gasum Oy	25	Gas transportation and marketing
	North Transgas Oy	50	Construction of a pipeline under the Baltic Sea
France	FRAgaz	50	Gas trading
Germany	Ditgaz	49	Gas trading
	Verbundnetz Gas	5	Gas transportation and marketing
	Wingas	35	Gas transportation and storage
	Wintershall Erdgas Handelshaus	50	Exclusive trader until 2012 for all the gas exported by Gazexport (Russia)
	Zarubezhgas Erdgashandel	100	Gas trading
Greece	Prometheus Gaz	50	Marketing and construction
Hungary	Borsodchem	25	Petrochemicals
	DKG-EAST Co. Inc.	38	Oil and gas equipment manufacturing
	General Banking and Trust Co. Ltd.	26	Banking
	Panrusgas	40	Gas trading and transport
	TVK	14	Petrochemicals
Italy	Promgaz	50	Gas trading and marketing
	Volta	49	Gas trading and transport
Latvia	Latvijas Gaze	16	Gas trading and transport
Lithuania	Stella-Vitae	30	Gas trading
Moldova	Gazsnabtransit	50	Gas trading and transport
Netherlands	Peter-gaz	51	Gas trading
Poland	Europol Gaz	48	Gas transport
	Gas Trading	35	Gas trading
Romania	WIROM	25	Gas trading (controlled through Wintershall Erdgas Handelshaus)
Slovakia	Slovrusgaz	50	Gas trading and transport
Slovenia	Tagdem	8	Gas trading
Turkey	Gamma Gazprom	45	Gas trading
Ukraine	Druzhkovskiy zavod gazovoi apparatury	51	Gas equipment manufacturing
	Institut Yuzhniigiprogaz	40	...
United Kingdom	Interconnector	10	Gas pipeline from Bacton (UK) to Zeebrugge (Belgium)
Yugoslavia	JugoRosGaz	50	Gas trading and transport
	Progress Gas Trading	50	Gas trading

Source: UNCTAD (2001)

Gazprom's equity investments outside Russia have mainly been conducted to support the corporation's exports and to improve its position in the global gas business. Gazprom is the world's biggest natural gas exporter, exporting almost 175 billion cubic metres (bcm) of gas to over 25 countries. (Liuhto, 2002a; see *Appendix 3*)

Yukos has subsidiaries in the Baltic States and in the USA. In the Balkans, Yukos has been working with a Croatian company, Jadranski Naftovod, to modernise the Adria pipeline. In the beginning of 2002, Yukos also completed acquiring a 49 per cent interest in the Slovak pipeline company, Transpetrol, which operates at the Druzhba pipeline. In October 2001, Yukos acquired a stake in a British–Norwegian engineering firm, Kvaerner, and purchased its London-based subsidiary, which is involved in engineering services in on-shore oil and gas projects. In addition, Yukos took over Kvaerner Process Technology's units in France, Italy, Switzerland and the UK. Experts expect Yukos to complete its acquisition in Mazeikiu Nafta Lithuania.

Surgutneftegaz, the third largest Russian oil company, has only domestic subsidiaries but nevertheless, it is heavily focused on export. Their exports represented almost 80 per cent of the company's total revenues in 2000. Recently, Surgutneftegaz has announced plans to buy oil and petrochemical processing facilities in Belarus and Ukraine in alliance with Slavneft.

Similarly, the Tyumen Oil Company (TNK) has activities abroad. TNK acquired the Lishichansk refinery in Ukraine through its subsidiary, TNK-Ukraina, in 2000. TNK also owns a filling station chain in Ukraine. TNK has signed an agreement with Petrol (Slovenia) to cooperate in marketing oil products in Bosnia-Herzegovina, Croatia, Macedonia and Yugoslavia.

Rosneft, a state-owned oil company, already participated in international operations during the Soviet era. In Ukraine, the company manages a quarter of the Black Sea Kherson oil refinery under a two-year agreement with existing shareholders, Kazakhoil and Alians. In Kazakhstan, Rosneft has agreements with the Texas-based First International Oil Corporation (to explore oil fields) and with the Florida-based Itera (to form an oil and gas extracting holding). Rosneft operates a petrol station network in Bulgaria and Romania jointly with the Russian–Belarus company, Slavneft.

In June 2001, Rosneft signed a contract with Colombia’s state oil company Ecopetrol and two other Colombian companies to launch oil extraction at a block in Southern Colombia. In Algeria, Rosneft has made a similar agreement with a local state-run oil company, Sonatrach, on the development of an oil field. In Iraq, Rosneft has signed an agreement to develop oil fields, but implementation depends on the United Nations sanctions policy. Rosneft is also expected to launch projects in Sudan.

In summer 2001, Slavneft signed a joint-venture deal to develop an oil field in Sudan. Slavneft holds a 93 per cent stake in this new company, which is agreed to operate in a region with 30 million tons determined oil deposit and a 200 million tons estimated volume. The estimated total investment volume made by Slavneft into the geological exploration and development of the deposit is USD 126 million. Furthermore, Slavneft has been screening possibilities for participating in projects in Iran, where it has already been involved in maintaining oil wells. The company has also signed a cooperation agreement in Iraq, although it is restricted by the UN sanctions. Slavneft, which coordinates Russian oil deliveries to Slovakia, intends to acquire filling stations in the country.

Table 6
Selected operations of Russian oil companies abroad
(in order of appearance in the text)

Company	Markets	Operations
Lukoil	Azerbaijan, Egypt, Iraq, Kazakhstan Bulgaria, Romania, Ukraine Azerbaijan, Baltic States, Czech Rep., Kazakhstan, Moldova, Ukraine, US UK Various countries	Oil production Oil refining Petroleum retailing Sales office Oil exports
Yukos	Croatia Slovakia Latvia, US Various countries	Pipeline project Pipeline company Marketing Oil exports
Surgutneftegaz	Various countries	Oil exports
TNK	Ukraine Ukraine Various countries	Oil refining Petroleum retailing Oil exports
Rosneft	Algeria, Colombia, Iraq, Kazakhstan Ukraine Bulgaria, Romania Various countries	Oil production Oil refinery management Petroleum retailing Oil exports
Slavneft	Bulgaria, Romania Iran Sudan Various countries	Petroleum retailing Maintaining oil wells Oil production Oil exports
Tatneft	Iraq Various countries	Oil production Oil exports
Sibneft	Various countries	Oil exports
Bashneft	Various countries	Oil exports

Tatneft has a representative office in Iraq, where the company carries out oil drilling. Tatneft is also expected to launch projects in Sudan. The other Russian major oil companies, Sibneft and Bashneft have been less active in internationalisation, except for export activities. Both companies currently export some 30 per cent of their oil production. *Table 6* summarises main operations of Russian oil majors abroad.

3.2. Russian metal conglomerates

Although oil and gas corporations dominate Russian outward FDI, some Russian metal companies have also expanded operations abroad.

Alrosa is one of the world's leading diamond mining companies, with one fifth of world raw diamond output and total revenues of USD 1.6 billion in 2001. The company not only exports, but it has opened units abroad, *e.g.* a representative office in Angola, Belgium, Israel and the UK. In Angola, Alrosa is an equity partner with a 33 per cent stake in the Catoca diamond mine, which produced diamonds worth USD 150 million in 2000. The company has expressed interest in further expanding its operations in Africa, namely in Botswana, Namibia and Tanzania.

Norilsk Nickel accounts for a major chunk of the global production of nickel, palladium, platinum and other rare and semi-precious metals. In October 2000, the firm formed a joint venture, Norgem, with the Belgian company, Sogem, to sell Norilsk's cobalt products. Norgem was registered in Belgium with Norilsk Nickel taking a 51 per cent stake. In Cuba, Norilsk Nickel has agreed to invest some USD 300 million to complete a nickel ore plant, which the USSR started to build in 1983. Recently the company announced that it is setting up a joint venture with a Canadian company, Argosy Minerals, to study co-operation in Eastern Australia.

Russia is the fourth largest steel producer in the world and 60 per cent of its output is exported. Severstal is the largest Russian steel producer. The company has expanded its sales, especially in North America and Asia, focusing particularly on the exports of specialised and value-added steel products in order to avoid anti-dumping disputes. Severstal may face difficulties in the US market since in March 2002 the USA imposed steel import tariffs of up to 30 per cent until 2004.

Russian Aluminium produces about 70 per cent of the primary aluminium in Russia. Asia has become the main market for Russian Aluminium, taking 50 per cent of its exports. The USA takes 30 per cent and Europe the remaining 20. Russian Aluminium has contracted to build a plant in Ukraine, the Pervomaysk plant, during the next three years. In Guinea, the company has signed a deal to manage a local bauxite plant for 25 years and develop the large Dian-Dian bauxite deposit. Russian Aluminium has also purchased a refinery in Romania and operates in Armenia via a joint venture.[7]

Over 75 per cent of output from the Novolipetsk Metallurgical Combine (NLMK) is exported to the Middle East, North America, Europe, Southeast Asia

[7] Siberian–Urals Aluminium Company, SUAL, has lately shown interest in buying a 69.9 per cent state stake in a rolling mill, Alprom, Romania.

and China. Besides exports, NLMK has expressed interest in international cooperation. NLMK also has plans to participate in the restructuring of Poland's steel industry (*Table 7*).

Table 7
Selected operations of major Russian metallurgical companies abroad
(in order of appearance in the text)

Company	Markets	Operations
Alrosa	Angola Angola, Belgium, Israel, UK Various countries	Diamond exploration Representative office Exports
Norilsk Nickel	Belgium Cuba New Caledonia, New Guinea Various countries	Marketing joint venture Building a nickel plant Ore plant Exports
Severstal	Various countries	Exports
Russian Aluminium	Romania Armenia, Ukraine Guinea Various countries	Refinery Aluminium production Bauxite, aluminium production Exports
NLMK	Various countries	Exports

3.3. The banking sector

Russia's largest privately owned bank, Alfa Bank, was founded in 1990. Today, the bank has more than 70 branches in Russia, Ukraine and Kazakhstan and subsidiaries in the United Kingdom, the United States and the Netherlands. The wholly-owned subsidiary in the Netherlands (Amsterdam Trade Bank N.V). Has a full European banking licence. It primarily serves clients in import and export finance. The London-based unit (Alfa Securities) was set up in 2000 and it provides brokerage, research and investment banking services.

Vneshtorgbank was established in October 1990 as a closed joint-stock company aimed at servicing the foreign economic relations of the Russian Federation. The bank is owned by the Central Bank of the Russian Federation with a share of 99.9 per cent. Vneshtorgbank has subsidiary banks in Austria, Cyprus, Luxembourg and Switzerland and representative offices in China, Italy and Ukraine. In Germany the bank has acquired an associated bank, the Ost-West Handelsbank, located in Frankfurt-on-Main.

Russia's seventh largest bank, by assets, Rosbank, is a part of the Interros Holding Company, which has majority ownerships in several Russian companies, such as Norilsk Nickel. Rosbank owns a subsidiary in Switzerland and maintains a representative office in China.

The Moscow Municipal Bank established the Bank of Moscow on March 7, 1995, at the initiative of the Russian government, which currently holds an over 60 per cent stake in the bank's capital. The Bank of Moscow has a fully-owned subsidiary in Belarus (Moscow-Minsk Bank), situated in Minsk, and controls a subsidiary in Latvia (Latvian Businessbank).

The Trust and Investment Bank (DIB) was formed in 1993. DIB is characterised as being the main settlement bank of YUKOS-Rosprom group and it offers investment-banking services mainly to Russian exporters and importers, industrial companies and regional governments. The first subsidiary of the bank, T&IB Holdings B.V. was registered in the Netherlands in March 2001.

Menatep St. Petersburg, a joint stock bank, was registered in 1995. The bank serves the financial flows of the enterprises in the Yukos-Rosprom group and is also a principal bank for Gazprom. The bank has a subsidiary in Armenia (Menatep-Erevan), the Netherlands (Menatep Securities BV) as well as Switzerland (Menatep Finance AS). In September 2001, the bank became the first foreign bank to open a subsidiary in Mongolia. The bank made this decision following the interests of its largest shareholders, Yukos (Fedorin, 2001).

Table 8

The operations of Russian banks abroad

Company	Markets	Operations
Alfa Bank	Kazakhstan, Ukraine United Kingdom, the US, Netherlands	Branches Subsidiaries
Vneshtorgbank	Austria, Cyprus, Luxembourg, Switzerland Germany China, Italy, Ukraine	Subsidiaries Associated bank Representatives
Rosbank	Switzerland China	Subsidiary Representative
Bank of Moscow	Belarus, Latvia	Subsidiaries
DIB	Netherlands	Subsidiary
Menatep SPb.	Armenia, Mongolia, Netherlands, Switzerland	Subsidiaries
Sobinbank	Ukraine	Representative
Vozrozhdeniye	Czech Republic	Representative
Mosnarbank	United Kingdom Singapore China, Canada	Head office Branch Representatives
International Bank of St. Petersburg	Estonia, Finland	Representatives
Ugra	Belgium	Representative

Another oil company, Lukoil, is one of the principle shareholders of Sobinbank. This bank is currently among the 30 largest Russian banks and runs a representative office in Ukraine.

In order to promote joint business operations between Russia and the Czech Republic, the First Russian–Czech Bank was established in 1996. The founders were the Investicni a postovni banka on the Czech side and the Vozrozhdeniye Bank on the Russian side. Currently, the Vozrozhdeniye Bank owns a 26 per cent stake in this joint bank, with which it has offices in both Moscow and Prague.

The Mosnarbank (Moscow Narodny Bank, MNB) claims to be the only Russian-owned bank in the United Kingdom. The company was established as early as 1911 in Moscow, and foreign agencies were opened in London and New York a couple of years later. Between the world wars, branches were opened in Paris and Berlin, and in the 1970s in Singapore and Canada. Nowadays the bank is owned by the Central Bank of Russia. The group head office is located in London, a subsidiary in Moscow and a branch office in Singapore. The representative offices are located in China and Canada.

The International Bank of St. Petersburg maintains representative offices in Finland since the summer of 2000 The representative office is said to have been established in order to serve companies, both Finnish and Russian, dealing with Russia (exporting or importing goods or acting otherwise in the financial sphere). The bank has also applied for permission to establish a branch office in Finland, but no licence was given by the Finnish authorities. In Estonia the bank established a representative in February 2002.

Even though large Russian banks have carried out the foreign operations presented above, they are not the only banks with intentions abroad. As an example from smaller banks, the Ugra bank could be mentioned. The bank was originally established in 1990 in the Hanty-Mansiisk autonomous region, and during the next decade it expanded, first to major Russian cities, until in 1998, when the company established its first representative office in Belgium.

4) Business expansion abroad supports Russia's overall globalisation

International economic ties provide benefits to all the parties involved, which none of them would be able to gain by acting alone. In addition, economic integration is an effective way of building international stability. Examination of FDI inflow to Russia makes it clear that foreign direct investment has not been able to integrate Russia as closely as the CEEC into a Pan-European economic collaboration. The modest FDI inflow to Russia is mainly due to the harsh business environment there: deficient business legislation, the inconsistent execution of laws, heavy bureaucracy and high corruption have kept potential foreign investors outside Russian borders.

If foreign firms have not succeeded in integrating Russia with global business, Russian corporations, via their outward FDI, have integrated their country with foreign markets more intensively than the companies of any other transition economy. Statistical data suggests that Russian corporations have expanded not only in the West but also in CEEC and the former Soviet republics.

The particularly strong expansion towards ex-CMEA countries has created some suspicions about the ultimate goal of integration, focused on whether the expansion of Russian companies abroad will lead to the greater integration of Russia in the global economy or to new block building. *Figure 1* clarifies the alternatives. The figure presents the two extreme possible outcomes of expansion abroad by Russian corporations. If business objectives dominate their internationalisation strategies, Russian corporations will easily find an appropriate niche in the Pan-European and global business world.

Through Russian investment in the current and enlarged EU, Russia would benefit directly from the advantages of enlargement. Moreover, Russian investment in the EU would support EU-Russian trade. Increasing EU-Russian trade would bring Russia closer to cooperation with Western nations, which in turn would ultimately strengthen stability in Europe and beyond.

It can be concluded that with a more active participation in global business Russian corporations can prepare the Russian economy for approaching WTO membership. Moreover, the activities of Russian companies in the enlarging EU market facilitate the building of the Common European Economic Space between Russia and the EU.[8]

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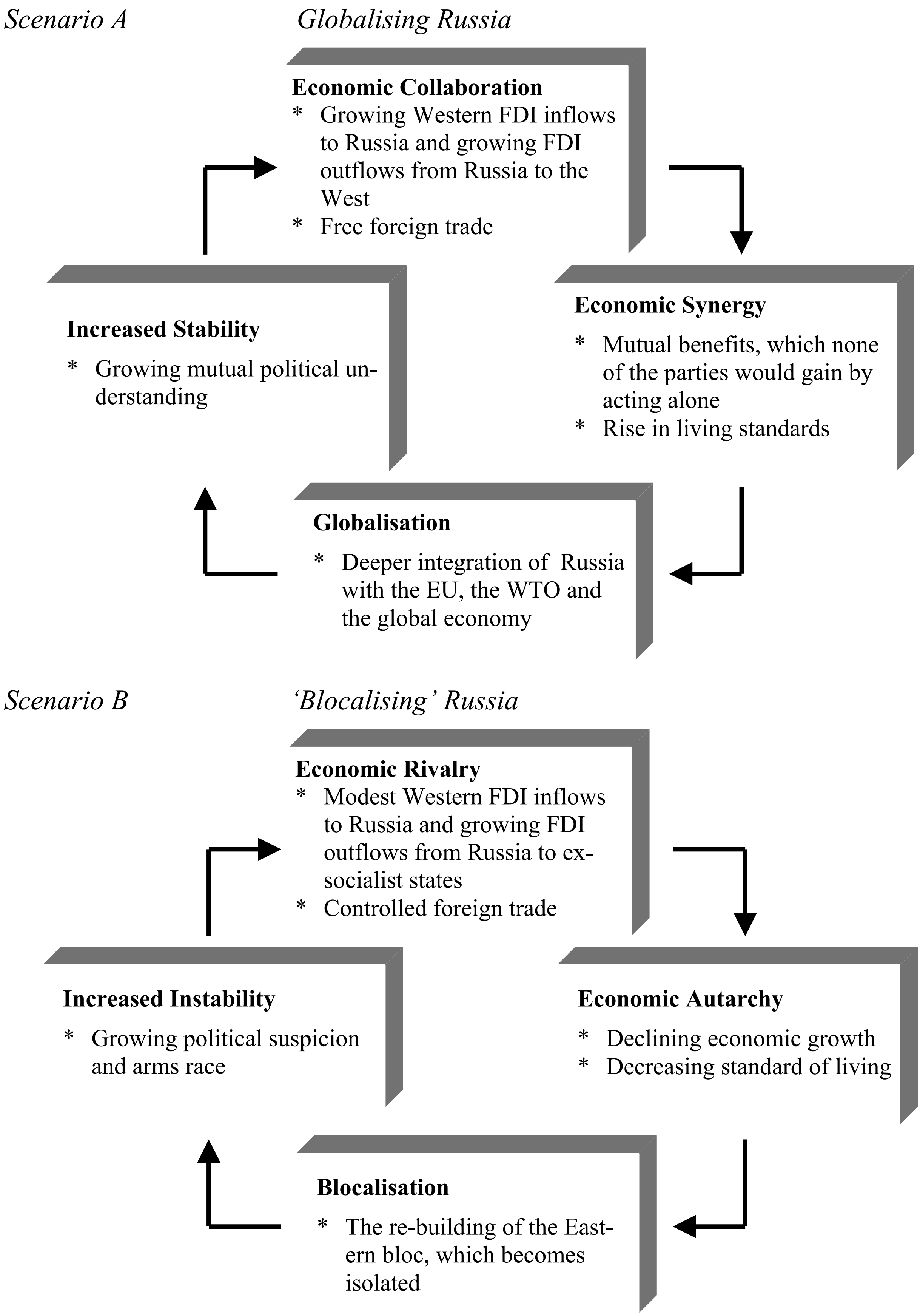
[8] Though the president of the WTO, Michael Moore stated in January 2002 that Russia's membership could already be a reality in the middle of 2003, Russia's vice-minister of economy Maksim Medvedkov, the leader of the Russian negotiation team, is less optimistic. Russia has to implement many changes, such as the reform of Russian customs operations, reducing custom tariffs and cutting subsidies before the WTO membership can be gained. Correspondingly, the planning of the Common European Economic Space has only started last year. Even if these goals cannot be accomplished overnight, they clearly show that Russia is opening towards the West, *i.e.* it seems to follow the globalisation scenario presented in *Figure 1*.

Figure 1
Two extreme scenarios of expansion by Russian corporations abroad



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IV.
Regional Cooperation

OUTWARD FOREIGN DIRECT INVESTMENT FROM THE BALTIC STATES AS A FACTOR OF REGIONAL INTEGRATION*

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Introduction

After the upheaval in Central and Eastern Europe (CEE), massive investments are needed to modernise the economy and raise productivity. Transition economies have in general low levels of domestic savings due to their low levels of incomes. Foreign direct investment (FDI) is an important contribution to the process of restructuring, economic growth and development of technology in transition economies. Estonia has been one of the most successful countries of CEE in attracting FDI on a per capita basis.

Estonia liberalised its capital movements further than required by its Europe Agreement. Foreign investors may open accounts in both foreign and domestic currency. Profits and enterprise liquidation income can be freely repatriated, and the currency is wholly convertible. Due to its very liberal economic policy, closeness to Finland and Sweden (to Finnish and Swedish capital), success in attracting FDI and a relatively fast economic development, Estonia has also become a source of direct investment to other countries (mainly to other Baltic states).

The factors affecting FDI differ from the factors that influence other international capital flows. FDI is defined as an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate). FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other economy. Such investment involves both the initial transaction between the two entities

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and all subsequent transactions between them and among foreign affiliates, both incorporated and unincorporated.

Although FDI depends on the average expected rate of return and the level of risk involved just as other foreign investments do, FDI is directly influenced by several specific groups of factors. These are first and foremost related to the market imperfections. In this paper, the trends of FDI into and from Estonia are described with some general features of investment climate in the Baltic States.

1) Comparison of Estonian FDI with that of other countries

Flows of FDI comprise capital provided (either directly or through other related enterprises) by a foreign direct investor to an FDI enterprise, or capital received from an FDI enterprise by a foreign direct investor. There are in principle three components in FDI:

* Equity capital is the foreign direct investor's purchase of shares of an enterprise in a country other than its own.
* Reinvested earnings comprise the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested.
* Intra-company loans or intra-company debt transactions refer to short or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises.

FDI stock is the value of the share of their capital and reserves (including retained profits) attributable to the parent enterprise, plus net indebtedness of affiliates to the parent enterprise.

International studies show that acquiring new markets and increasing sales have been the main motivation for making FDI. The development in East Europe (in post-socialist countries) has not been different. Apart from the sales motive, cost factors also play an important part in FDI decisions. In Eastern Europe a favourable cost factor has most often been the low labour cost. In addition to market considerations, both strategic position factors (to gain first mover advantages and/or to follow customers/competitors) and investment climate factors have played very important roles in the FDI decision-making process (Hirvensalo and Hazley, 1998; Mayer, 1998; Ziacik, 2000).

Earlier the differences in factor endowments (*i.e.* cost of labour, availability of natural resources) were among the most decisive factors in explaining the location of FDI in the target countries. However, the significance of these factors has declined during the last decades and other factors have gained importance. For example, the institutional framework has increased in importance (Tahir, 2000).

Table 1
Major FDI-related indicators in Estonia, 1993–2000

	1993	1994	1995	1996	1997	1998	1999	2000
GDP in current prices, bn kroons	21,6	29,6	40,7	52,4	64,3	73,3	75,4	84,3
Mean annual population, mn	1,517	1,499	1,484	1,469	1,458	1,450	1,442	1,439
FDI inflows, bn kroons	2,153	2,819	2,313	1,814	3,694	8,071	4,448	6,807
FDI outlflows, bn Kroons	0,082	0,030	0,029	0,484	1,913	0,082	1,240	2,666
FDI inflows per capita, kroons	1419	1880	1558	1234	2533	5568	3084	4730
FDI outflows per capita, kroons	54	20	20	330	1312	56	860	1853
Investments in fixed assets, bn kroons	4,401	6,843	8,761	12,313	16,467	19,529	17,537	19,500
FDI inflows as % of investments in fixed assets	48.9	41.2	26.4	14.7	22.4	41.3	25.4	34.9
FDI outflows as % of investments in fixed assets	1.9	0.4	0.3	3.9	11.6	0.4	7.1	13.7
FDI inward stock, bn kroons	…	…	…	10,257	16,456	24,428	38,397	44,495
FDI outward stock, bn kroons	…	…	…	1,339	3,086	2,660	4,376	7,449
FDI inward stock as % of GDP	…	…	…	19.6	25.6	33.3	51.0	52.8
FDI outward stock as % of GDP	…	…	…	2.6	4.8	3.6	5.8	8.8

Sources: Statistical Office of Estonia (http://www.stat.ee/statistika fr.html; Bank of Estonia (http://www.ee/epbe/sdds/iip)

Foreign direct investors may also obtain an effective voice in the management of another business entity through means other than acquiring an equity stake. These are non-equity forms of FDI, and they include subcontracting, management contracts, franchising, licensing and product sharing. Data of transnational corporate activity through these forms are usually not separately identified in balance-of-payments statistics. These statistics, however, usually present data on royalties and licensing fees, defined as „receipts and payments of residents and non-residents for: (1) the authorised use of intangible non-produced, non-financial assets and proprietary rights such as trademarks, copyrights, patents, processes, techniques, designs, manufacturing rights, franchises, *etc.*; (2) the use, through licensing agreements, of produced originals or prototypes, such as manuscripts and films.

According to UN statistics (World Investment Report 2000, 2000), in 1999 FDI inflows in the world were USD 865.5 billion, from this Central and Eastern Europe received USD 21.4 billion or 2.5 per cent. Inward FDI flows as percentage of gross fixed capital formation in 1998 were, according to UN statistics, in the world 11.1 per cent, in Central and Eastern Europe 12.9, in Estonia 38.4, in Latvia 27.8, and in Lithuania 35.4 per cent.

Outward FDI flows as percentage of gross fixed capital formation in 1998 were, according to UN statistics, in the world 11.5 per cent (sums of inflows and outflows are not absolutely equal by UN statistics), in Central and Eastern Europe 1.4, in Estonia 0.4, in Latvia 4.2, and in Lithuania 0.2 per cent.

At the end of 2000, foreign investments made into Estonia formed 90,864 million kroons. Of the foreign investments made into Estonia 49.0 per cent were direct investments (44495 million kroons). A significant part of direct investments came from Sweden (40.5%) and Finland (29.8%). Other important sources were Norway (4.3%), the USA (4.2), Denmark (4.0%), Germany (2.6%), the UK (2.4%), the Netherlands (2.2%), Liechtenstein (1.5%), Russia (1.2%), Switzerland (1.1%), Singapore (1.0%), Italy (0.7%), Ireland (0.4%), Austria (0.3%), and Latvia (0.2%) (http://www.ee/epbe/fdi/4b/html.en).

The most attractive sectors for foreign direct investors in Estonia were finance (25.0%), transport, storage and communication (21.8), manufacturing (21.5%), wholesale and retail trade (15.6%), real estate, renting and business activities (6.9%), electricity, gas and water supply (2.4%), hotels and restaurants (2.0%), construction (1.5%), agriculture, hunting and forestry (1.3%), and other community, social and personal service activities (1.1%). In addition to FDI, long-term loan capital has a significant position among investments made into Estonia. Debt securities issued and other investments in the form of trade credit or deposits of non-residents at banks in Estonia are of a slightly smaller importance. Regulatory environment in Estonia is quite favourable for attracting FDI inflows into the country because government regulations do not affect seriously the firms' operation and their decisions on expansion or closing down the business.

Because of the predominance of external liabilities, Estonia's net investment position at the end of 2000 was negative by 46,875 million kroons, which makes up 55 per cent of the expected GDP of the last four quarters.

2) Estonian direct investment abroad

Internalisation of Estonian firms was accomplished in the early 1990s primarily using indirect and direct exports. As late as in 1996 Estonian firms really started to use investment as a foreign market entry method. It was followed by the first significant boom of outflow in 1997 totalling 1912.9 million EEK. At that time Estonia was factually the leading outward investing transition economy with regard to per capita flows. In 1998 a heavy fluctuation and stagnation of outward FDI followed. High volatility of FDI outflows appears to be characteristic as the total stock of FDI abroad is very limited. Even a single operation reducing investments abroad causes significant changes in outflows. The 1993–2000 FDI (inflow, outflow and surplus of direct investments) are presented in *Table 2*.

Table 2
Foreign direct investment, 1993–2000
(bn kroons)

Year	FDI (net)	Inflow	Outflow
1993	2.071	2.153	-0.082
1994	2.789	2.819	-0.030
1995	2.282	2.313	0.029
1996	1.330	1.814	-0.484
1997	1.781	3.694	-1.913
1998	7.990	8.071	-0.081
1999	3.208	4.448	-1.240
2000	4.141	6.807	-2.666

Source: http://www.ee/epbe/makromajandus

Table 3
Direct investment stock from Estonia to other countries by fields of activity
(31 December 2000)

	Mn Kroons	Percentage
Finance	4517.8	60.6
Real estate, renting and business activities	1072.6	14.4
Transport, storage and communication	770.9	10.3
Manufacturing	658.3	8.8
Wholesale, retail trade	346.4	4.6
Construction	32.9	0.4
Other	50.1	0.9
Total	*7449.0*	*100.0*

Source: http://www.ee/epbe/fdi

The majority of Estonian investments abroad were made into real estate, rent, and business services and finance. More than two thirds of investments were made into Latvia and Lithuania. The increase of direct investments abroad resulted, on the one hand, in the strengthening of the economic positions of Estonian companies. On the other hand, this rapid development can also be attributed to the improved access to local and foreign credit resources. This conclusion is supported by the fact that when access to credit resources became more limited in 1998 and in the first half of 1999 when Estonia's economic situation deteriorated, investment outflow from Estonia fell sharply.

Table 4
Direct investment from Estonia to other countries
(31 December 2000)

	Mn kroons	Percentage
Latvia	3994.2	53.6
Lithuania	2329.2	31.3
Cyprus	605.6	8.1
Ukraine	94.6	1.3
Russia	42.4	0.6
Bahamas	24.9	0.3
Poland	15.6	0.2
Other	345.2	4.6
Total	*7449.0*	*100.0*

Source: http://www.ee/epbe/fdi

After the Russian crisis in late 1998 direct investment outflows were replaced by the process of taking back loans from affiliates of Estonian firms abroad. Outflows into transport, storage and communications were drastically reversed, and the economic turbulence of 1998 led to further reversals and losses in total outward direct investment. Operating losses and loan repayments reduced outward investment especially in industry, transport, storage and communications, while banking losses and consolidation affected the financial sector. In consequence, the withdrawal of outward investments, including portfolio investments, raised net capital flows into Estonia. Most of the investments abroad were in finance, real estate, leasing, and business services and trade.

In 2000, Estonian direct investors directed capital into Latvian finance, real estate, rent and business services sector, as well as into wholesale and retail. Investing into affiliated companies abroad remained substantial. Half of the direct investment outflow consisted of investments into share capital and the other half was loans. The biggest increase was recorded in long-term loan capital claims. The most important part of these capital flows was related to strategic investments made into other Baltic states by banks and various financial intermediaries.

On these grounds the following conclusions can be drawn:

* FDI outward stock at the end 2000 was 16.7 per cent of FDI inward stock (7449.0 and 444,951 million kroons respectively). We can conclude that Estonian FDI abroad were less successful than FDI made in Estonia (losses in Russia, *etc.*).
* FDI inflows per capita were 5568 kroons in 1998, 3084 kroons in 1999 and 4730 kroons in 2000. FDI outflows per capita were 860 kroons in 1999 and 1853 kroons in 2000.
* FDI inflows as percentage of investment in fixed assets was 34.9 per cent in 2000, while FDI outflows as percentage of investment in fixed assets was 13.7 per cent.
* FDI inward stock as percentage of GDP at current prices is more than 50 per cent, FDI outward stock as percentage of GDP at current prices was 8.8 per cent at the end of 2000.

The stability of outward direct investments is questionable due to their concentration in the volatile Baltic financial sector. Outflows have mainly resulted from the expansion of Estonian commercial banks, financial services and insurance companies (belonging mostly to the Swedish capital) into the Latvian and Lithuanian markets. At the end of 2000, 60.6 per cent of the Estonian outward direct investment stock had been invested in the financial sector, with other sectors following far behind: real estate, renting and business activities 14.4, transport, storage and communication 10.3, manufacturing 8.8, wholesale and retail trade 4.6 per cent.

The major group of outward investments is deriving from the banking sector, which indicates that the domestic market is becoming too small for Estonian commercial banks and they are entering neighbouring Baltic markets. The major investors were *Hansapank* and *Ühispank*, the two biggest commercial banks in the Baltic states, who bought several Latvian and Lithuanian small commercial banks. This also explains why the largest part of total outward FDI of Estonian firms were made in the form of loan capital. The proportion of share capital and reinvested earnings was only 6.6 per cent.

Estonian manufacturing companies have not used outward investment as a foreign market entry method widely, which have mainly been limited to small investments in the food processing industry.

Direct investment outflows appear uncharacteristically volatile. This is due to the low absolute level of outward direct investment, which results in a single major operation swelling the aggregate figure. Although high in per capita terms, Estonian direct investments are actually not important in total FDI inflows into Latvia, its main recipient between 1993 and 2000.

Many data recordings can actually be traced back to individual purchases: A meat plant acquired the largest meat-packing plant in Latvia. An Estonian based textile, paper and property business extended its operations to Latvia and Lithuania. The Tallinn Dairy acquired a milk-processing plant in Ukraine, and Tallinn's largest department store opened an unsuccessful branch in Helsinki.

In 2000 Estonia was the best in economic terms among the Baltic States. However, the future is not clear. Latvia has the central geographical position. Riga is potentially the "capital of the Baltic States" and Latvian and Lithuanian markets are larger than the Estonian market. There is an obvious competition between Tallinn in Estonia and Riga in Latvia in the race to acquire the reputation of being the "hub" of business life in the Baltic region. Vilnius in Lithuania seems to be out of the race. Both Lithuanian main cities, Vilnius and Kaunas, are land-locked, while Tallinn and Riga have their harbours (Tiusanen and Talvitie, 1998).

The Baltic States cannot offer a large and affluent internal market for foreign investors. The Baltic sub-region has a market of only some 8 million inhabitants. The Baltic states can geographically offer a bridgehead position to foreign firms interested in Russian (and other CIS) markets (Tiusanen and Jumpponen, 2000).

3) Direct investment from Estonia to the main host countries

International credits ratings published by different institutions are often used to reflect the investment climate in various countries. In 2002, credit ratings for the Baltic countries were the following: Estonia A- (IBCA) and BAA1 (Moody's); Latvia BBB (IBCA) and BAA2 (Moody´s); and Lithuania BBB- (IBCA) and BA1 (Moody´s).

Different studies assessing the investment opportunities in transition economies list the main external barriers as follows (Hirvensalo and Hazley, 1998):

* central bureaucratic, administrative and legislative issues;
* protracted and complex negotiations or approval procedures;
* frequent changes of government officials and difficulties in finding the decision-makers who would accept responsibility; inconsistent policy changes and conflicting information from different ministries.

Latvia

Latvia has a general policy of foreign investment and appropriate legal acts have been passed to maintain this. The basic principle of this policy is to facilitate the flow of foreign capital into those areas of the Latvian economy which require high levels of capital investment or complete or partial modernisation of equipment, or into those areas which are poorly developed but which could develop Latvia's export base.

The foreign investment policy sets down certain criteria under which the usefulness of foreign capital offers is evaluated (*Conditions for…*, 1996):

* The impact of investment on the Latvian economy (especially where the following areas are concerned: job creation, the use of local raw materials, resources and services, and exports of Latvian goods).
* The impact of investment on productivity, development of technology, improvement of production quality and broadening of the range of produced goods.
* The impact of investment on competition in the proposed area.
* Possible domination by certain countries in the Latvian economy.
* The impact of investment on the competitiveness of Latvian goods on the world market.
* The impact of investment on the environment.

Problems for investors in Latvia were the following: the selection of companies to be privatised; the privatisation process itself; the use of privatisation certificates; the unresolved questions of land ownership; the treatment of enterprise liabilities. Serious problems for foreign investors in Latvia are related to the acquisition of information about new legislative acts. Court cases take a very long time to be tried (Spica, 1999). Product certification and registration is difficult (Hirvensalo and Hazley, 1998).

According to the statistics of the Bank of Estonia, Estonia had on 31 December 2000 in Latvia direct investments of EEK million 3994.2 (53.6 % of all direct investments abroad). According to Latvian statistics, FDI stock by countries in Latvia, Estonia was the sixth investor in Latvia (5%), after Denmark (14%), the USA (10%), Sweden (8%), Russia (7%) and the UK (7%). Estonia was followed by Finland (5%) and Norway (4%).

Lithuania

Lithuania's record in attracting foreign capital is not especially impressive. This is true despite a relatively successful privatisation programme. Lithuania shows a rather nationalistic attitude when it comes to asset sales to foreigners.

The criticism voiced by foreign investors in Lithuania is mostly about the state's heavy-handed approach towards business (Spica, 1999). Companies had experienced problems due to either the complicated nature of procedures or the protectionist policies of the government. Legislative environment apparently restricts foreign investments at both establishment and operation levels (Hirvensalo and Hazley, 1998).

According to the statistics of the Bank of Estonia, Estonia had on 31 December 2000 in Lithuania direct investments of EEK million 2329.2 (31.3% of all direct investments abroad). On June 30 2000 Estonia had, according to statistics of the Lithuanian Central Bank, an FDI stock in Lithuania LTL million 629.77 (http://www.lbank.lt/Eng/publications/PDF/mb002/35.pdf). This was 7.1% of all FDI in Lithuania on 30 June 2000. Estonia was the fifth investor in Lithuania, after Sweden (18.1%), the USA (13.4%), Finland (9.9%) and Denmark (9.7). Estonia was followed by the United Kingdom (7.0%), Germany (7.0%), Switzerland (5.7%), Norway (3.7%) and Luxembourg (3.3%).

4) Some examples on company level

As 84.9 per cent of Estonian investments abroad have been made in the other Baltic states (Latvia 53.6%; Lithuania 31.3%) and 60.6 per cent of Estonian investments abroad are connected with the financial sector, it is possible to conclude that the main direct investors abroad are *Hansapank* and *Ühispank* in Latvia and Lithuania. The rest of the investors and target countries are represented very modestly.

The strategies of the two biggest Estonian commercial banks have been quite different. *Hansapank* was founded in 1991. *Swedbank* administers banks in Latvia and Lithuania through Estonian *Hansapank*. *Hansapank* acquired a rather small Latvian bank (*Ventspils UBB*) with a mere 2.5 per cent market share. In 2000 the market share of *Hansapank* in Latvia was over 10 per cent in loans and almost 13 per cent in deposits (in all 36 offices). An acquisition route in Lithuania is open when the remaining state-owned local banks are privatised, but restructuring a rather large Lithuanian bank is not necessarily an attractive option for *Hansapank*. *Hansapank* is aiming at an outside expansion with Pan-Baltic strategy. *Hansapank* is positioned to leverage its experience gained in the relatively advanced Estonian market in less developed Latvian and Lithuanian markets.

Besides the Swedbank, there is another Swedish bank, *SEB* (*Skandinaviska Enskilda Bank*en), pursuing an aggressive expansion strategy in the Baltic region. SEB acquired in 1998 a major stake in Estonian *Ühispank*. *SEB* is going directly to all three Baltic states. *SEB* chose in 1998 (when coming to the Baltic states) just these commercial banks (Estonian *Ühispank*, Latvian *Unibanka* and Lithuanian *Vilnius Banka*) that had previously concluded mutual co-operation agreements.

As was mentioned above, other investors and target countries are of minor importance:

* *Ober-Haus* (real estate company) signed on 5 January 2001 a contract for the management of a shopping centre and a movie house in Gdynsk, Poland. *Ober-Haus* has 14 offices in Estonia, Latvia, Lithuania and Poland.
* *AS A. Le Coq*, the subsidiary of the Finnish beverage group *Olvi OY*, increased on 27 November 2000 its holding in the Lithuanian brewery *Raguta* to 50 per cent.

5) The case of "*Ösel Foods*"[1]

General description

Ösel Foods AS was established in Saaremaa, an Estonian island in the Baltic Sea, in 1993. Today it belongs to three persons. Two Estonians possess 50 per cent of the shares and a Finnish the other 50 of them. The two Estonian owners bought up wild berries and consigned cranberries to *Marli* factory in Finland. In return they received the juice concentrate Mehukatti, which was sold in Estonia. They bought equipment from Sweden, rented rooms from Saaremaa meat and dairy factory and started to manufacture the concentrate.

As the company was not able to satisfy the demand for Mehukatti, in November 1993 a manufacturing complex was established in Reola, near the second largest Estonian town, Tartu. In Reola the production complex is situated in a large farm formerly owned by the Estonian Agricultural Academy. *Ösel Foods AS* invested 12 million kroons into manufacturing.

In January 1999, *Ösel Foods AS* bought from a Norwegian company a fishing manufactory in Paljassaare, an area of the Estonian capital Tallinn. One reason for selling the manufactory to *Ösel Foods AS* was that they had access to Russian sale channels that could also be used for trading fish. The fishing unit was in a bad shape due to the Russian financial crisis of August 1998 and the loan from Hansapank together with *Ösel Foods AS* own investment was regarded as a sufficient condition to vitalise the fishing manufacture.

At the beginning of 2000, the parent company *Ösel Foods AS* announced the press that their new board planned to make several changes in the structure of the company and to take it to the stock exchange. With the intention of increasing the capitalization of the company and making it public, there was also a need to make it more open and transparent to attract new owners. The idea was to create a holding company with different subunits, such as *Ösel Esva AS*, which cans fish. *Ösel Foods AS* continues with soft drinks, *Ösel Mari AS* deals with berries and *Ösel Invest AS* holds investments in Russia.

[1] The contribution of Evelin Aarma is acknowledged in preparation of the case study on *Ösel Food*.

FDI abroad

Exports to Russia were considered as an important strategy for the company because the Russian cities, Moscow and St. Petersburg seemed to have a big demand for Estonian food products. At the same time, there were specific conditions for exports. The cap between wholesale and retail sale prices was several times larger than in Estonia due to larger numbers of intermediates causing very high retail prices. A picture was created that everything was very expensive and it was possible to earn a large amount of money. Really, wholesale prices were low and the exporter had to base on the economy of scale. All leading producers of the world were represented and on the ketchup of *Ösel Foods AS* had to compete on the market with more than 200 other similar products. High competition led to a situation that for market entry products had to be sold on credit. This created for Estonian companies heavy losses after the 1998 financial crisis in Russia.

A serious obstacle has been created by the customs tariffs system. In May 1996, the Russian Customs Committee initiated a new regulation according to which customs tariffs were calculated on the basis of the quantity of goods, not on price as previously. As Estonia did not have a Most Favoured Nation (MFN) regime with Russia, the Estonian exporters met double tariffs compared with exporters from countries having the MFN agreement. The tariffs soared to 40 per cent of the price of soft drinks and 35 per cent of the price of ketchup. Another major source of problems has been high transportation costs, which constitute up to 30% of the price of soft drinks. On the other hand, fixed to the US dollar, rouble and the relatively high inflation in Russia created macroeconomic conditions where real effective foreign exchange rate of the kroon against the rouble depreciated and supported Estonian exporters.

The importance of Russian exports increased substantially in 1997. Avoiding of customs tariffs and diminishing transportation costs, *Ösel Foods AS* decided to establish a production unit in Moscow. The idea was to create a good basis for manufacturing and starting with ketchup and mayonnaise to move further with juice concentrates and fish processing.

A joint venture with the Russian wholesale company *Mir 93* was founded in 1997. The share capital of the joint venture with the name, *Ösel Invest AS* was one million USD of which *Ösel Foods AS* put into the company about 60 per cent. A suitable place was found around 20 km from the central area of Moscow. The rent agreement for the use of 2400 square metres land and facilities was signed with local authorities for 20 years. The employment of 100 local people was planned.

In February 1998, the construction company finished rebuilding an old dining place of a Soviet time manufacturing plant. The equipment for the unit was brought from Estonia. Only a small part of the equipment was bought for share capital additionally. All costs related to the new unit in Moscow amounted to 21 million kroons, 8 million kroons for construction and 13 million kroons for equipment. The output was planned at a level of 1000 tons per month. At that scale of production, the investment costs would be covered during two years.

The start of production was postponed several times due to various reasons. First, there were problems with importing equipment into Russia from Estonia tax free. Then problems with installation and training emerged. After that obtaining production allowances and certificates from Russian respective services was postponed several times. In August 1998, the company was ready to start production in Russia.

The joint venture in Moscow started operation in a few weeks after the financial crisis. The relatively costly imported inputs created losses after the decline of Russian prices in USD terms following the deep devaluation of the rouble. In October 1998, the company was using only 25% of its capacities for the production of ketchup. At the same time, the company introduced the production of plastic bottles in Moscow. The company made a contract with the *Baltimor* company in St. Petersburg for 1 million bottles per month. Most of the revenue during 1999 came from the production of plastic bottles. The respective equipment worked 24 hours a day.

Nevertheless, due to the decline of exports and low production in Russia, *Ösel Foods AS* made heavy losses in 1999. At the same time, as the company reinvested profits and used a limited amount of bank credits, consolidation was possible in 2000.

The company met the following challenges: (1) to create a large enterprise with a turnover of a billion kroons and emerge with substantial market share after two to three years; (2) to consolidate the factory and sell it then to some global company in the same field; (3) to accept losses and to think about market exit.

The main problems, according to the managers of the company, have been the difference in business culture and the distance of 1000 kilometers, which is too long for the operative management of a company. The management of the joint venture was taken over by Russian partners in 2000. In 2001, the company in Moscow is in sale and *Ösel Foods AS* expects to get some compensation for its assets.

Conclusions

Although the volume of FDI is quite low on a global scale, Estonia is one of the most successful transition countries of CEE attracting FDI on a per capita basis. Due to liberal economic policies, closeness to Finland and Sweden (Finnish and Swedish capital), success in attracting FDI and relatively fast economic development Estonia has also become a local (mainly Baltic) direct investor abroad.

Though Estonian firms are important foreign investors in Latvia and Lithuania, the real reason of such a situation is mostly the geographical closeness of Estonia to Finnish and Swedish capital. The ultimate goal of Finnish and Swedish firms is not only to operate in Estonia, but to move forward to the south. Estonia serves simply as the first step in realising this strategy.

It is easier for Estonian businessmen and administrators (managers) to operate in Latvia and Lithuania than for Finnish and Swedish people since Estonians are familiar with the local economic environment and have personal contacts. Estonian top managers are engaged in Finnish and Swedish ventures.

Estonian investors meet (psychological) resistance in Latvia and Lithuania. Some people tend to think that relying on the common Soviet heritage Estonians buy their national firms. Still, this resistance is weakening. The main reasons are (1) the number of firms belonging only to Estonian capital is decreasing and (2) most Estonian investors employ local top managers. In fact, Estonia does not act in the Baltic region as a pioneer. It is rather a temporary agent. FDI from Estonia to Latvia and Lithuania mostly belongs to Finnish or Swedish capital flowing through the country.

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Carpathian Euroregion: Results, Problems and Prospects with Special Regard to EU Accession

A Ukrainian Approach

Zsuzsa Ludvig[*]

1) The Carpathian Euroregion as a unique example of crossborder cooperation

The Carpathian Euroregion (CE) was the first euroregion having been formed by members (counties, towns and voivodships) belonging only to Central and Eastern European countries (Hungary, Poland, Ukraine, Romania and Slovakia).[1] It was established in February 1993, in a relatively early period of the Eastern European transition process, especially in the case of Ukraine. However, it certainly shows that the opportunities that might be earned by this kind of cooperation were realised soon in Ukraine. It also provides an explanation why three other oblasts (Cernivci, Ivano-Frankivs'k and L'viv *oblasti*) joined the euroregion so quickly after its foundation. (The only Ukrainian founding member was Transcarpathia.)

Though it is a common feature of most regions on the peripheries to be at a lower economic development level compared to their country centres, the peripheral situation seemed extremely striking in case of the cooperating regions in the Carpathian Euroregion. For instance:

* In 1994 the value of GDP per head in the five Hungarian CE members was 27 per cent of EU average.

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[1] Romania and Slovakia had only held an "associated" or "observer" status due to their governments' reservations before they gained full membership in 1997 and 1999, respectively.

* In 1992 the share of Slovakian CE members in total invested FDI in Slovakia was only 3.5 per cent while their population proportion equals one-fifth of all inhabitants.
* In 1993 the proportion of Polish CE members in aggregate Polish investments amounted to 4.4 per cent compared to their 6.1 per cent share in the population.

Owing to its enlargements the territory and the population of the Carpathian Euroregion have become as large as those of a state. (*Table 1* and *2*) The enormous extent combined with the high number of states involved raise specific problems. Though, in principle, it is an example of cross-border cooperation, in practice it consists of parts that are not only non-neighbours but are located rather far away from each other. On the one hand, the CE has member regions without almost any links to each other, on the other hand, it envelops borderlines burdened by conflicts (among them of ethnic type) rooted in the past. Both *Table 1* and *2* show a Ukrainian dominance, which is not reflected in the effective regional activity. The two dominating national sides belong to the two other "founding" countries, Poland and Hungary. There is a slight rivalry between the two over the leading role in the region.

Table 1

CE territory (2000) after "enlargements"

	Thousand km^2	Percentage
Poland	18.7	11.6
Hungary	28.6	17.7
Romania*	42.1	26.0
Slovakia	15.7	9.7
Ukraine	56.6	35.0
Total	*161.7*	*100.0*

* excluding Hargitha county

Table 2

CE population (2000) after "enlargements"

	Thousands	Percentage
Poland	2375	14.6
Hungary	2609	16.0
Romania*	3326	20.4
Slovakia	1544	9.5
Ukraine	6429	39.5
Total	*16283*	*100.0*

* excluding Hargitha county

2) The Carpathian Euroregion and Ukraine

Soon after gaining independence Ukraine expressed its willingness to join Europe and this intent has become more pronounced since then. From the outset the Carpathian Euroregion has also been considered as a kind of bridge, a possible way of linking Ukraine to Europe. All other members in the region belonged to countries with a promise for future EU membership, except Ukraine. This country has a special but in its essence still unclear partnership agreement with the EU, however, its ultimate aim is full membership through different stages. According to a Ukrainian presidential document set forth in Brussels these stages are the following:

(1) 2002–2003: solving problems with entering the WTO;

(2) 2004: creating a Free Trade Area with the EU;

(3) 2007: Customs Union with the EU;

(4) 2007: Association Agreement;

(5) 2011: necessary preconditions for Ukraine's accession to the EU.[2]

The reality of this timetable will basically be decided by Ukrainian domestic developments. On the other hand, the possibility of Ukrainian EU membership depends on the outcome of Eastern enlargement and the internal reforms of the European Union. Besides the role of a bridge or gateway to Europe the socio-economic spill-over impacts of crossborder cooperation have been of great importance for the Ukrainian participation in the CE. (*Table 3*)

Table 3

Some basic indicators of Ukrainian CE members

1999–2000

	Share in all Ukrainian population	Official unemployment rate (%)	Share in all Ukrainian FDI (%)
Transcarpathia	2.6	5.1	2.3
Ivano-Frankivs'k oblast	2.9	7.2	1.2
L'viv oblast	5.4	6.1	3.5
Cernivci oblast	1.9	3.7	0.4
Above-mentioned together	12.8	…	7.4
Ukraine	100.0	3.7	100.0

Source: national statistics

[2] Quoted from the lecture delivered by Hryhorii Nemyria in a seminar "Ukraine and the enlarged European Union", Warsaw, 11–13 April 2002.

Summarising the economic situation in the four oblasts concerned it can be said that they all are in a peripheral situation still, with growing and relatively high unemployment rates compared to the national average, with small share of GDP, low investment rates, lack of necessary structural changes, *etc.* These are the main reasons why expectations toward the cooperation in the framework of the Carpathian Euroregion were so high from the beginning in Ukraine.

Transcarpathia, that belongs to the founding members, has always been the most active Ukrainian member, and it provided the Secretary with accommodation for some years. Anyhow, the other three oblasts have shown less or limited interest in CE work. Far distances, the lack of existing personal and business contacts can be found among the reasons. The outstanding activity of Transcarpathia has mostly been due to Hungarian–Hungarian links. At the same time L'viv and Cernivci oblasts began to show more activity and interest in other euroregions with Polish and Romanian partners. (The Bug and the Sub-Danube euroregions can offer them better opportunities compared to the county-size large Carpathian Euroregion, whose peripheries they lie on.)

One of the main achievements of the Carpathian Euroregion is its contribution to diminishing the still existing mistrust of Central European nations and ethnic groups towards each other. The creation of a framework for the cooperation of Hungarians, Romanians, Polls, Ukrainians and Slovakians and other smaller groups in one organisation is CE's main merit. One of the interviewed persons in Poland said that a worsening situation in minority issues, ethnic conflicts could have resulted in a "second Balkan conflict". Therefore offering the participating nations the chance to cooperate, the CE provides the opportunity for partitioned ethnic groups to build up close ties with the "mother country".

Although Transcarpathia is in a unique situation of having common borders with all the other four countries, it only has truely active relations with the Slovakian and Hungarian neighbours. The most characteristic ties are of a Hungarian–Hungarian type. (Approximately 12% of Transcarpatian population belongs to the Hungarian ethnic group.) They involve fruitful business contacts, cooperations between universities, students exchanges and also a vivid investment activity of the Hungarian companies. (*Table 4* shows the number of joint ventures in Transcarpathia, most of which made with the initiative of Hungarian firms.) By April 2001, Hungary became the most important investor in Transcarpathia. Special legal conditions for investment in Transcarpathia are ensured by the Law on the Special Regime for Investment Activity in the Transcarpathian Oblast and the Presidential Decree on the Special Economic Zone 'Zakarpattya'. These pieces of legislation grant special tax and customs privileges to investors with investment projects worth at least USD 250,000 in priority fields.

Similarly to Hungarian–Transcarpathian links, Ukrainian cooperation with the Polls near the Polish border is also fruitful. The big number of joint ventures in L'viv oblast assumes considerable investment activity on the part of Polish firms.

Table 4
Number of joint ventures

	1990		1999	
	Number	Share in all joint ventures in Ukraine (%)	Number	Share in all joint ventures in Ukraine (%)
Transcarpathia	3	3.6	345	4.7
Ivano-Frankivs'k oblast	1	1.2	144	2.0
L'viv oblast	10	12.2	776	10.5
Cernivci oblast	2	2.4	87	1.2
Above-mentioned together	16	19.4	1352	18.4
Ukraine	82	100.0	7362	100.0

Source: Ludvig – Süli (2000): Cooperation and catching up within the CE (in Hungarian)

3) IWE research on the Carpathian Euroregion

The Institute for World Economics of the Hungarian Academy of Sciences has had a research project focusing on the results, problems and prospects of the Carpathian Euroregion over the last two years. In the first stage we made a statistical analysis on the economic and infrastructural development of all five members in the region. Our original goal was to investigate the concrete results of all the nine years and the achievements in catching up related to euroregional work. Very briefly, conclusions can be drawn as follows: From the very beginning until today, we cannot talk about the closing up of the regions (not even to national averages). The results of joint efforts within the framework of the euroregion are of a different nature. The peripheral situation of CE members has remained a major characteristic and reality sharply contrasts expectations held at the time of forming the region.

At the second stage, we made interviews with the national representatives of the euroregion in all five countries. (Officials engaged in the issue, leaders of self-governments and some representatives of the civil society were also asked). By collecting ideas and opinions of competent persons we tried to draw up a general picture of different country approaches. We tried to quantify these opinions by asking all the interviewed persons to score the main results of CE work and the major obstacles to it as well.

The following view on the results, problems and prospects is based on answers from Transarpathia, the most active and well-informed Ukrainian member-oblast of the euroregion.

4) The main fields of achievements and failures – seen from Ukraine

Generally, the interviewed Ukrainian/Transarpathian officials gave a very pessimistic picture of euroregion activity. The main average on a 10 points scale was only 4.4 when valuing euroregion success as a whole. It was only the Ukrainian national side that had the greatest expectations towards economic development, an obvious, perceivable improvement in living standards from the beginning. The reason of these expectations lies in the fact that the Ukrainian members were on the lowest level of economic development of all cooperating regions. Naturally, based on the experiences of West European euroregions, these kinds of results may be expected only in the long term, for 8–9 years are not enough to reach them. (*Table 5* shows

Table 5

The scores of interviewed persons on euroregional achievements

Main achievements (above 6 points)	Still acceptable achievements (4-6 points)	Poor results, failures (below 4 points)
Diminishing of mistrust between nations and ethnic groups	Promoting infrastructural development	Promoting economic development
Promoting “neighbourly relations”	Promoting relations between entrepreneurs of different countries concerned	*Improvement in border crossing*
Organising common conferences	Promoting trade links within the euroregion	*Providing information on the partner countries' legal and administrative regulations*
	Organising international fairs and exhibitions	*Common efforts in environment protection*
	Creation of turistical map of CE	*Promoting investment in partner countries*
	Cooperation between universities	*Promoting tourism*
	Organising common sport, cultural, *etc.* competitions	Improvement in transport conditions
	Organising joint research projects	*Creation of the image of the CE*
		Organising transborder police cooperation

Maximum points: 10; minimum points:1

Source: Ludvig- Süli (2002): Results, problems and prospects of the CE the long list of failures or poor results and the very short list of successes or main achievements, as well as the fields with still acceptable results.) The main results of the euroregion cooperation are of a non-material kind but they all belong to such general values as (1) diminishing mistrust between nations and ethnic groups, (2) promoting "neighbourly relations" and (3) reaching cultural, educational understanding.

Taking the list of failures or insignificant results we can conclude that most of them are related to economic issues. Besides, little improvement has been brought by the euroregion in gathering and providing information on the partner countries' legal and administrative regulations. It is interesting that even improvements in the very awkward question of border crossing, which had been due to definite euroregion incentives, were considered not to be satisfying in Ukraine. (The Carpathian Euroregion had initiated at governmental level in the countries concerned – for example in Hungary and Ukraine – to open several new border crossing points or reconstruct old ones. Many of the proposals have been carried out.)

5) The main problems in euroregion activity, reasons of failures – seen from Ukraine

The opinions of interviewed Ukrainian persons and officials had a lot in common. The large distances resulting the impossibility of common actions or the lack of common interests were mentioned by all of them. The possibility of terminating membership in the giant organisation has also been mentioned as a kind of solution to emerging problems. In my view, one should agree with the realistic assumption that separation could undermine the already achieved results in neighbourly relations, diminishing mistrust and the general opening up towards each other.[3]

The most serious problems are related to financial difficulties, the lack of capital – *i.e.* the little amount of invested foreign capital –, the underdeveloped infrastructure. (*Table 6*) It is not easy to find solution to these problems, at least not in the short or medium term. Another obstacle to successful operation is caused by the frequent changes in leadership. The main body, the Council, consists of mostly politicans, self-government leaders who are elected at different times for a 4–5-year period in each country. A possible way out of this problem could be involving people from civil societies.[4] Nevertheless, according to the Ukrainian answers, personal conflicts within the organisation and different interests in the cooperation in general are the least serious problems.

[3] To be a little more optimistic, it must be emphasized that there are well-functioning sub-regions within the Carpathian Euroregion, the activity of which should be supported and strengthened. These non-official subregions are in most cases two or three-sided. (For example, with Hungarian–Ukrainian–Slovakian or Polish–Slovakian or Hungarian–Romanian participants.)

[4] There has only been one single member representing civil society, a Hungarian.

Table 6
The scores of interviewed persons on the main problems of the CE

Most serious problems (7-10 points)	Serious problems (4-7 points)	Non-serious problems (below 4 points)
Scarcity/shortage in financial resources	Language barriers	*Different interests of members in euroregional cooperation*
Lack of self-contained budget	Different levels of economic development of the members	Personal conflicts in the organisations
Border-crossing problems	Different levels of infrastructural development of the members	
Lack or decrease of interest of outsider sponsors	Shortage in experts	
Frequent change of CE leaders	Structural problems	
	Scare temderomg	
	Inefficiency in participating on tenders	

Maximum points: 10; minimum points: 1
Note: Italics in the table indicate issues in which Ukrainian scores show a difference from average.

Here I would like to turn to a serious shortcoming in euroregion activity, the problem of submitting tenders which, contrary to the Ukrainian responses, is considered to be among the most serious problems in the other four countries. This question leads us to the issues of relations between the EU and Ukraine and the impacts of EU enlargement.

6) Relations with the EU, the possible impacts of accessions

Compared to the other four countries, the awareness of already available EU funds supporting East European crossborder cooperation has been on a lower level in Ukraine. It is especially important to make headway in this respect too, since one of the main conclusions drawn from the whole Carpathian Euroregion project was that only EU funds – either the accessible or the would-be available after Eastern enlargement – could exert the necessary pulling effect on development. Analysing the prospects of the CE, it was a common opinion in Ukraine (and elsewhere too) that enlargement would relieve the region of its present deadlock in the wake of widening EU funds. (First of all by the emerging possibilities within the Interreg program.) It could help to solve the most serious structural problems, such as establishing an independent, professional and permanent secretariat, and a self-contained budget. In order to make a maximum use of the emerging availability of EU funds Ukraine would need much more experts speaking the “EU-language”, managing effective tendering, of course. This is a prerequisite of Ukraine’s strategic aims of the associated status or full membership as well.

At the same time, taking into account the impacts of EU enlargement, fears have been expressed regarding the impact of the Schengen requirements. The Schengen border will divide the territory of the CE causing serious difficulties in everyday communication. This is a special problem of the Ukrainian member regions. Though the introduction of a visa regime seems to be inevitable on the Ukrainian borderlines by the accessing countries, the way of introduction – whether it will be a soft or a strict regime – is very important. (Some examples for the softening of a visa regime: establishment of additional border crossing points, modernisation of existing ones, liberalising visa-issuing systems, *etc.*)

For the moment it is merely a hope that the Schengen border will function not only to devide but to connect as well. It may be assumed because Ukraine – and the Ukrainian members of the CE – could serve as a gateway to other CIS countries and their huge, potential markets. In principle, a favourable geopolitical situation could give a strategic significance to this region.

It was a general view held both in Ukraine and in other countries that the Carpathian Euroregion as an example of cooperation within Central and Eastern Europe might exert positive impacts on EU enlargement decisions. This is especially important in the case of Ukraine, the country that does not even have the promise of the EU for membership or associated status. The problem is that at present the concrete results of euroregion activity are far from being satisfactory or convincing.

* * * * *

Appendices

Appendix 1

EU–Russian Common European Economic Space (CEES)[*]

Table 1
What is Common European Economic Space?

* Long-term initiative launched in May 2001 (Stockholm summit).
* Objective: to underpin Russia's ongoing economic reforms and help Russian companies to take advantage of the prosperity that EU enlargement will bring.
* Coherence between the respective legislative standards.
* Russia would use the present economic reform programme to make its laws and regulations compatible with those of the EU's.

Table 2
Variants of definitions of CEES

* Formal integration *vs.* systematic programme of measures enhancing proximity.
* Definition in terms of existing integration frameworks *vs.* descriptive definition of the final stage formalised as CEES.
* Choice between a pre-condition of FTA and similarity to European Economic Area.
* Closed integration *vs.* open integration – preferential treatment measures *vs.* universal proximity algorithm applicable to intra-European proximity with other partners.
* Unilateral process of Russian legislation adaptation *vs.* bilateral process where both parties are ready for concessions.
* Limited approach (with emphasis on four freedoms) *vs.* comprehensive approach encompassing sectoral issues.

[*] *Appendix 1* is based on the presentation of Igor Kolosnitsyn, head of the Russian European Center for Economic Policy (RECEP). Tables are based on the research conducted by Vadim Novikov, RECEP.

Table 3
Principal preliminary classification of the chapters in the acquis *vis-á-vis* the concept of CEES

Chapters not immediately relevant to the concept of the CEES	Chapters seen as "detrimental"*	Chapters less fundamental**	Essential chapters***
11. Economic and Monetary Union	7. Agriculture	9. Transport policy	1. Free movements of goods
15. Industrial policy	8. Fisheries	12. Statistics	2. Freedom to provide services
16. Small and medium enterprises	10. Taxation	14. Energy	3. Freedom of movement for persons
17. Science and research	13. Social policy and employment	19. Telecommunications and information technologies	4. Free movement of capital
18. Education and training	22. Environment	20. Culture and audio-visual policy	5. Company law
21. Regional policy and coordination of structural instruments	23. Consumers and health protection	26. External relations	6. Competition policy and state aid
24. Cooperation in the fields of justice and home affairs			25. Customs union
27. Common foreign and security policy			
28. Financial control			
29. Financial and budgetary provisions			
30. Institutions			

* Should these chapters be "introduced", the economic competitiveness of Russia would decrease.
** Chapters less fundamental but important for those economic policy measures that can be realistically introduced in the near future.
*** Essential chapters, that have to be accounted for in the process of economic reform.

Appendix 2

RUSSIAN OIL AND GAS EXPORTS TO THE EU

Attila Kulcsár*

Russia and the European Union are historical and natural partners in the energy sector. Some figures from the 1990's illustrate their interdependence in this field. According to the 1999's data Russian energy exports account, in value, for 45 per cent of exports to the EU. More than half of Russian oil exports was supplied to the EU in 1999. Nearly two-thirds of Russia's natural gas was delivered to European countries. More than half of the European exports was transported to the EU. These facts show the significance of energy cooperation between Russia and the European Union.

1) Strategic dimensions

1.1. The importance of the EU for Russia

* The EU is the main trading partner of Russia (it takes 40 per cent of Russia's trade).
* The EU is the largest provider of economic and technical assistance for Russia: for example, in upgrading the industrial base and satisfying the need for investment in the energy sector, which is estimated at 726 billion euros between 2001 and 2020. (*Graph 1* and *2*)
* The enlarging EU will ensure Russia's energy exports and market share in the Central European and the Baltic regions, which are heavily reliant on energy imports.

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1.2. The importance of Russia for the EU

* Russia is the sixth trading partner of the EU.
* EU objectives are the opening of energy markets to competition and securing energy supplies through the diversification of sources by geographical regions. Russia is an important supplier of energy: first world exporter of natural gas and second world exporter of oil. Especially since 11 September 2001 Russia has played a major role on the oil market as a new alternative source of massive oil supplies, and as a more reliable partner than several countries in the Middle East, for example, Iraq or Libya.

1.3. Common interests

* The importance of stable energy markets: reduced volatility in oil markets, long term contracts for natural gas, security of energy supplies.
* The need for reliable energy trading partners.
* The reduction of environmental damage from the use of energy – according to the Tokyo Protocol.

In October 2000 at the energy summit between the EU and Russia, the EU agreed to help Russia to develop its oil and natural gas reserves in return for a long-term energy supply commitment, and promised to boost Russia's oil and natural gas exports.

2) Oil and natural gas exports to the EU

2.1. The EU as an export market

The EU region is a net importer of energy. In 1999, while the EU 15 consumed 16 per cent of the world's energy, they produced only the half of it. Import dependency varies by fuel and individual country, with an overall import dependency for the entire EU of around 50 per cent. In 1999, the EU was a net importer of natural gas (9% of world production *vs.* 16% of consumption), and especially of oil (5% of world production *vs.* 18% of consumption). Germany, Italy and France are the EU's largest net importers of energy; the United Kingdom is the only significant net exporter. EU oil and natural gas are imported primarily from Russia, Norway North Africa and the Persian Gulf. (*Graph 3* and *4*)

2.2. Oil exports

Crude oil exports are the key source of income for Russia, as revenues from exports provide approximately a quarter of the Russian government's income.

Since 1991, Russian oil exporters have increasingly shifted their focus from the countries of the CIS and Central Europe to Western Europe, to the EU region. As countries in the former Soviet Union have racked up oil debts, Russian oil exporters targeted customers in Western Europe, where demand for oil is strong, supply is limited and payment is in cash.

The majority of Russian oil exports flow to countries such as the United Kingdom, France, Italy, Germany and Spain. The share of net exports to countries outside the former USSR rose from 50 per cent in 1992 to nearly 90 per cent in 2000, and the share of net exports to former COMECOM region decreased. So it was a successful change of orientation. Russia's net exports outside the CIS totalled 3.8 million bbl/d in 2000, while only 570,000 bbl/d was exported to CIS region. (*Graph 5*)

2.3. Natural gas exports

The Russian Gas Law of 1999, according to which the government determined to keep domestic natural gas prices artificially low, means that the country's natural gas industry is heavily dependent on exports to finance its production. Russian natural gas exports to Europe now account for 65 per cent of Russia's total natural gas exports.

Historically, the majority of Russian natural gas exports were sent to Eastern Europe – the former COMECOM region –, but since the collapse of the Soviet Union Russia is trying to diversify its export options, destinations. Russia continues to export significant amounts of natural gas to the CIS because of the existing distributional network linking the former Soviet republics, but Gazprom is shifting its export strategy to sell more natural gas in the EU and Turkey. Russia is also looking for markets in China, Japan and South Korea.

Russia's natural gas supply amounts to more than 25 per cent of EU natural gas supplies, and with the energy agreement signed by the Union and Russia in October 2000, Russia is eager to increase this percentage. Gazprom, Russia's sole natural gas exporter to Europe, already has contracts to deliver 6.2–7.2 trillion cubic feet/year to Europe beyond 2007. However, if Gazprom is to fulfil this long-term aim of increasing its European sales, it will have to boost its production, as well as secure more reliable export routes to the region. Several proposed new export pipelines would serve European markets if constructed.

The major markets of Russian natural gas are France, Germany and Italy. (*Graph 6*)

2.4. Export routes

A well-organized pipeline system with big capacity can insure steadily growing oil and natural gas exports. Transneft is the state-owned company responsible for Russia’s extensive oil pipeline system. The company lacks the financial background to repair or upgrade many of these malfunctioning pipes and Transneft’s focus has been on building new pipelines instead, to increase and diversify export routes for oil exporters. Russia’s main export pipeline to Europe is the 1.2 million bbl/day capacity Friendship that traverses Belarus before splitting into Northern (to Poland and Germany) and Southern routes (to Hungary, Slovakia and the Czech Republic). Russia’s ability to export its oil to world markets is limited. The country’s main export terminals for crude oil and oil products, with an aggregate capacity of 1.7 million bbl/d (in Ventspils–Latvia, Klaipeda–Lithuania, Tallin–Estonia, and Odessa–Ukraine with a capacity of more than 600,000 bbl/d), are located outside Russia, forcing the country to pay billions of dollars a year transit fees to export oil.

Since oil exports are a major source of central budget revenues, Russia seeks to increase its domestic capacity and reduce the transit fees payments. Thus the government and the Russian oil majors are building a number of new pipelines and export terminals, such as the Baltic Pipeline System to Port Primorsk, which gives Russia a direct outlet to Northern and Western European markets.

Russia’s main natural gas export pipelines to Europe are the Brotherhood, the Progress and the Soyuz (via Ukraine), the Yamal-Europe and the Northern Lights (via Belarus to Germany), with capacities of nearly 2 Tcf. In an effort to diversify her export routes and reach new markets, Russia is planning to build several natural gas export pipelines: the Blue Stream pipeline to Turkey, the Yamal-Europe 2 to Germany and France.

3) Behind the curtains: the export strategy of Russia and its companies

3.1. Relationship between oil exports and the economy

Since energy accounts for 40 per cent of Russia's exports and 13 per cent of the country's real GDP, Russia's economy is extremely sensitive to global energy price fluctuations, which means that only 1 USD/bbl decrease in the oil price is a significant blow to the budget. As a result, the decline in world oil prices in 2001 put the brakes on Russia's economic recovery, which was fuelled by high oil prices in 1999–2000 and increased competitiveness of Russian exports in the aftermath of the 1998 financial crisis. Although the windfall in oil export revenues in 1999–2000 stimulated increases in other industrial sectors and helped the Russian government to pay down some its 154 billion USD foreign debt, structural reforms slowed down in the euphoria of the oil revenues. While Russia is a key oil and gas exporter, the chance for economic reforms depends on the success of the energy sector.

Russia is not a member of OPEC, although in recent years the government frequently attempted to coordinate its export strategy with the organization to stabilize world markets.

3.2. The strategy of oil and gas exporting companies

The major Russian oil and gas companies are the backbone of the country's economy. Therefore they have important influence on Russia's energy policy, and their strategies appear in the country's strategy. The strategy of the majors generally include the following:

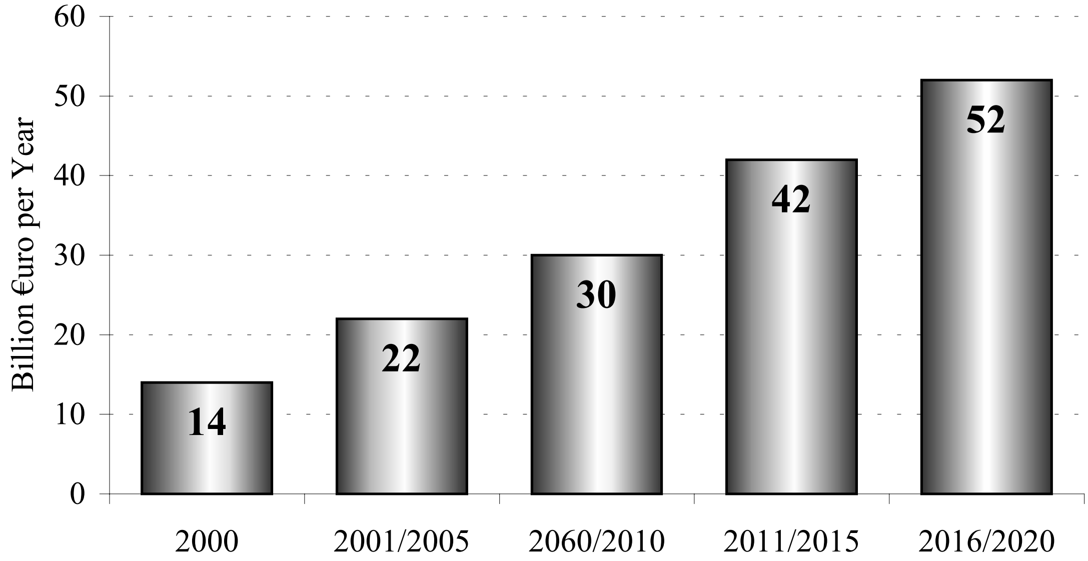
- Company growth.
- Production growth (to extent the presence of companies at the foreign markets).
- Spanning the lack of investment (to reinvest a greater part of the profits); production sharing agreement contracts with foreign supermajors and independents; the enhancement of partnership with the EU.
- Other targets: high-skilled employees, successful managerial and corporate development, etc.

The biggest Russian energy companies, Gazprom and the several vertically integrated oil companies, Lukoil, Yukos, SNG, TNK and Rosneft play a vital role in the European energy markets, through their intensive, sometimes aggressive international activities. This group of corporates has been developing a corporation network in Europe, with numerous joint ventures and some strategic partners. This network covers the company's downstream interest and market share in the continent.

It is often unavoidable that government policies and company interests confront each other. For example, in December 2001 and March 2002 in the case of quota agreements between Russia and the OPEC: company interests were to boost oil production, while the government's main targets were to stabilize the oil market, and so the price of oil. (The government has a formidable tool, Transneft, which is a state-owned transport monopoly, thereby the state can control and limit energy exports. An interministerial commission determines companies export quotas for each quarter.)

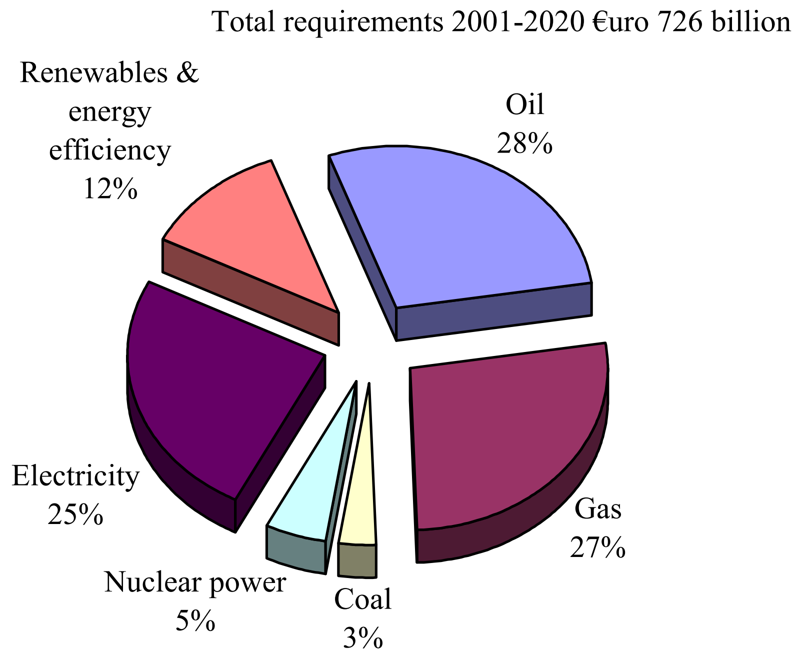
* * * * *

Graph 1
Russia's energy sector investment requirements
Part 1



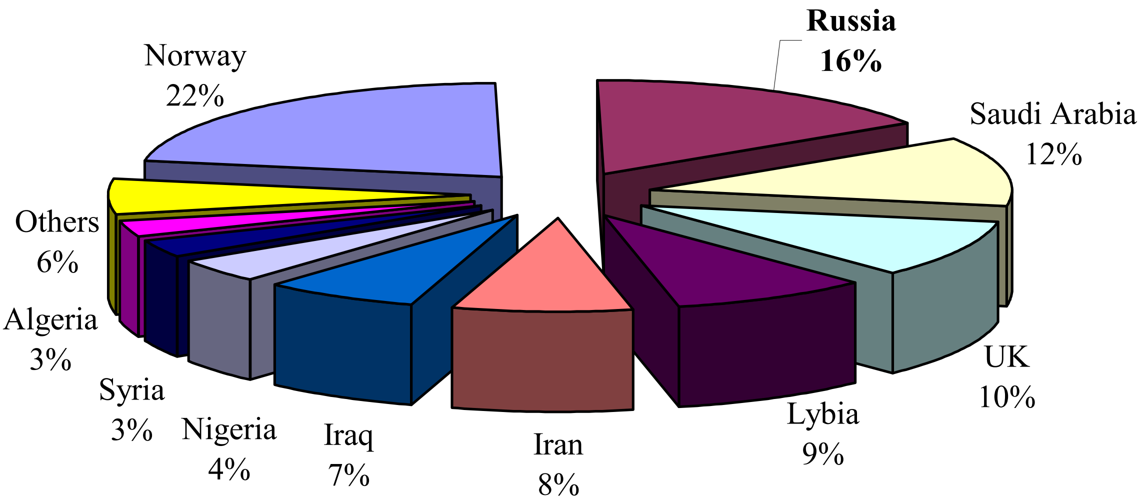
Source: IEA 2001. Average of the forecast range of investment needs.

Graph 2
Russia's energy sector investment requirements
Part 2



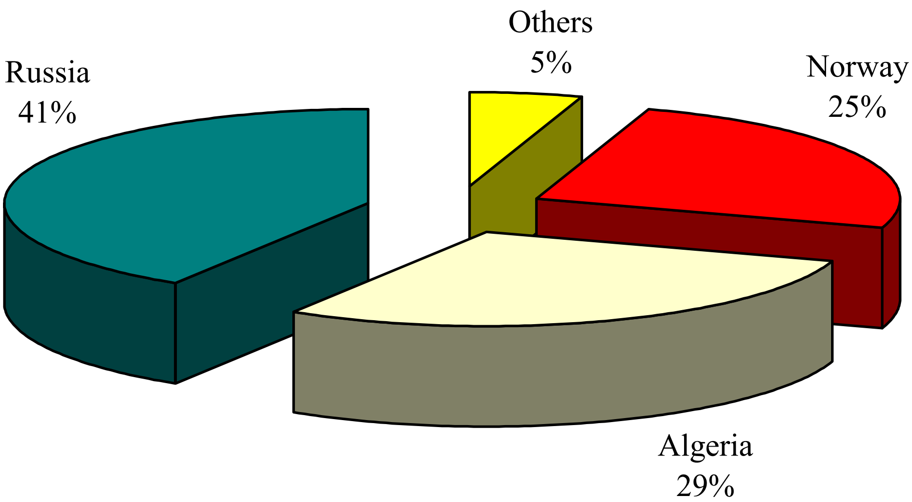
Source: IEA 2001. Average of the forecast range of investment needs.

Graph 3
Origins of EU crude oil imports by countries, 1999



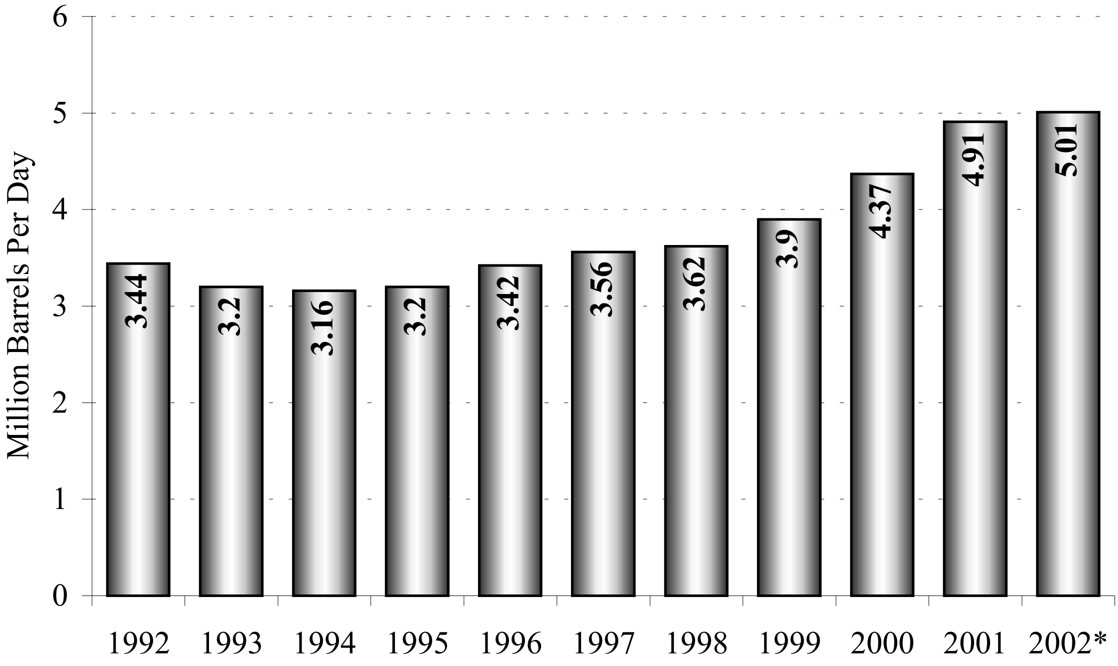
Source: IRAN Ecommerce, 2000.

Graph 4
Origins of imports into the EU in 1999
Natural gas



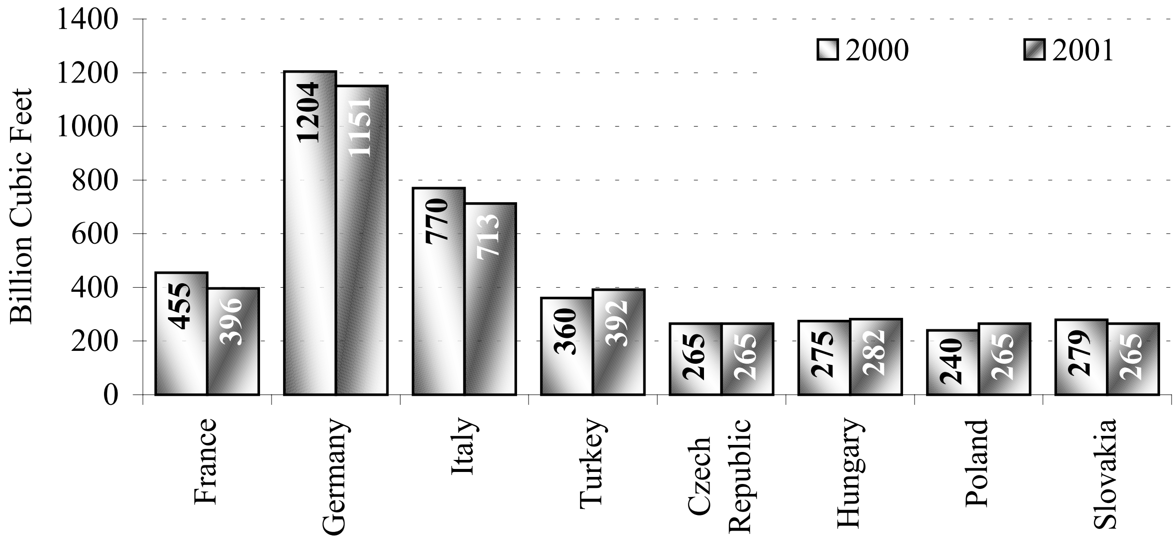
Source: Christian Cleutinx: Towards an EU–Russia Energy Partnership, 2002.

Graph 5
Russian net oil exports, 1992–2002*



* 2002 figures are projected
Source: EIA, 2002.

Graph 6
Gazprom natural gas exports to major European consumers
2000–2001

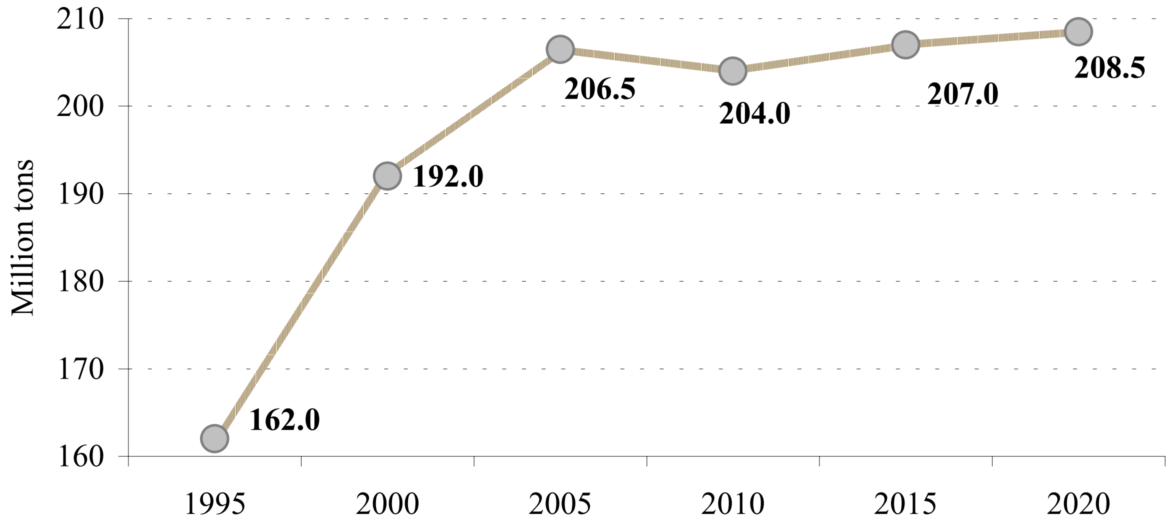


Source: Gazprom, 2001.

Some forecasts and scenarios for the period between 2000–2020

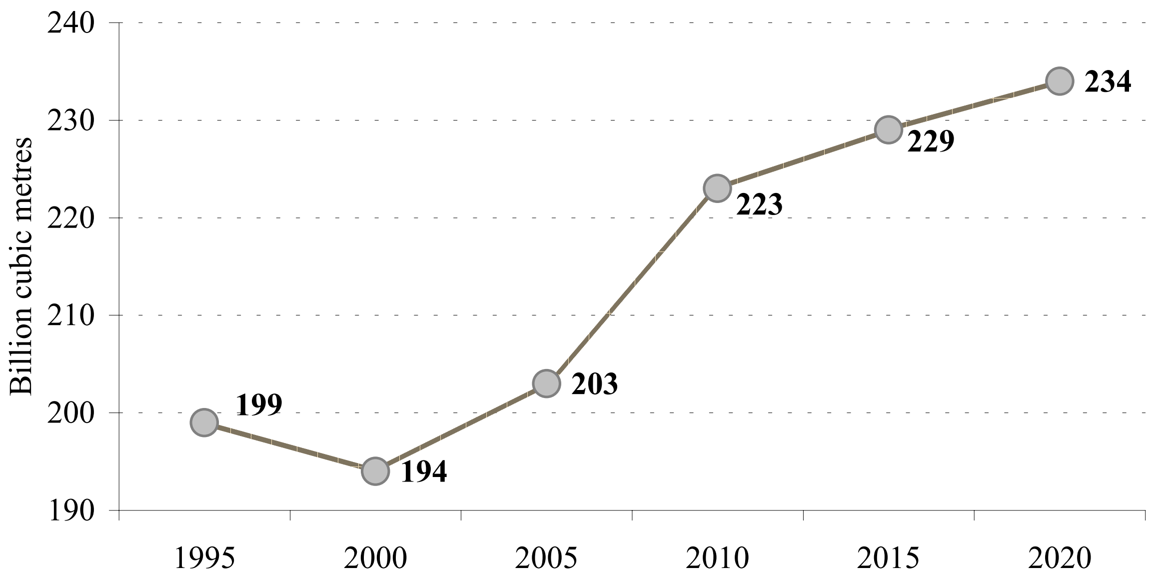
From the Russian view

Graph 7
Russian oil and oil products exports – best case



Source: Alexey M. Mastepanov: Energy Strategy of the Russian Federation to the Year 2020.

Graph 8
Russian natural gas exports – best case

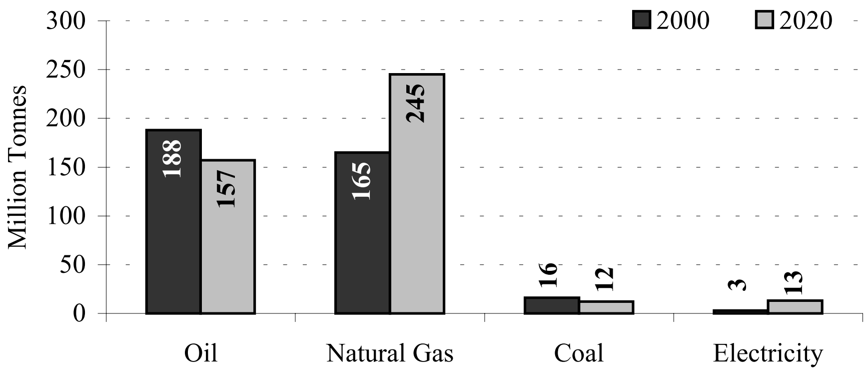


Source: Alexey M. Mastepanov: Energy Strategy of the Russian Federation to the Year 2020.

From the EU view

Graph 9

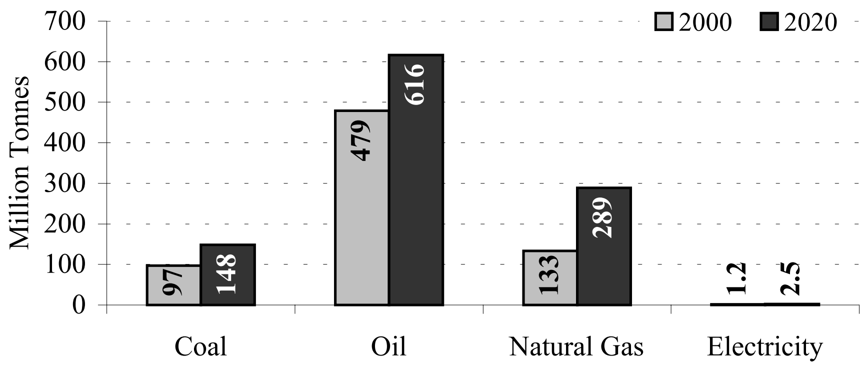
Russian energy exports



Source: Christian Cleutinx: Towards an EU–Russia Energy Partnership, 2002.

Graph 10

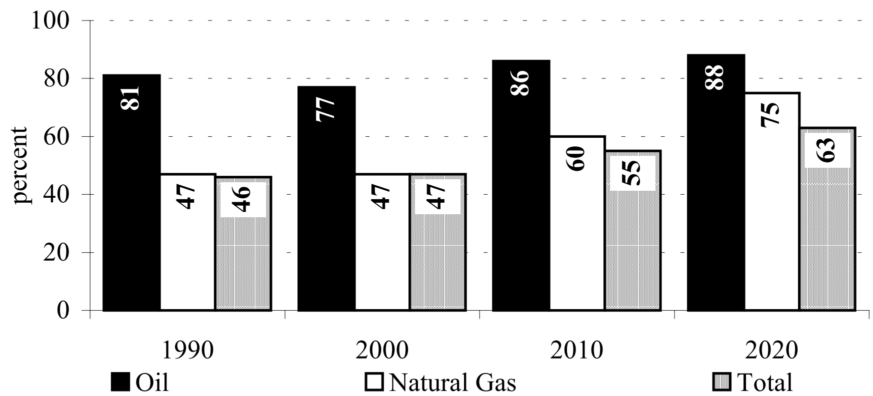
EU energy imports



Source: Christian Cleutinx: Towards an EU–Russia Energy Partnership, 2002.

Graph 11

EU 30: external dependence on energy products



Source: Christian Cleutinx: Towards an EU-Russia Energy Partnership, 2002.

Appendix 3

Russia's Top 50 Exporters*

Name	Industry	Exports (USD mn)	
		2000	1999
1. Gazprom	*Oil and gas industry*	*15933.1*	*10409.4*
2. Lukoil	*Oil and gas industry*	*5713.8*	*2931.0*
3. Yukos	*Oil and gas industry*	*5247.5*	*2548.2*
4. Tyumen Oil Company (TNK)	*Oil and gas industry*	*3477.5*	*1236.3*
5. Tatneft	*Oil and gas industry*	*2629.5*	*953.4*
6. Norilsk Nickel	*Non-ferrous metallurgy*	*2246.9*	*1835.5*
7. Russkiy Aluminiy	*Non-ferrous metallurgy*	*2161.6*	*2451.1*
8. Surgutneftegaz	*Oil and gas industry*	*1700.5*	*750.6*
9. Sibneft	*Oil and gas industry*	*1699.9*	*950.1*
10. Rosneft	*Oil and gas industry*	*1294.5*	*752.6*
11. Severstal	*Ferrous metallurgy*	*1067.1*	*875.5*
12. Slavneft	*Oil and gas industry*	*1018.1*	*480.1*
13. Alrosa	*Non-ferrous metallurgy*	*877.4*	*730.3*
14. Novolipetsk Metallurgical Combine	*Ferrous metallurgy*	*866.0*	*619.0*
15. Bashneft	*Oil and gas industry*	*858.7*	*639.9*
16. Magnitogorsk Metallurgical Combine	Ferrous metallurgy	849.2	679.0
17. ONAKO	Oil and gas industry	681.6	413.5
18. Sidanko	Oil and gas industry	662.3	331.7
19. Itera	Oil and gas industry	657.1	1252.5
20. TVEL	Engineering	571.0	362.0
21. Moscow Oil Company	Oil and gas industry	529.4	-
22. Siberia-Urals Aluminum Company	Non-ferrous metallurgy	506.4	506.1
23. Evrazholding	Non-ferrous metallurgy	470.8	264.3
24. Bashneftekhim	Chemical and petrochemical industry	442.8	427.7
25. Uralskaya GMK	Non-ferrous metallurgy	424.3	298.7
26. Nizhnekamskneftekhim	Chemical and petrochemical industry	225.4	-
27. Antey Concern	Engineering	403.4	236.0
28. Ilim Pulp Enterprise	Wood, timber and pulp industry	340.0	250.0
29. AvtoVAZ	Engineering	335.7	155.1
30. Metalloinvest	Ferrous metallurgy	257.6	188.3
31. Akron	Chemical and petrochemical industry	222.2	229.2
32. Oskol Electrometallurgical Combine	Ferrous metallurgy	213.1	179.7
33. RAO UES	Electrical power	212.3	185.7
34. Volgograd Aluminum	Non-ferrous metallurgy	189.9	174.6
35. Salavatnefteorgsintez	Chemical and petrochemical industry	180.2	93.6
36. Sibur	Chemical and petrochemical industry	179.3	0.2
37. Polarnoye Siyaniye	Oil and gas industry	169.1	28.8
38. Ammophos	Chemical and petrochemical industry	168.1	196.7
39. Lebedinsky GOK	Ferrous metallurgy	166.6	31.6
40. Tolyattiazot	Chemical and petrochemical industry	165.8	81.9
41. Aviastar	Engineering	155.2	67.2
42. VSMPO	Non-ferrous metallurgy	155.0	131.9
43. Volga	Wood, timber and pulp industry	151.6	149.1
44. Kristall	Engineering	141.2	181.5
45. Yakutugol	Coal industry	140.4	130.2
46. Kondopoga	Wood, timber and pulp industry	137.3	113.9
47. Interkhimprom	Chemical and petrochemical industry	125.6	51.9
48. Arkhbum	Wood, timber and pulp industry	113.5	73.1
49. Syktyvkar LPK	Wood, timber and pulp industry	110.0	76.6
50. Kuibyshevazot	Chemical and petrochemical industry	102.6	66.7

* *Companies discussed by Kari Liuhto and Jari Jumpponen in this volume are highlighted in italics.*
Source: Expert-RA (2001).

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