

A Baltic Rim Regional Agenda

Michael E Porter

Örjan Sölvell

1. Introduction

Motivation for the project

A decade after the fall of the Iron Curtain the Baltic Rim Region is experiencing nothing short of an explosion in cross-regional activity. Reviving old ties between the old “Hansa”-cities, between the Baltic Countries and its cousins in Scandinavia, and between the large continental powers Russia, Poland, and Germany – activity is clearly bridging many of the borders that were artificially closed between the West and East of the region.

Politically, this process is not without its challenges as attested by the numerous discussions around the extension of NATO and the Northern Dimension of the EU. Even in the sphere of economics the enthusiasm about potential gains-from-trade for all partners meets the reluctance of interest groups in east and west that fear an explosive mixture of low-wage competition and brain drain.

We believe that the Baltic Rim Region can develop into a globally competitive part of the world economy when it succeeds to develop a joint competitiveness vision for the future. By both developing the elements of a strong regional diamond and a mentality of competitiveness and innovation and change, the region can foster clusters of strong companies generating productivity growth and improvements in prosperity. The regional agenda offers:

- Improved efficiency following from market enlargement and a stepping stone to global markets
- Long-term potential for restructuring and increased specialization throughout the region
- Increased competition stimulating the upgrading of firm strategies and innovation
- Enhanced attractiveness for all involved countries on outside firms, capital and people

The project “A Baltic Rim Regional Agenda” sets out to analyze the current status of the Baltic Diamond based on the cluster theory developed by Prof. Michael E. Porter. Bringing together academics, politicians, and managers we will develop a thorough understanding of the status quo to gain the key ingredients of an action plan to move the region towards a joint vision of value creation and competitiveness. The Baltic Rim Regional Agenda offers a platform for creating a mindset of innovation and cooperation, raising the level of competitiveness throughout the region.

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Main Objectives

The project has two main objectives: First, we want to generate an insightful description of the status of the regional diamond today. In order to do that, we will apply new developments in the theory of clusters as well as drawing upon new data.

Second, we want to use these insights to provide actionable recommendations for leaders in the region. This applies to the overall regional aspects as well as to the cluster-specific issues in different locations. We realize that this project can only be a starting point to engage politicians and managers in an effort to develop specific action plans. However, our experience from regions throughout the world has shown how a project like this can succeed in igniting the creativity of regional leaders to develop their joint agenda; we are thus aiming for nothing short than a “Baltic Rim Regional Agenda” owned by the whole region.

2. Main Elements of the Project

The projects consists of four main elements that work together to reach our project objectives. First, we will study the elements of the regional diamond, i.e. the conditions that affect business activity across the region. Second, we will look at institutions and networks spanning across the region to understand their objectives and the way they interact. Third, we will look at specific clusters in different locations within the region to understand how the regional diamond affects their development. Finally, we will - as part of the Global Competitiveness Report (GCR) led by the World Economic Forum - conduct a comparative survey of leaders in the region.

Regional Diamond

New research on the role of regions in cluster development has established how factors on different levels – regional, national, and local – affect the competitiveness of specific clusters. While, for example, the externalities of related and supporting industries is most strongly felt locally, the legal infrastructure is mainly a national affair.

In this project, we have identified six elements of the diamond that are determined on the regional, i.e. the cross-border level. These elements are

- Competition between national clusters and evolution of cluster specialization within the region
- Level of cluster integration driven by integrating forces (flows of goods, FDI, technology, people) and slowed down by fragmenting forces (general trade and investment barriers, cluster-specific barriers and mental barriers)
- Capital markets; specifically the ease of capital transactions between countries
- Logistical infrastructure for cross-border trade and mobility
- IT/Telecom infrastructure (Internet, fixed & mobile telecom) for cross-border communication
- Training, education, and brain-circulation in the region

Looking at these six elements we will be able to understand the interconnections between national products and services as well as factor markets. The degree of regional competition and

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the linkages between local clusters are key determinants driving the ability of clusters to improve innovativeness, productivity, and – ultimately – prosperity.

Regional Networks and Institutions

A critical success factor for regions is the development of reinforcing goals and policies. A common competitiveness paradigm assures improvements in the business environment to be spread across the region, it increases the effectiveness of national policies, and it often elevates the attractiveness of the whole region to outsiders.

In this project, we will map regional institutions (including the divisions of multilateral organizations like the EBRD, the IMF, and the EU) including UBC (founded 1991), CBSS (founded 1992), BCCA (founded 1992), Pro Baltica Forum (founded 1992), and BDF (founded 1998), all with an important influence on the business environment. We seek to answer the following key questions:

- What are the regional institutions and their foundation histories?
- What are their responsibilities and objectives?
- How do the institutions interact, cooperate and compete?
- Do they share a common vision for the region?

Understanding these regional networks and institutions is critical both for the description of the status quo and for the development of future action plans and a common competitiveness agenda. Working with key institutions from the start will allow us to anchor ownership of the project's results in the region.

Local Clusters in the Region and Cluster Integration

The work on clusters has shown that innovation, productivity, and ultimately prosperity is created in clusters of geographically proximate companies linked by externalities and complementarities. The ability of these clusters to prosper and develop depends on the combination of regional, national, and local factors covered in the diamond framework.

In this project, we have initially selected a number of clusters for specific analysis (national level initially including Russia, Estonia, Latvia and Lithuania, and regional level):

- Internet Banking
- E-Commerce
- Software programming
- Mobile Telephony and telecommunications
- Logistics
- Financial markets

These cluster studies will allow us to look into a number of issues: First, we can analyze the effects of the regional diamond on the specific clusters. Second, we can compare the development and the linkages across the region in the different clusters. And third, in each case they will be the basis of specific action recommendations on a cluster level.

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Global Competitiveness Report, GCR, survey

Each year, the World Economic Forum (WEF) performs under the supervision of Prof. Michael E. Porter and Prof. Jeffrey Sachs a survey of national competitiveness. The data solicited through questionnaires allows an understanding of countries' current and potential competitiveness on a detailed level.

For this project, we have asked the WEF to include the remaining countries of the region, ie the Baltic Countries and the St Petersburg area (city and oblast), into the panel. For the future, we aim to augment the existing questionnaire with additional questions covering issues of particular importance to the Baltic region. These additional questions will be developed based on the results of the current project.

The data from the GCR survey provides important data for the understanding of the regional diamond. In particular, it allows combining regional factors with a comparative analysis of the quality of the national business environment and the status of company operations and strategy across the involved countries.

3. Theoretical background

Traditional views of regionalism

Regions like the Baltic Rim have traditionally been analyzed from the perspective of trade liberalization, i.e. specifically customs union-theory. Only recently has the revival of work recognizing the locational dimension of economic activity added more granularity to this view. Regionalism as a form of partial trade liberalization has always been viewed with some skepticism. In the literature, the problem of trade diversion, i.e. the creation of trade flows within a region despite inherently more efficient suppliers outside the region, dominated. In the political arena, the special case of a region consisting of rich and poor has led to concerns about low-wage competition on the one or fear of brain drain and exploitation on the other side.

We believe that these concerns are at least partially a result of a limited understanding of how the microeconomics of the business environment works. Besides cost differences and *comparative advantage*, regions can provide various linkages and externalities to strengthen *competitive advantage* of its clusters.

Clusters and competitiveness

How things are done determines the level of productivity and thus the level of prosperity in a region. The cluster theory has developed a thorough understanding on the way that clusters drive the *how*, i.e. the level of sophistication in business activity. A cluster is defined as a “geographically proximate group of interconnected companies and associated institutions in a particular field, linked by commonalties and complementarities.” Recent work in cluster theory has also established the key role of clusters as drivers of innovation; this provides the dynamic extension to the static view on the link between clusters and productivity levels.

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Clusters reach across the traditional boundaries of industrial classifications. By combining the competencies of different actors in a competitive arena, they can achieve performance levels unattainable for individual companies or even industries.

The Diamond framework

To understand the sources of locational competitive advantage providing the environment for successful clusters we use the “Diamond” model. This model – the ‘engine’ of dynamism in a cluster - integrates four interrelated influences on the business environment:

- Context of Firm Strategy and Rivalry
- Factor (Input) Conditions
- Related and Supporting Industries
- Demand Conditions

In addition, the analysis includes the business environment on the national level, including the role of government, scientific infrastructure and the existence of networks and linking institutions.

The “Diamond” integrates the key influences on companies’ business environment. Recent work on the diamond theory has further developed the role of the regional, the national, and the local level influences on a cluster. The current project is an important step in applying this thinking to another real life case.

4. Workplan

Methodology

The project combines a number of tested methods to generate and analyze the data from the Baltic Rim region. To achieve the necessary granularity we combine data from a number of different sources using the theoretical framework sketched above.

The main methods to be used are quantitative surveys, in-depths interviews, and statistical analysis of secondary data. More specifically, we will use the GCR survey, conduct in-depths interviews with decision-makers in regional institutions as well as across the selected cluster, and undertake a revealed competitive advantage-analysis of the regions trade data.

The teams will work strongly hypothesis-driven at any time collecting their current views in a working document that will be further developed and testing using additional data. This process has proven to focus the work on the critical elements of the analysis towards an action-oriented understanding of the status quo.

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Responsibilities

The project will be conducted by researchers in St. Petersburg (SSE), Riga (SSE and BICEPS), and Boston (HBS). The overall project management will be provided by Prof. Örjan Solvell and Dr. Christian Ketels, under the supervision of Prof. Michael E. Porter.

Teams

Boston:

Dr. Christian Ketels (cketels@hbs.edu)
Professor Michael E Porter (mporter@hbs.edu)
Professor Orjan Solvell (osolvell@hbs.edu)
Mr Daniel Vasquez (dvasquez@hbs.edu)

St Petersburg:

Dr. Carl Fey (carl.fey@hhs.se)

research assistants

Ms. Rachel Doern (rachel.doern@sseru.org)
Dr. Olga Trofimenko (olga.trofimenko@sseru.org)
Ms. Kssenia Egorova (kegorova@freemarkets.com)
Ms. Natalia Libo (natalia.libo@sseru.org)
Dr. Sergei Shaposhnikov (sergei@ss2944.spb.edu)
Dr. Igor Dukeov (Igor.dukeov@sseru.org)

Riga:

Professor Alf Vanags (alf@eurofaculty.lv)

research assistants

Ms. Jevgenija Kezika (jevgenija.kezika@sseriga.edu.lv)
Ms. Yelena Zhovnikova (yelena.zhovnikova@sseriga.edu.lv)
Ms. Maari Ross (Maari.Ross@sseriga.edu.lv)
Mr. Kaido Kaarli (kaido.kaarli@sseriga.edu.lv)
Ms. Ieva Malinauskaite (ieva.malinauskaite@sseriga.edu.lv)
Ms. Ülle Adamson (Ulle.Adamson@sseriga.edu.lv)

Milestones

Baltic Development Forum, Summit 2000 (Malmo, September 2000)

A Baltic Rim Regional Agenda:

Michael E Porter, Professor, Harvard Business School

Orjan Solvell, Professor Stockholm School of Economics

Annual meeting, World Economic Forum (Davos, January 26, 2001)

A Roadmap for the Baltic Countries:

Valdas Adamkus, President of Lithuania

Lennart Meri, President of Estonia

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Poul Nyrup Rasmussen, Prime Minister of Denmark
Orjan Solvell, Professor, Research Fellow, HBS, USA
Vaira Vike-Freiberga, President of Latvia
Challenger: Sergei A. Karaganov, Chairman Council on Foreign and Defence Policy,
Institute of Europe, Russia

Moderator: Uffe Ellemann-Jensen, Chairman Baltic Development Forum, Denmark

Council of the Baltic Sea States, Fostering Economic Cooperation in the Baltic Sea Region
(Berlin, March 13, 2001)

Participation by Christian Ketels

Sweden and the Baltics: A New Place In Europe for Sweden's Baltic Neighbors (New York,
March 21, 2001)

"Putting the Baltic Rim on the Front Page of TIME Magazine: Enhancing the
Attractiveness of the Baltic Countries" by Orjan Solvell, Professor Stockholm School of
Economics (IIB), Research Fellow, Harvard Business School, USA

Northern Dimension Business Forum (Tallinn, April 3-4, 2001)

Participation by Orjan Solvell

Baltic Development Forum, Summit 2001 (St. Petersburg, September 23-25, 2001)

5. Project Partners

The project brings together a group of academic institutions with leading expertise on cluster theory and the Baltic region. Equally critical for the success of this venture we have found partners in the region that are willing to make the Baltic Rim Regional Agenda their agenda. The project continuous to be open for further partners in the Baltic region that are willing to be part of this initiative to reshape the competitiveness paradigm of their region.

Academic partners

- Institute for Strategy and Competitiveness, Harvard Business School, Boston
Director: Professor Michael E Porter (mporter@hbs.edu)
- Institute of International Business, IIB, SSE, Stockholm
Director: Professor Orjan Solvell (osolvell@hbs.edu)
- Stockholm Institute for Transition Economics and the East European Economies, SITE
Director: Professor Erik Berglöf (erik.berglof@hhs.se)

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- SSE St. Petersburg
Dean: Dr Jan Eklof (jan.eklof@hhs.se)
- SSE Riga
Dean: Dr Anders Paalzow (anders.paalzow@hhs.se)
- BICEPS, Riga
Director: Professor Alf Vanags (alf@eurofaculty.lv)

Regional partners

- Baltic Development Forum, Copenhagen
Chairman: Mr Uffe Ellemann-Jensen
Contact: Anne Dorte Riggelsen, BDF (adr.baltic@mm.dk)
- World Economic Forum, Geneva
Contact: Dr Peter Cornelius (peter.cornelius@weforum.org)

The project is sponsored by:

**ABB
Axel Johnson
Harvard Business School
Institute of International Business
Nordea**

For more information please contact:

Janice Long
jalong@hbs.edu
tel: +1-617-384-5938
fax: +1-617-384-7268