



July 2002

The Northern Dimension of the European Union

- strengthening the regional approach to Russia

Position paper of the Confederation of Danish Industries

1. Introduction

One of the tasks of the Danish EU presidency in the second half of 2002 will be to look at the next action plan for the Northern Dimension of the EU and to map out the general principles on which it is going to be built.

The Confederation of Danish Industries believes that the Northern Dimension initiative is an important instrument to enhance co-operation in the North East of Europe and a way to integrating Russia with the rest of Europe.

This paper describes the challenges with which the Union is faced after enlargement and advocates a considerable strengthening of the Northern Dimension and an enhanced role for the European Commission.

The paper first analyses the situation in Eastern Europe and Russia and, on that basis, discusses the functioning of the Northern Dimension so far. It finally moves on to making proposals on how it could be improved and further developed.

2. Executive summary

Propositions for strengthening the Northern Dimension, developed in this paper include:

- A new EU approach to structural and regional development aid comprising regions in the present EU, the enlarged EU and regions in Russia and other neighbouring countries.

- Enhanced engagement of all EU member states and partner countries to the Northern Dimension.
- Opening up of a specific budget line for the Northern Dimension and/or more co-ordination between available EU programmes and with international financial institutions and individual donor countries.
- Creation of a specialised Northern Dimension unit in the European Commission
- Concrete proposals for initiatives, e.g. on facilitation of trade and investment, intensification of the business based on energy resources and stimulation of the transport business.
- Development of a new working method comprising the formulation of precise objectives, standards for project definition and deadlines.
- Implementation of a monitoring and measuring mechanism building on bench marking and best practices.
- Setting up a business advisory body for business oriented projects.

3. The situation in Eastern and Northern Europe after enlargement

Turn-around in Eastern Europe

In 2004, eight Central and Eastern European countries have a good chance to become members of the European Union, thus accomplishing their disengagement from their Communist past¹. In the 13 years that have past since 1989, these countries have shown remarkable will and ability to change. Through economic reform and integration with the European Union they have managed to lay the foundation for a functioning market economy, and they have also reaped the benefits from these efforts in terms of increasing prosperity.

A step in the right direction

However, it would be wrong to assume that EU membership for the applicant countries will solve all problems and heal all scars from the Communist past of Eastern Europe. It is more correct to state that enlargement of the Union with the applicant countries of Eastern Europe is a first, but important, step to solving the problems of the region.

¹ Estonia, Latvia, Lithuania, Poland, The Czech Republic, Slovakia, Slovenia and Hungary

Long time to catch up

As their standard of living is, as a rule, still relatively low compared to that of the present EU, it will undoubtedly take decades to catch up. The prospect of having to adapt fully to EU standards and rules means that the painful transition is not yet over. To speed up the process, the accession countries will need financial support like other regions of low economic performance.

Barriers to trade and investment

Companies active in the region still report about barriers to trade and investment in these countries. In a survey carried out by the Confederation of Danish Industries² serious problems were reported in relation to border crossing, customs procedures, testing and certification of goods, corruption and bureaucracy³. It would be a mistake to assume that enlargement would solve these problems very fast. It will take years for the accession countries before they become a profoundly integrated and well-functioning part of the Internal Market.

New neighbours

It is also important to realise that the present enlargement does not complete the process of healing Europe politically and economically after the Cold War. A number of countries will still be outside the EU, the most important of them being Russia.

Russia

Russia is in this respect by far the biggest challenge for the EU. The question is how to repeat the relatively successful transition in Eastern Europe in Russia, whose problems are far more serious and for whom membership of the European Union is not an option for the time being. In other words Russia doesn't have that prospect of becoming a member, that has stimulated the process enormously in Eastern Europe, nor does it automatically have access to all the development instruments that are part of the EU mechanism.

Instruments needed

What is needed, are powerful instruments to stimulate and support the positive development in Russia and integrate it with its western neighbours. If successful, this process would not only open up for a considerable market potential and economic progress, but also be decisive for future peace and stability in the region.

² DI Survey on barriers to trade and investment in the Baltic Sea Region, December 2000

³ These findings have been confirmed in UNICE's recent evaluations of the candidate countries' progress towards EU accession, June 2002

4. Russia

Political problems

Politically, Russia has become more stable since the coming into power of president Putin, and there seems to be no doubt that the president is working hard to reform Russian society and public authorities in order to achieve growth and prosperity for the country.

Overall, the development is moving in the right direction. During the last year, Russia has improved its ability to withstand political and economic crises and its competitiveness has increased. In absolute terms, however, Russia is not doing too well. The country still has a very strictly regulated economy, and is faced with the challenge of fighting a very considerable degree of corruption.

Economic structure

In terms of trade, Russia has established strong links to the EU and to the candidate countries. But so far Russian export is totally dominated by oil, gas, minerals and some forestry products. In the long run, the situation is not satisfactory, and Russia needs to look at the reasons for its poor ability to export manufactured products.

Problems encountered by companies

From a company viewpoint, Russia still very much has to be treated as an emerging market, as it is in reality far from being a functioning market economy with modern and stable framework conditions for business activities. One of Russia's problems is the poor performance of its federal and local administration, which creates serious problems for implementation and enforcement of legislation in practically all areas concerning business activities. Other problems are ever changing and non-transparent legislation, for instance in the area of tax legislation, technical regulations and product safety certification, high criminality rates, corruption, an unreliable court system and underdeveloped financial markets.

Seen from a business perspective, there is an urgent need for improving general framework conditions for business. Approximation of regulations and procedures to those of the WTO and the European Union will open up new opportunities for trade in goods and services and create a more predictable business environment in the whole of Russia, see chapter 5 below.

Regional problems

Seen from the point of view of the European Union as a neighbour to Russia there are a number of more specific and regional problems and issues, which need to be dealt with as well.

Environment and natural resources

Russia has a heavy environmental legacy from the communist era, and the advantages of EU-Russian co-operation in this area are obvious. The sustainable use of natural resources, management of nuclear waste and the fight against

air and water pollution, particularly across frontiers, are priorities here.

Energy partnership

Russia holds the world's largest natural gas reserves, the second largest coal reserves, and the eighth largest oil reserves. Europe already today acquires about a fifth of all oil and gas from Russia. To ensure EU energy supply, a strategic partnership between Russia and Europe regarding exploration, exploitation and transportation of energy is therefore essential. Also, changes in the electricity market could have a major influence on the European energy market. There are, however, many challenges and difficulties to overcome.

Decline in oil and gas sector

During the last years a number of problems have been threatening a favourable development, as Russian oil and gas production has been falling due to run down equipment, poorly developed fields, insufficient reinvestments and low rate of exploration for opening up reserves. Moreover, problems are posed for foreign energy investment in particular by unpredictable changes in legislation, overgrown bureaucracy and difficulties with repatriation of profits.

Energy transition

In order to make the large energy reserves in the northwestern part of Russia and the growing energy consumption in the EU meet each other, new energy transition routes are needed. There is also a need for promoting trade in electricity in the region, which requires better integration of the electricity grids around the Baltic Sea and construction of additional east-west transmission lines.

Construction and energy efficiency

Construction in the region requires building technology with associated energy saving solutions such as energy management, modern district heating, energy conservation and advanced utilisation of renewable energy sources.

Kyoto obligations

In this context it is also relevant to consider the fact that all countries in the region have signed the Kyoto protocol. As a consequence they are under the obligation to reduce their energy consumption and thereby reduce emission of greenhouse gasses. It should be borne in mind that money spent in the Eastern countries will have a far greater impact on the environment than money spent in the EU.

Border crossing and transport

A very large part of the transport that flows in and out of Russia either goes on ships in the Baltic Sea or passes the land borders of other countries in the that region. Well-functioning border crossing, modern customs procedures and adequate transport infrastructure are of crucial importance. Development of the maritime, road and railway transport routes in the Baltic Area play a central role in this respect.

Information society

Managing the challenges of sparsely populated regions, long distances, harsh climate and sustainable utilisation of the

natural resources also call for developing information society strategies for the countries in the region.

Kaliningrad

A special challenge for EU-Russian co-operation after enlargement is the Russian exclave of Kaliningrad. A particular effort should be made to promote the economic development of this part of Russia and make it part of the successful economic development in the Baltic Sea Area.

5. General and regional approaches to integration

Integrating the former East Block

Solving the many – general and regional – problems described above is first and foremost done through integration of the former East Block countries in the institutions and systems of Western market.

EU membership for Eastern Europe

For the Central and Eastern European applicant countries, the most important milestone along that way has been the association agreements with the European Union leading up to full accession within a couple of years from now, thus bringing about a full alignment of business and other relevant regulation to that of the EU.

EU agreements with Russia

In the case of Russia, the European Union has provided a Partnership and Co-operation Agreement (PCA) with the aim of promoting the integration of Russia into a wider area of co-operation in Europe, and with the perspective of creating a common market (so-called Common Economic Space).

WTO

Russian membership of the WTO, which is strongly supported by European business, is another import instrument aiming at committing Russia to substantial liberalisation of investment and trade in goods and services.

EU's Northern Dimension

Recognising that the Northern region of the EU is the Union's only direct geographic link with Russia and that there is a considerable interdependence between Russia and the Baltic Sea Region and the European Union, the EU created the concept of the Northern Dimension in 1997.

Regional focus

The Northern Dimension should be seen as a supplementary regional approach which could contribute to security, stability and sustainable development of the region, focussing on *issues related to geographical closeness and physical environment* such as business activities, environmental protection, nuclear safety, energy, transport and fight against crime across borders. Through creating regional coherence and synergies and good relations with Russia, the concept of the Northern Dimension was created with a view to benefiting the whole of the European Union and being an integrated part of its policy towards Russia.

6. A critical view at the present functioning of The Northern Dimension

Support from the business sector

The business community in the Baltic Sea area regards the Northern Dimension of the EU as an important means to develop the business environment in the region, including Russia. The area offers great potential for increasing trade and investments including intra-industrial trade, subcontracting and outsourcing.

Weak Northern Dimension

Unfortunately EU's Northern Dimension has been rather poorly founded, institutionally and financially. A decision to create a proper new regional initiative could not be reached in 1997 and the subsequent Action Plan for the Northern Dimension from 2000 was not sufficiently precise and has not turned out very operational.

Funding

Furthermore no specific financial resources were allocated to the Northern Dimension action plan. The existing financial instruments have not been sufficiently co-ordinated and the European Commission has not had specialised personnel to deal with the Action Plan.

Only few tangible results

The result has been that several years have past and still only few tangible results are seen. The Northern Dimension has been mentioned at every European Council over the last three years, yet hardly any concrete initiatives or projects, except those in the environmental sector, have so far been started.

New opportunity now

The coming months present an opportunity to strengthen the Northern Dimension as the Danish EU Presidency is under the obligation to map out the guide lines the next Northern Dimension Action Plan. The new action plan itself will be drafted next year, but the principles on which the revision should build will have to be decided in the second half of 2002.

Still an essential initiative

Even if the business communities in the Baltic Sea Region have been relatively disappointed by the first years of the Northern Dimension initiative, it should still be seen as *potentially essential for fostering increased growth and development in the region, if developed in the right way*. That requires identifying priorities for action, formulating concrete projects, providing the right funding and choosing an effective institutional set-up.

Model for co-operation

A successful Northern Dimension – building on creating development through regional focus – could also serve as a model for co-operation with other neighbouring regions in Eastern Europe, such as Ukraine, Belarus and Moldova.

7. Business priorities for action

Moving beyond problem identification

When looking at the problems of the region, both the general ones concerning the framework conditions for business and the ones relating to specific sectors, there is certainly no lack of areas where initiatives need to be taken. The 2000 Action Plan for the Northern Dimension neatly identifies them. But the Action Plan, though a very eloquent advocate for the benefits of the Northern Dimension, is still rather vague on the means and tools available for the implementation of its ideas and the envisaged actions are not particularly well developed.

Concrete proposals

What is needed, is to make priorities and to pick out areas for specific action. From a business viewpoint specific regional action is needed to promote:

- Facilitation of trade and investment.
- Intensification of business based on energy and other natural resources.
- Stimulation of the transport business.

./. Examples of such concrete proposals for initiatives and projects, developed by the business communities in the Baltic Sea region⁴, can be found in annex 1.

These proposals will address some of the most pressing problems with practical barriers to trade and investment and developing the energy, transport and infrastructure sectors as called for above.

Other business priorities for developing concrete initiatives would be areas such as information technology, high quality education as well as environment, including radioactive waste management. The Northern Dimension could also benefit from a strengthened Arctic co-operation.

Chapter on emission trading

Concerning the environment, the action plan should include a specific chapter on technical support to the implementation of the directive on emission trading and implementation of the Kyoto flexible mechanisms in the Baltic Sea Region.

Business to business

In order to effectively stimulate trade and investment at micro level, it is recommended also to work with programmes that proactively support co-operation between companies in the area, such as business to business programmes.

⁴ The proposals have been developed by the Business Advisory Council (BAC) to the Council of Baltic Sea States, CBSS. The Confederation of Danish Industries is representing Danish business and industry in BAC

8. Funding

Need for public funding

It is obvious that the primary source for the future development of trade and investments in the region must be private capital. Improvement of the general framework conditions for business will stimulate such investments. However, at the present stage there is a great need for public (co-)funding of projects intended to open the way for private ventures (See examples in annex 1).

Changes required

On the basis of experience until now, business recommends changes in the financial set-up of the next Northern Dimension Action Plan, both in terms of the overall resources available and the co-ordination of financial resources available for the Northern Dimension.

Resources enough

Considering the very different living standards in the European Union and countries in the former East Block, and the considerable need for development described above, it would be useful for the European Union to take an overall strategic discussion on the future allocation of resources available for regional development. The regions of the present EU, the enlarged EU and countries such as Russia should be looked at together. When one considers the sums available for structural and cohesion purposes inside the Union – and for that matter the sums available for agricultural aid – one has to conclude that *the overall resources are there*, and that is only a matter of priority how and where they are considered most urgent to spend. In other words, there is every reason to include considerations like these in the coming discussions, which will begin in 2004, on the financial perspectives of the Union covering the period 2007-2013.

EU programmes

When looking at the instruments presently available for financing Northern Dimension initiatives, it is obvious that a higher degree of focus is called for. The primary EU resources for Russia come from the Tacis programme whose aim is to support the reform process in Russia⁵. The accession countries benefit from the Phare, ISPA and SAPARD programmes, which support their preparation for EU membership. The Interreg programme supports social and economic development across borders, in particular regions bordering the accession countries.

Other sources

⁵ Evaluation of the Tacis programme shows that it has reached good results on the “micro” level, but not contributed in any considerable way to the overall reform process.

International financial institutions such as EBRD, Nordic Investment Bank (NIB), Nordic Project Fund (NOPEF) and Nordic Environment Finance Corporation (NEFCO) as well as individual donor countries are also actively supporting the development of the region and have played a valuable role so far.

Better co-ordination

What is lacking is better co-ordination between Phare, Tacis, Interreg and other EU fundings. Today this co-ordination is very difficult and causes many problems for projects covering both Phare and Tacis. Allocations are geographically separate and there are different programme periods and co-financing requirements.

Even better a specific budget-line

Considering the problems caused by different budget lines, another and even better approach would be to allocate specific financial resources to the Northern Dimension and open a specific budgetline, as it has been done in similar cases. This would create a much better focus and develop the Northern Dimension into a more powerful tool.

Finally, better co-ordination with international financial institutions and co-financing between national donors, Nordic funds and EBRD are called for.

Promotion through existing agencies

When working with EU-funded company to company linkage programmes, it is advisable to promote these through existing national and regional investment promotion agencies and financing institutions.

9. Institutional framework

Enhanced role for Commission

Another way of strengthening the Northern Dimension is to strengthen its procedural and institutional set-up. It should not only be made more efficient in order to promote the realisation of the specific projects but also reflect the fact that the Northern Dimension is a policy *initiative that will benefit the European Union* as a whole and strengthen its relations with Russia. A precondition for the future success of the Northern Dimension initiative is that the European Commission gives its full backing to it both in words and in deeds.

Horizontal policy unit

Within the Commission, appropriate staff and other resources should be allocated to develop and steer the work with the Northern Dimension. A specialised unit with a real co-ordinating role should be established, and the work must efficiently involve all relevant directorates general guided by a common conceptual view of the development of the region. In short, the *Commission should act as the driving force* behind the operation and development of the Northern Dimension.

Commitment of member states

The work of the Commission should take place in close co-operation with the partner countries and with the regional co-operation institutions of the Baltic Sea Area. It is equally important that the Northern Dimension is given political anchorage at member state level both on the EU side and in the governments of the countries concerned – small and big alike. For outlining future actions and monitoring development in the Northern Dimension framework meetings at appropriate levels should be organised regularly.

Concrete and measurable

In addition to formulating concrete proposals for initiatives and projects in the next Northern Dimension Action Plan, as advocated above in chapter 6, a way to make it more operational would be to develop a working method comprising the formulation of precise objectives, standards for project definition, deadlines and a mechanism to monitor that the Action Plan is being carried out according to plan.

Bench-marking

A supplementary tool to monitor the progress of the Action Plan could be the setting up of bench-marks on actual achievements in central areas such as the time spent on border crossing, amount of investments in specific sectors and/or more generally, bench-marks as employed in the Lisbon process. An annual benchmark report could also include examples of best practices that have spurred interregional development.

Business advisory body

Finally, since many of the Northern Dimension initiatives and projects are business oriented, it is worth considering setting up a body with representatives from the business world to give advice on the administration and development of the Northern Dimension.

10. Conclusions**Recommendations**

After enlargement one of the main challenges of the European Union is to ensure effective economic integration of Russia with both present EU member countries and the Eastern and Central European accession countries.

The main set of instruments to achieve this is Russian integration into global systems like the WTO and bilateral co-operation agreements between EU and Russia such as the Common European Economic Space.

An additional, and equally important, instrument is regional co-operation and development as promoted in the Northern Dimension, where focus is on issues related to geographical closeness and physical environment.

The Confederation of Danish Industries strongly supports the Northern Dimension initiative and believes it could and should be improved and further developed.

Propositions for strengthening the Northern Dimension, developed in this paper include:

- A new EU approach to structural and regional development aid comprising regions in the present EU, the enlarged EU and regions in Russia and other neighbouring countries.
- Enhanced engagement of all EU member states and partner countries to the Northern Dimension.
- Opening up of a specific budget line for the Northern Dimension and/or more co-ordination between available EU programmes and with international financial institutions and individual donor countries.
- Creation of a specialised Northern Dimension unit in the European Commission
- Concrete proposals for initiatives, e.g. on facilitation of trade and investment, intensification of the business based on energy resources and stimulation of the transport business.
- Development of a new working method comprising the formulation of precise objectives, standards for project definition and deadlines.
- Implementation of a monitoring and measuring mechanism building on bench marking and best practices.
- Setting up a business advisory body for business oriented projects.

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Annex 1

Table of initiatives and project-concepts proposed by BAC.

Energy and Natural Resources

Initiative/project	A joint EU-Russia committee on energy exploration	Technical cooperation regarding gas and oil production in the Barents Sea	Resumed/increased production at old oilfields	Refinery capacity
Purpose	This committee should review legislation and rules to ensure that the barriers preventing EU companies to compete fully with Russian firms for the right to explore and exploit petroleum resources are identified. The committee should also consider various ways to support Russia in developing policies regarding oil and gas.	EU should together with Norway offer to provide advice and help. The objective ought not necessarily to be a fast exploration but a process where Russia can increase production by utilising reserves that are the most economically favourable	Licenses could be given to firms to revitalise production and use the remaining reserves. At the same time the operators could rectify some of the environmental hazardous legacy from previous production periods	An assessment of the state of conditions in Russian refineries in NW Russia.
Partners	Russian government officials, EU representatives, representatives of the Northern Dimension-countries, representatives from relevant Russian firms in the energy sector, representatives of relevant existing and potential investors in the energy sector.	Russian authorities, private foreign investors/operators, experts from EU and EES countries, Norwegian authorities	Russian authorities, private foreign investors/operators, International Financial Institutions	Russian oil companies, EU experts
Possible financing	Mainly participants self-financing + some EU funds.	EU, Russia	Private capital, possibly International Financial Institutions, EU or International Financial Institutions for pilot study to review technical aspects but also to design the complicated license agreements.	The purpose is not to finance the modernisation of the refineries, as they compete with other refineries on the world market the financing must be made on the conditions of the market.

Initiative/project	Natural gas pipe-line capacity and transparency in pricing and neutrality in taxation	Integration of electricity grids in the Baltic Sea Region.	Private companies role in forest management and ownership
Purpose	Possibly in the framework of the EU - Russia energy dialogue to find suitable agreements regarding the routing of future extended natural gas pipe line capacity from Russia to EU. Also to help the countries in the Baltic Sea Region to develop a setting where commercial companies and governments can make rational investment decisions in transit infrastructure, by improving the transparency in pricing of transit services and to eliminate discriminatory taxation.	To further determine what kind of structure is suitable for the electricity grids in the Baltic Sea Region. To determine a suitable way to secure both technically and economically the supply of electricity in the Kaliningrad exclave. To indicate the potential for investments in expansion and modification of the national grid and international connection including DC links between the three different systems in the Baltic Sea Region;	To create legal and practical means for foreign investors to play a larger role in the Russian forestry sector and to use their know-how to introduce sustainable and profitable methods.
Partners	EU, members states, concerned Baltic Sea States, Russian authorities , Russian companies, energy companies in EU, International Financial Institutions	Electricity companies (BALTREL), national governments, EU experts, International Financial Institutions.	Experts from EU members states and Russia, private companies, International Financial Institutions
Possible financing	International Financial Institutions, EU	EU-funds,	EU-funds, (the actual acquisitions/leases must be mainly privately financed, possibly with some International Financial Institutions lending)

Transport

Initiative/project	Via Baltica Investment Programme	Rail transport in Transport Corridors I and IA	Development of investment plans for roads in Transport Corridor II and in the north and middle sections of Transport Corridor IX	Improving interoperability between haulage companies in different parts of the Baltic Sea Region.	Private rail operators in Transport Corridors II and IX	Air transport cooperation
Purpose	Gradual improvement of the roads making up Transport Corridor I. A continuation of	To evaluate the future potential for increased rail transport. Study concepts for	Building on existing agreements, further trying to find strategies for the improved	To make it possible for more companies in the region to meet the requirement of being able to	To find what conditions are needed to attract private investors to	To increase air safety by improving cooperation between Russian air control and

	the present programme.	commercially viable investments.	roads..	operate transport chains with high quality demands. Another aspect is the alignment of the legislation for international road traffic between EU and Russia, thus making operations easier.	help own and run rail transport along the two transport corridors.	other countries in the Baltic Sea Region. To improve safety standards. To review the barriers to foreign investors operating air lines in Russia.
Partners	National road administrations, TINA Secretariat, International Financial Institutions	Baltic countries and Polish government, rail operators, business community representatives, EU experts, International Financial Institutions	Government officials from the concerned countries, Phare, Tacis, TINA, International Financial Institutions private investors.	Private haulage companies, shippers, EU experts, Phare, Tacis, national authorities.	IFI, private companies, government officials from the concerned countries	National air transport authorities, Eurocontrol, air companies
Possible financing	National tax payers, International Financial Institutions	Private companies, International Financial Institutions, EU	Countries, International Financial Institutions . ISPA	Phare, Tacis	IFI, EU	

Trade

Initiative/project	Efforts to reduce waiting times at border crossings	Russian commitment to the principle of a sizeable reduction in national standards and requirements that are not in conformity with international or European standards.	Using applicant countries experience in giving advice to Russian firms on export ability	Improved export promotion activities
Purpose	In line with the concept "2 hours in 2000" reduce waiting times for lorries at border crossing by new procedures, training and by combating corruption	To help trade integration by removing technical barriers that stops or impairs trade.	To increase economic integration by helping Russian manufacturing industry to export. This also helps to build a competitive consultancy sector in the applicant countries.	To help governments to develop export promotion efforts by using the most effective means and learning from the experience of other agencies..

Partners	National customs administration, other national authorities maintaining border control functions, EU experts,	Russian and European standardisation bodies, relevant Russian ministries	Business organisations, private consultants.	Export promotion agencies, MoFA's, private export consultants
Possible financing	Countries concerned, Phare, Tacis, Intereg	Tacis	Tacis	National financing, Phare

Investments

Initiative/project	Review of conditions for foreign direct investments in Russia.	Forums for structured dialogue between government and investors.
Purpose	To study and evaluate conditions for foreign investments, particularly in north-western Russia. Based on the result appropriate changes can be initiated by the government..	To open for a prepared and structured dialogue about problems facing foreign investors in the country and to agree on plans to eliminate or reduce problems.
Partners	Russian government (federal, regional and local), foreign companies, EU experts	National governments, foreign investors
Possible financing	Russian government, Tacis, IFC,	Governments, business organisations or private companies.