Strengths and Weaknesses in the Baltic Sea Region

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Additional information on competitiveness research can be found at the website of the Institute for Strategy and Competitiveness, www.isc.hbs.edu
Two Questions

• Where does the Baltic Sea Region stand?

• Is the Region on a sustainable trajectory?
Dimensions of Strengths and Weaknesses

Outcomes
- Prosperity
- World market position
- Innovation
- Integration

Assets
- Macroeconomic, political, legal, and social context
- Business environment quality
- Company sophistication

Capabilities
- Institutions
- Trust
- Common ‘language’
- Leadership
Economic Outcomes

- High prosperity in the north-west, high growth in the south-east

- World market position solid but not improving

- Innovation position strong but not improving

- Level of integration is significant but unbalanced across parts of the region
Prosperity
Cross-National Regions and BSR Countries

GDP per Capita, US-Dollar, PPP, 2005

Growth of Prosperity, CAGR, 2000 - 2005

Source: Groningen Growth and Development Centre and The Conference Board (2006), IMF (2006), authors’ calculations

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Investment and Exports

FDI Inflows over Time

FDI Inflows as % of Gross Domestic Investment

Inward FDI Stock as % of GDP, 2004

<table>
<thead>
<tr>
<th>Region</th>
<th>Inward FDI Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Union</td>
<td>32%</td>
</tr>
<tr>
<td>Baltic Sea Region</td>
<td>32%</td>
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<tr>
<td>Central European Region</td>
<td>23%</td>
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<tr>
<td>World</td>
<td>22%</td>
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</table>

Source: UNCTAD (2006), author’s analysis.
Patenting Intensity over Time
Baltic Sea Region Countries

Patents per 1000 Capita

Integration

Foreign Direct Investment Flows

Share of inward FDI from other BSR countries, 1999 - 2004

Source: UNCTAD, national statistical offices, author’s calculations

BSR average

Source country
- Sweden
- Finland
- Denmark
- Estonia
- Norway
- N Germany
- Latvia
- Iceland
- Lithuania
- NW Russia
- N Poland
Economic Assets

- Sound macroeconomic policies, sound institutions and legal systems, and few social issues
  - But economically small region at the European periphery with few metropolitan regions

- Well established financial markets, solid skill and science base, and a regulatory environment supporting fair and open competition
  - But low attraction of skilled foreign labor, weak incentives for investment and risk taking, and remaining gaps in infrastructure

- A core group of multinational companies from the region and wide-spread adoption of modern management practices
  - But few new companies of significant size emerging
Microeconomic Foundations
Business Competitiveness Index Ranking over Time

# Knowledge Creation

## Top Universities in the Baltic Sea Region

<table>
<thead>
<tr>
<th>Institution</th>
<th>Country</th>
<th>World Rank</th>
<th>BSR Rank</th>
</tr>
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<tbody>
<tr>
<td>Karolinska Inst Stockholm</td>
<td>Sweden</td>
<td>45</td>
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<td>Univ Copenhagen</td>
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<td>Chalmers Univ Tech</td>
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<tr>
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<tr>
<td>Univ Southern Denmark</td>
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<tr>
<td>Univ Turku</td>
<td>Finland</td>
<td>203-300</td>
<td>13</td>
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</tbody>
</table>
Capabilities

• Wide set of cross-regional institutions and long historical legacy of linkages across the region but very different recent historic experiences

• Generally high level of trust in the north-west but unclear whether this carries over to cross-regional relations and the south-east

• Broad consensus on the importance of competition and the impact of globalization but different views on the role of government

• General tendency to believe in the power of institutions with less tradition in individual leadership
The Formula of Baltic Sea Region Growth
The Nordic Model

Sound domestic policies
• Macro
• Institutions
• Skills
• Infrastructure
• Openness

Globalization
• Huge opportunities from opening markets
• Companies with long legacy of global presence

Technological change
• Increasing role of know-how in value creation and growth of science-related industries play to strengths of the region

= Strong economic growth
The Formula of Baltic Sea Region Growth

The Baltic Model

Legacy
• Sound skill base

Openness and Incentives
• Openness for trade and investment
• Aggressive FDI attraction efforts
• Low taxes

Location
• Revitalization of historic relations to Northern and Western neighbors

= Strong economic growth
The Formula of Baltic Sea Region Growth
The Integration Model

Legacy
• Tradition of close ties across the Region

Institutions
• Leveraging EU and NATO institutional structures to provide stability

Historic Opportunity
• Willingness in Western Europe to push for integration
• Consensus in Eastern Europe

= Strong growth of integration
The Formula Hitting its Limits

Traditional challenges remain in place
- Economically small region at the European periphery

Baltic Sea integration policies are losing traction
- Past model of west-to-east transfers has reached its limit
- EU membership of Baltic countries and Poland create a competing arena
- The EU context changed the dynamics of relations to Russia

Domestic policy models are losing traction
- Nordic countries need to provide better environment for human skill-intensive entrepreneurial companies
- Baltic countries need to invest in creating new capabilities

Competitors are catching up
- Many countries are significantly upgrading their domestic policies
The Challenge of Economic Heterogeneity

**Low**

- Easy to develop a **common identity**
- Easy **applicability** of others’ experience
- Balanced **distribution of benefits**
- Regional cooperation is **easier** but provides fewer benefits

**High**

- Huge potential gains from **regional benchmarking**
- Huge potential gains from **division of labor**
- Regional cooperation is **harder** but provides **higher benefits**
Putting the Baltic Sea Region at the Top of Europe

Key Issues

• Aggressively pursue **full regional integration**, especially when it hits politically sensitive areas

• Intensify the integration of **private sector leaders** and companies into regional cooperation efforts

• Identify the **unique economic value** that the Baltic Sea Region aims to provide as part of the global economy

• Address individual weaknesses in the business environment, focusing on the areas **most critical** to the Region’s strategic position