The Baltic Rim Regional Agenda

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Baltic Rim Economic Region 2001

• Achievements
  – Economic growth supported by stable monetary and fiscal policies overcoming the transition crisis
  – Bilateral and regional co-operation initiatives
  – EU accession of Poland and Baltic Countries under way

• Current worries
  – Downturn in the world economy
    • Limit to inward FDI and exports
    • Disproportionate effect on Telecom/IT, the region’s most dynamic sector
  – Continuing weaknesses in the microeconomic environment, like corruption in some of the Baltic Countries and Russia

• Long term challenges
  – Upgrade national competitiveness
  – Leverage the national economies with a regional strategy
  – Create an institutional structure for cooperation to fully mobilize the region’s economic potential
Baltic Rim Economic Performance

Note: Irish GNP per capita is about 20% lower than the reported GDP per capita figure due to large dividend outflows to foreign investors. We use GNP per capita for Ireland because it is more representative. For other countries GDP and GNP are very similar.

Source: WEO
Baltic Rim Economic Challenges

Three Agendas

I. Address weaknesses in national business environments

II. Enhance competitiveness via regional coordination

III. Create an institutional structure to support and coordinate efforts to improve regional competitiveness
Sources of Rising Prosperity

• A nation’s standard of living (wealth) is determined by the productivity with which it uses its human, capital, and natural resources. The appropriate definition of competitiveness is productivity.
  – Productivity depends both on the value of products and services (e.g. uniqueness, quality) as well as the efficiency with which they are produced.
  – It is not what industries a nation competes in that matters for prosperity, but how firms compete in those industries.
  – Productivity in a nation is a reflection of what both domestic and foreign firms choose to do in that location. The location of ownership is secondary for national prosperity.
  – The productivity of “local” industries is of fundamental importance to competitiveness, not just that of traded industries.

• Nations compete in offering the most productive environment for business
• The public and private sectors play different but interrelated roles in creating a productive economy
Determinants of Productivity and Productivity Growth

Macroeconomic, Political, and Legal Context for Development

Microeconomic Foundations of Development

- Sound macroeconomic policies and a stable political/legal context are necessary to ensure a prosperous economy, but not sufficient.
- Competitiveness ultimately depends on improving the microeconomic foundations of competition.
Global Competitiveness Report 2001
The Relationship Between Microeconomic Competitiveness and GDP Per Capita, 2000 Data

R^2 = 0.842
Productivity and the Microeconomic Business Environment

Context for Firm Strategy and Rivalry

- A local context that encourages **efficiency**, **investment**, and **sustained upgrading**
- Open and vigorous competition among **locally based rivals**

Factor (Input) Conditions

- **High quality, specialized inputs** available to firms:
  - human resources
  - capital resources
  - physical infrastructure
  - administrative infrastructure
  - information infrastructure
  - scientific and technological infrastructure
  - natural resources

Demand Conditions

- **Sophisticated and demanding** local customer(s)
- Unusual local demand in **specialized segments** that can be served globally
- Customer needs that **anticipate** those elsewhere

Related and Supporting Industries

- Presence of capable, locally-based **suppliers** and firms in **related fields**
- Presence of **clusters** instead of isolated industries
The Microeconomic Business Environment
Estonian Telecom/IT Cluster

Context for Firm Strategy and Rivalry

Demand Conditions
- Demand for Internet banking and other services (E-government)
- Test market for wireless services (parking, positioning system)
- Affection for mobile phones strongly reminiscent of the Nordic region

Related and Supporting Industries
- Emerging Telecom cluster (manufacturers, service providers etc.)
- Inward investment: Ericsson, Nokia, Elqotec and others

Factor (Input) Conditions
- Good technical training (TTU, IT college, Tartu and technical schools)
- Links between operators and universities
- High level of FDI in infrastructural build-up
- Close position to Finland both geographically and culturally

Emerging Telecom cluster (manufacturers, service providers etc.)

Three rivals in mobile telecom: EMT, Radiolinja, Q-GSM (Netcom)

Several fixed service providers (since Jan 2001: ET, Uninet, TELE2, and other smaller)

State ownership in Estonian Telecom down to 27% (rest: 49 % Telia and Sonera, 24% publicly traded)
Stages Of Competitive Development

Factor-Driven Economy → Investment-Driven Economy → Innovation-Driven Economy

Input Cost → Efficiency → Unique Value

Baltic Rim Economic Challenges

Three Agendas

I. Address weaknesses in national business environments

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Russian Competitiveness

Context for Firm Strategy and Rivalry

Strengths
- Financial Market Sophistication (69)
- Overall Infrastructure Quality (65)
- Extent of Bureaucratic Red Tape (64)
- Administrative Burden for Start-Ups (64)

Challenges
- Intellectual Property Right Protection (73)
- Tariff Liberalization (69)
- Hidden Trade Barriers (68)
- Intensity of Local Competition (67)

Factor (Input) Conditions

Strengths
+ Railroad Infrastructure Quality (17)
+ Availability of Scientists and Engineers (31)
+ Quality of Math & Science Education (32), Scientific Research Institutions (33)

Challenges
- Local Supplier Quality (61)
- Railroad Infrastructure Quality (17)
- Availability of Scientists and Engineers (31)
- Quality of Math & Science Education (32), Scientific Research Institutions (33)

Related and Supporting Industries

Strengths
+ Local Availability of Machinery (9), Parts (14), and Services (16)

Challenges
- Laws Relating to IT (72)
- Stringency of Environmental Regulations (58)
- Consumer Adoption of Latest Products (58)

Demand Conditions

Strengths
- Overall Infrastructure Quality (65)
- Extent of Bureaucratic Red Tape (64)
- Administrative Burden for Start-Ups (64)

Challenges
- Local Supplier Quality (61)
- Intellectual Property Right Protection (73)
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- Hidden Trade Barriers (68)
- Intensity of Local Competition (67)

Note: Rank by countries; overall Russia ranks 58 of 75
Source: Global Competitiveness Report 2001
Estonian Competitiveness

**Strengths**
- + Administrative Burden for Start-Ups (7)
- + Quality of Math and Science Education (17)
- + Port Infrastructure Quality (21)
- + Quality of Scientific Research Institutions (22)
- + Extent of Distortive Government Subsidies (10)
- + Hidden (12) and Open (17) Trade Barrier Liberalization

**Challenges**
- - Police Protection of Businesses (51)
- - Bureaucratic Red Tape (41)
- - Railroad (41) and Air Transport (40) Infrastructure Quality
- - Local Equity Market Access (35)
- - Favoritism by Government Officials (39)
- - Decentralization of Corporate Activity (37)
- - Extent of Locally Based Competitors (35)
- - Presence of Demanding Regulatory Standards (35)
- - Buyer Sophistication (32)

**Demand Conditions**
- + Government Procurement of Advanced Products (17)
- + Laws Relating to IT (21)

**Related and Supporting Industries**
- + Local Availability of IT Services (23)

*Note: Rank by countries; overall Estonia ranks 28 of 75
Source: Global Competitiveness Report 2001*
Finnish Competitiveness

Context for Firm Strategy and Rivalry

Strengths
+ Favoritism by Government Officials (1)
+ Hidden (1) and Open (2) Trade Barrier Liberalization
+ Extent of Distortive Government Subsidies (2)

Challenges
- Cooperation in Labor-Employer Relations (11)
- Intensity of Local Competition (7)

Factor (Input) Conditions

Strengths
+ University/Industry Research Collaboration (1)
+ Telephone/Fax Infrastructure Quality (1)
+ Administrative Burden for Start-Ups (2)
+ Quality of Scientific Research Institutions (2)

Challenges
- Road Infrastructure Quality (31)
- Quality of Math and Science Education (13)
- Quality of Management Schools (12)

Demand Conditions

Strengths
+ Laws Relating to IT (1)
+ Government Procurement of Advanced Products (2)
+ Buyer Sophistication (2)
+ Consumer Adoption of Latest Products (3)

Challenges
- Local Supplier Quality (13) and Quantity (10)

Note: Rank by countries; overall Finland ranks 1 of 75
Source: Global Competitiveness Report 2001
## Stages Of Competitive Development

### Policy Priorities

**Factor-Driven Economy**
- Create and maintain overall political and macroeconomic stability, and establish the rule of law
- Establish good quality physical infrastructure quality and universal education
- Open markets
- Create the conditions for assimilating world-class technology and attracting foreign direct investments

**Investment-Driven Economy**
- Invest in upgrading physical infrastructure, regulatory frameworks, and research capabilities
- Foster the development of clusters
- Create the capacity to improve upon foreign technology and extend capabilities across the value chain

**Innovation-Driven Economy**
- Deepen cluster development
- Create world-class research resources
- Create the conditions for firms to develop unique strategies and best-in-the world innovations

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## Appropriate Roles of Government in Economic Development

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<tbody>
<tr>
<td>1.</td>
<td>Establish a <strong>stable and predictable</strong> macroeconomic, political, and legal environment</td>
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<td>2.</td>
<td>Improve the availability, quality, and efficiency of <strong>general purpose inputs, infrastructure, and institutions</strong></td>
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<td>3.</td>
<td>Set overall <strong>rules and incentives</strong> governing competition that encourage productivity growth</td>
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<td>4.</td>
<td>Facilitate <strong>cluster development and upgrading</strong></td>
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<td>5.</td>
<td>Create an explicit, ongoing <strong>process of economic change</strong> and competitive upgrading which informs citizens and mobilizes the private sector, government at all levels, educational and other institutions, and civil society.</td>
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</table>
Public / Private Cooperation in Cluster Upgrading
Minnesota’s Medical Device Cluster

Context for Firm Strategy and Rivalry

- Aggressive trade associations (Medical Alley Association, High Tech Council)
- Effective global marketing of the cluster and of Minnesota as the “The Great State of Health”
- Full-time “Health Care Industry Specialist” in the department of Trade and Economic Development

Factor (Input) Conditions

- Joint development of vocational-technical college curricula with the medical device industry
- Minnesota Project Outreach exposes businesses to resources available at university and state government agencies
- Active medical technology licensing through University of Minnesota
- State-formed Greater Minnesota Corp. to finance applied research, invest in new products, and assist in technology transfer

Demand Conditions

- State sanctioned reimbursement policies to enable easier adoption and reimbursement for innovative products

Related and Supporting Industries

- Minnesota Project Outreach
- Active medical technology licensing through University of Minnesota
- State-formed Greater Minnesota Corp. to finance applied research, invest in new products, and assist in technology transfer
Government Policy for Cluster Upgrading
Estonian IT Society Initiative

Context for Firm Strategy and Rivalry

- Privatization of national telecom operator company
- Deregulation of telecom markets
- New Telecommunications act (Feb 9, 2000)
- Cable Distribution act (1999)
- Digital signature and digital ID cards under development

Demand Conditions

- Promotion of using E-government (possibly municipal election in 2002)
- Promotion of E-banking

Related and Supporting Industries

- Establishment of an Estonian Informatics Council
- Establishment of an Estonian Education and Research Data Communication Network, EENET

Factor (Input) Conditions

- 'Tiger leap' (Tigrihüpe) Internet project in all public schools (1996) and now in higher education
- Installation of regional fiber network for Internet access (Külate)
- Opening of an IT College for applied education (2000)
- Privatization of national telecom operator company
- Deregulation of telecom markets
- New Telecommunications act (Feb 9, 2000)
- Cable Distribution act (1999)
- Digital signature and digital ID cards under development

Demand Conditions
Role of Government
Government Policy Towards Clusters

• Government should support the upgrading of all clusters
  – Productivity depends on how firms compete not what industries they compete in
  – One cluster often affects the productivity of other clusters

• Government should reinforce established and emerging clusters rather than attempt to create entirely new ones
  – Build on strengths / apply a market test
  – New industries emerge from established ones

• Cluster upgrading involves removing obstacles, relaxing constraints, and eliminating inefficiencies that impede productivity and innovation
Baltic Rim Economic Challenges
Three Agendas

I. Address weaknesses in **national business environments**

II. **Enhance competitiveness via regional coordination**

III. Create an **institutional structure** to support and coordinate efforts to improve regional competitiveness
The Mutual Dependence of Nations and Regions

• A nation’s economic growth and prosperity can be greatly enhanced by a healthy regional economy
  - Large, accessible markets for exports and foreign investment
  - Nations become more attractive as places to invest
  - Nations can focus on their unique strengths

• A nation will inevitably suffer if it is isolated or an island amid countries that are not prospering

• A nation’s productivity can be greatly enhanced by regional coordination versus unilateral action
Regional Strategy and Competitiveness

Traditional View
• Regions as free trade zones

New View
• A regional strategy as a powerful tool to enhance competitiveness in each of the countries
  - Gains from internal trade and investment
    and
  - Policy coordination that creates mutual benefits to productivity in all countries. Harness economies of specialization and externalities across borders in infrastructure, regulation, and other areas
  - A powerful lever for speeding up the process of economic upgrading at the national level
  - A lever for promoting interest and investment in the region by the international community
## Regional Economic Coordination

### Illustrative Policy Levers

<table>
<thead>
<tr>
<th>Factor (Input) Conditions</th>
<th>Context for Strategy and Rivalry</th>
<th>Demand Conditions</th>
<th>Related and Supporting Industries</th>
<th>Regional Governance</th>
</tr>
</thead>
</table>
| - Improve regional transportation infrastructure | - Coordinate macroeconomic policies | - Agree on foreign investment promotion guidelines to limit forms of investment promotion that do not enhance productivity | - Establish ongoing upgrading process in clusters that cross national borders, e.g.  
  - Tourism  
  - Agribusiness  
  - Textiles and Apparel  
  - Information Technology | - Share best practices in government operations |
| - Create an efficient energy network | - Eliminate trade and investment barriers within the region | - Set minimum safety standards | | - Improve regional institutions  
  - Regional development bank  
  - Dispute resolution mechanisms  
  - Policy coordination body |
| - Upgrade/link regional communications | - Simplify cross-border regulations and paperwork | - Establish reciprocal consumer protection laws | | - Develop a regional marketing strategy |
| - Upgrade/link financial markets | - Guarantee minimum basic investor protections | | | |
| - Upgrade higher education through facilitating specialization and student exchanges | - Coordinate activities to ensure personal safety | | | |
| - Expand cross-border business and financial information access and sharing | | | | |

**Factor (Input) Conditions**
- Improve regional transportation infrastructure
- Create an efficient energy network
- Upgrade/link regional communications
- Upgrade/link financial markets
- Upgrade higher education through facilitating specialization and student exchanges
- Expand cross-border business and financial information access and sharing
- Coordinate activities to ensure personal safety

**Context for Strategy and Rivalry**
- Coordinate macroeconomic policies
- Eliminate trade and investment barriers within the region
- Simplify cross-border regulations and paperwork
- Guarantee minimum basic investor protections

**Demand Conditions**
- Agree on foreign investment promotion guidelines to limit forms of investment promotion that do not enhance productivity
- Establish reciprocal consumer protection laws

**Related and Supporting Industries**
- Set minimum environmental standards
- Set minimum safety standards

**Regional Governance**
- Establish ongoing upgrading process in clusters that cross national borders, e.g.
  - Tourism
  - Agribusiness
  - Textiles and Apparel
  - Information Technology
- Share best practices in government operations
- Improve regional institutions
  - Regional development bank
  - Dispute resolution mechanisms
  - Policy coordination body
- Develop a regional marketing strategy
Levels of Regional Economic Cooperation

**Broad Economic Areas, e.g. Europe**
- Remove **barriers to trade, investment, and factor movement**
- Establish **common minimum standards** and coordinate investments in **joint physical infrastructure**

**Groups of Proximate Neighboring Nations, e.g. Baltic Rim**
- Coordinate efforts to enhance the **microeconomic business environment**
- Cross-border **cluster** integration and development
- Proximity enables countries to jointly market the **attractiveness** of the region to the outside world
- Regional institutions and **governance** are required to steer this process

- The broader **European economic area** offers a level playing field for trade and investment
- The **Baltic Rim regional agenda** supports deeper upgrading of the microeconomic environment and cluster development
Benefits of Regional Cooperation

**Developing economies**
- Inflow of skills and technology via FDI
- Access to international markets and distribution channels
- Access to sophisticated customers
- Competitive pressure to upgrade the efficiency of operations

**Advanced economies**
- Access to larger markets for goods and especially for services
- Efficient specialization along the value chain
Illustrative Levers for Baltic Rim Regional Strategy

• Integration of logistical infrastructure
• Enabling brain circulation
• Programs to upgrade higher education in the region
• Coordination of environmental policies on global warming
• Policies to enable cluster interchange and integration
• Institutions for regional governance
• Baltic Rim as a platform for East-West trade
• Baltic Rim integration depends on good logistical networks
• The next challenge is to move from planned structures to competition in this still government-dominated sector
Labor is not a generic commodity where immigrants just replace local labor

Circulation of people provides two-way benefits for productivity, human capital, and business relationships
Proximity and Cluster Development
Inward FDI into Estonia (1990-2000)

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Sweden</td>
<td>39.2%</td>
</tr>
<tr>
<td>Finland</td>
<td>31.1%</td>
</tr>
<tr>
<td>US</td>
<td>4.5%</td>
</tr>
<tr>
<td>Norway</td>
<td>4.3%</td>
</tr>
<tr>
<td>Denmark</td>
<td>4.1%</td>
</tr>
<tr>
<td>Germany</td>
<td>2.7%</td>
</tr>
<tr>
<td>Great Britain</td>
<td>2.6%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.1%</td>
</tr>
<tr>
<td>Russia</td>
<td>1.4%</td>
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</tbody>
</table>

Total of 21.3 billion SEK (1990-2000)

• Over 50% of Estonia’s exports come from partially/wholly foreign-owned companies

Source: Dagens Industri 010127
Cluster Integration
E-Banking in the Baltic Countries

**Government**
- Governments, especially in Estonia, have developed action plans for Internet use

**Factor (Input) Conditions**
- Pool of young workers with IT skills
- No legacy systems deter shift to e-banking
- Relatively high Internet penetration in Estonia

**Context for Firm Strategy and Rivalry**
- Opening to foreign banks
- Scandinavian owners push e-banking development

**Demand Conditions**
- Customers are quickly becoming more Internet-savvy
- Effective legislation in a number of countries on e-banking services

**Related and Supporting Industries**
- IT/Telecom cluster emerging is across the Baltic Countries
- Lack of public access to Internet is a hindrance, especially in Latvia and Lithuania. Also, the prices of PCs remain high
Cluster Integration in Banking
Mutual Benefits

- Investments and acquisitions by Scandinavian banks have transformed the banking industry in the Baltic Countries after the crisis of the early 1990s
- Hansabank, now part of a Scandinavian banking group, was one of the most successful local start-ups in the Baltics
- The elements of the regional approach
  - Quick transfer of modern risk management techniques and a solid asset base through foreign owners
  - Combination with understanding of the local market to provide appropriate product offering

**Advantages for the Baltic Countries**

- National economies in Baltic Countries gained a modern, functional financial infrastructure

**Advantages for Nordic Countries**

- The Scandinavian banks gained a new market, and experience to operate successfully in low/medium income economies
Cluster Integration in Telecommunications
Ownership of Telecom Operators in the Baltic Countries

Finland
- Sonera
- Radiolinja
- Finnet International

Sweden
- Telia
- Tele2
- EMT Estonian Telephone company
- Q-GSM
- Uninet
- Balticcom
- LMT

Denmark
- Tele Danmark
- Tele2 Lithuania
- Omnitel
- Lietuvos Telekomas
- Comliet

Estonia
- Estonian Telecom
- Radiolinja
- Estonian Telephone company
- EMT
- Uninet

Latvia
- Lattelekom
- Tele2

Lithuania
- Bite
Cluster Integration in IT/Telecom
Effects across the region’s countries

• Nordic telecom operators have taken stakes throughout the region
• Nordic telecom hardware producers have started to extend the value chain of the cluster across the region
  – Labor-intensive manufacturing (handsets)
  – Selected R&D
  – Test market for new applications
• Start-ups exist across the region in manufacturing and telecom services
• Governments like in Estonia, have initiated IT/Telecom-related projects

Advantages for
the Baltic Countries, NW Russia

• Baltic and Russian companies can develop an IT/Telecom offering and activity system that is uniquely positioned for low/medium-income countries

Advantages for
Nordic Countries

• Nordic companies can bolster their focus on advanced markets by making use of regional locations for less expensive manufacturing, R&D, and market testing
Baltic Rim Economic Challenges

Three Agendas

I. Address weaknesses in **national business environments**

II. Enhance competitiveness via **regional coordination**

III. Create an **institutional structure** to support and coordinate efforts to improve regional competitiveness
Organizing for Competitiveness
Examples of Baltic Rim Regional Organizations

Public Sector
- Council of Baltic Sea States
- Baltic Sea States Sub-Regional Cooperation
- Union of Baltic Cities
- Baltic Council
- Nordic Council

Private Sector
- Baltic Chambers of Commerce Association
- Baltic Sea Business Summit
- Baltic Tourism Council
- National Foreign Investors Councils, e.g. FICIL

Baltic Rim activities of International Organizations
- EU Northern Dimension
- OECD Baltic Programme
- EBRD
- World Bank
- IMF

NGOs
- Baltic Development Forum
- Pro Baltica
- East West Institute
- Northern Dimension Business Forum
Organizing for Competitiveness
Baltic Rim Competitiveness Council

E.g.
- International Trade
- Border Handling ("2 hour 2002", EDI)
- Tax Policy and Capital Formation
- Technology Policy

E.g.
- Brain Circulation and Vocational Training
- Corruption and Tax fraud
- EU Northern dimension action plan

E.g.
- Tourism
- Telecommunications
- Textiles
Moving to Action

• Create a regional competitiveness institution
  – The **Baltic Rim Competitiveness Council**; one regional body to coordinate economic policies and to foster private/public initiatives

• Develop a concrete action agenda
  – E.g., Upgrading of the **physical networks** connecting the region
  – E.g., Creating conditions for greater **brain circulation**
  – E.g., Working groups to pursue **regional cluster strategies** in tourism and telecommunications

• Set an **ambitious goal**: the Baltic Rim as the next global “hot spot”
Back-up
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