



The Baltic Rim Regional Agenda

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This presentation draws on ideas from Professor Porter's articles and books, in particular, The Competitive Advantage of Nations (The Free Press, 1990), "The Microeconomic Foundations of Economic Development," in The Global Competitiveness Report 1998, (World Economic Forum, 1998), "Clusters and the New Competitive Agenda for Companies and Governments" in On Competition (Harvard Business School Press, 1998) and ongoing statistical study of clusters, Competing for Prosperity: The Microeconomic Foundations of Development, forthcoming, and "What is Strategy?" (Harvard Business Review, Nov/Dec 1996). No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means - electronic, mechanical, photocopying, recording, or otherwise - without the permission of Michael E. Porter.

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

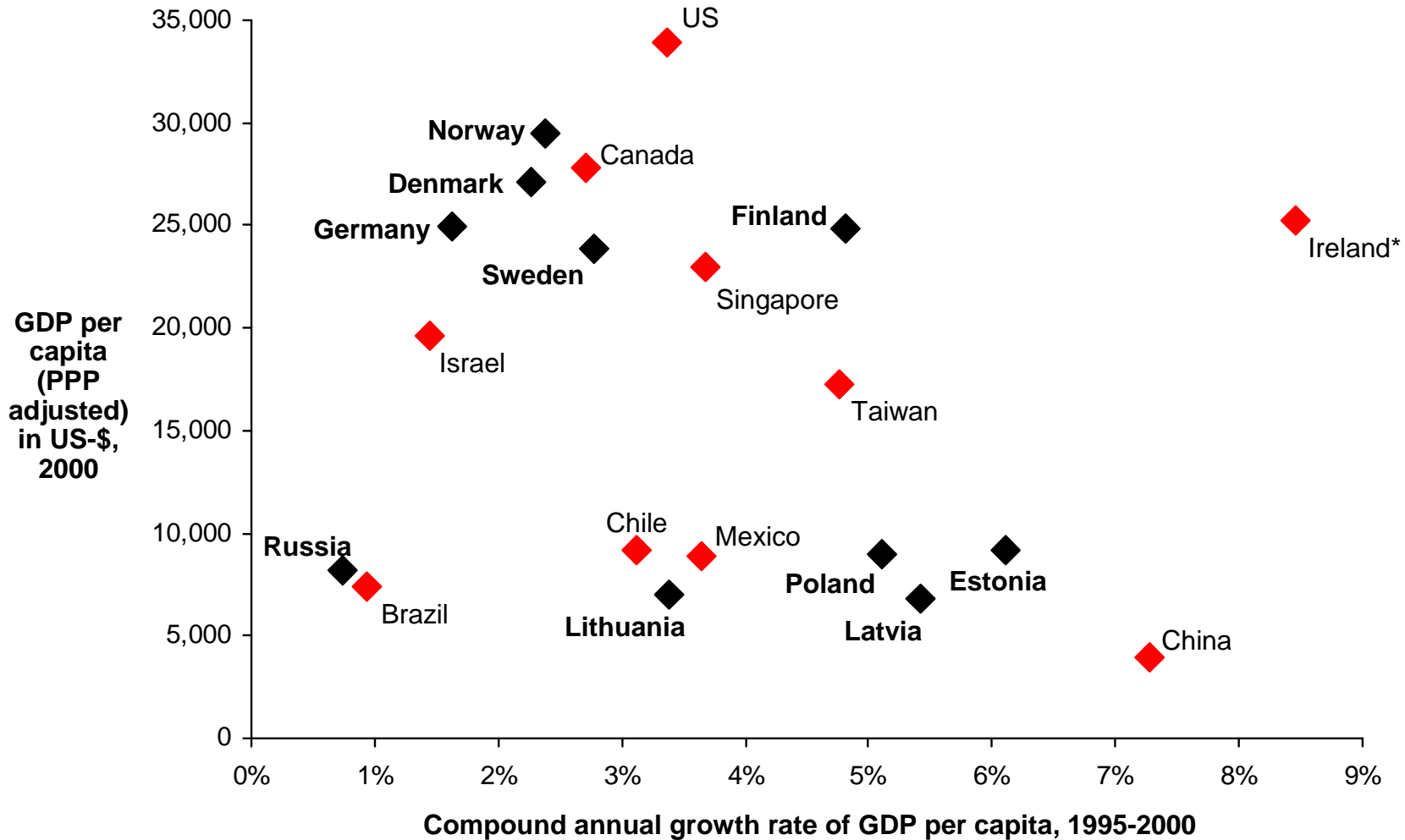
- **Current worries**

- 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

Sophistication
of Company
Operations and
Strategy

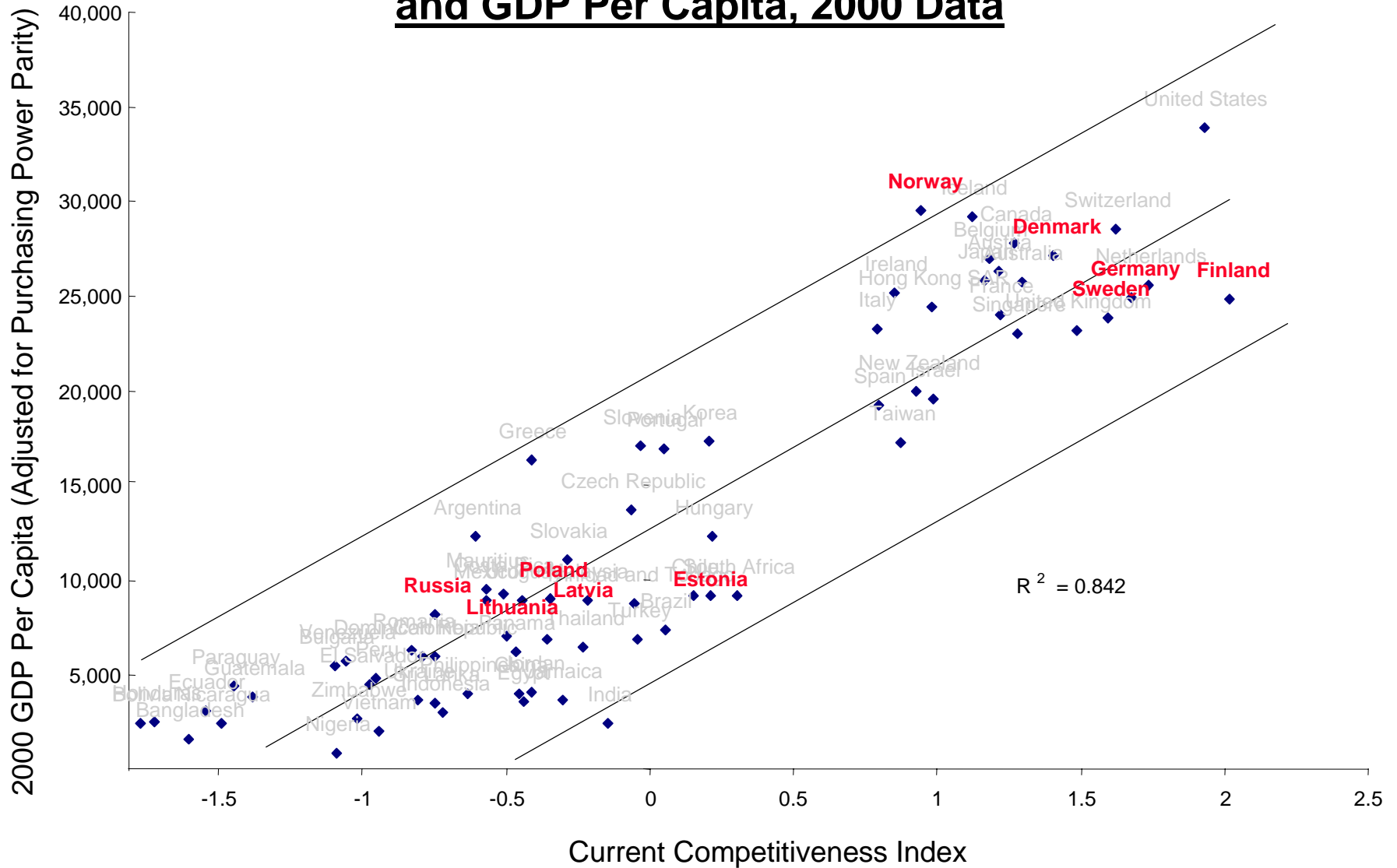


Quality of the
Microeconomic
Business
Environment

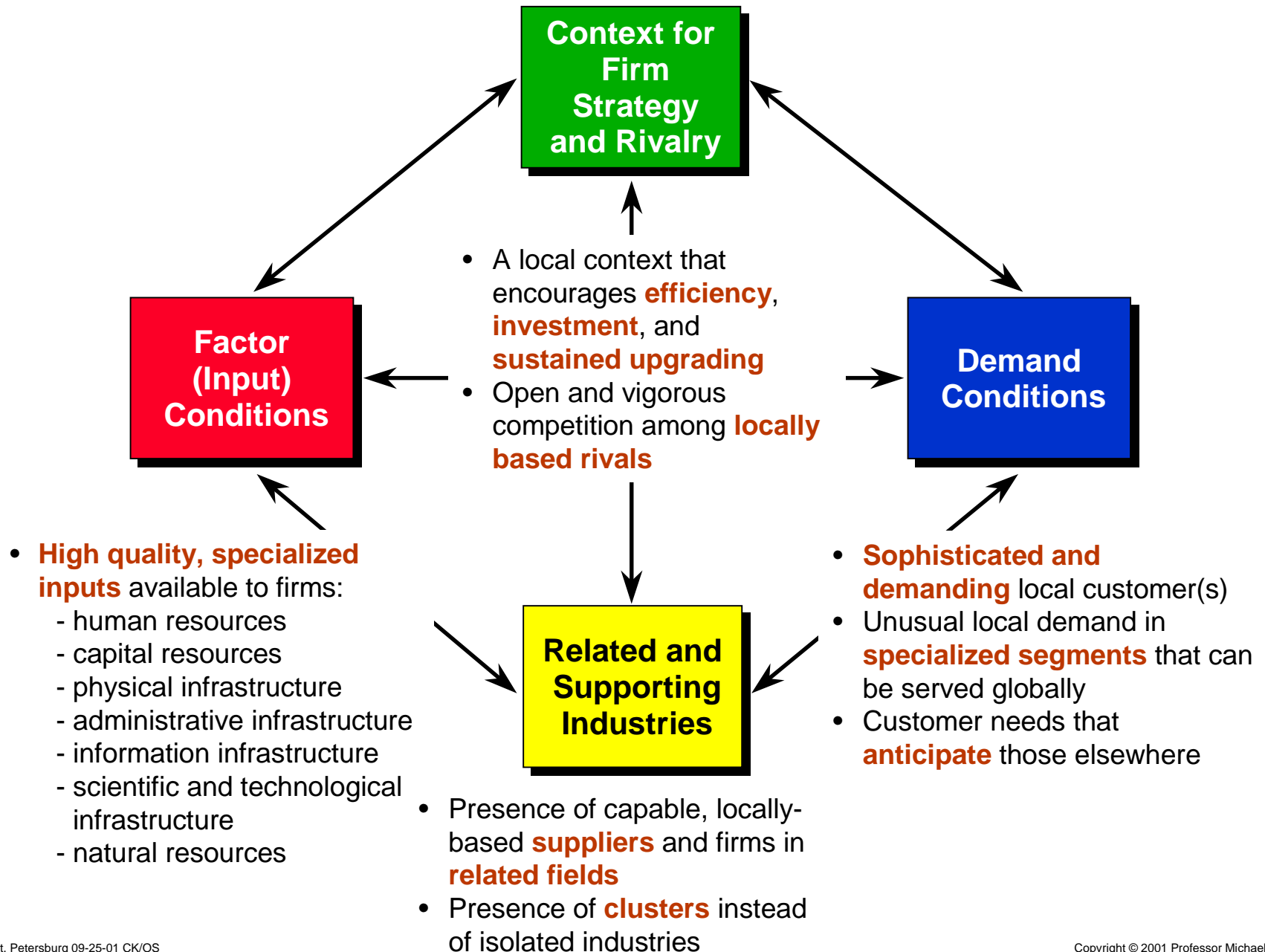
- Sound macroeconomic policies and a stable political / legal context are **necessary** to ensure a prosperous economy, **but not sufficient**
- Competitiveness ultimately depends on improving the **microeconomic foundations** of competition

Global Competitiveness Report 2001

The Relationship Between Microeconomic Competitiveness and GDP Per Capita, 2000 Data

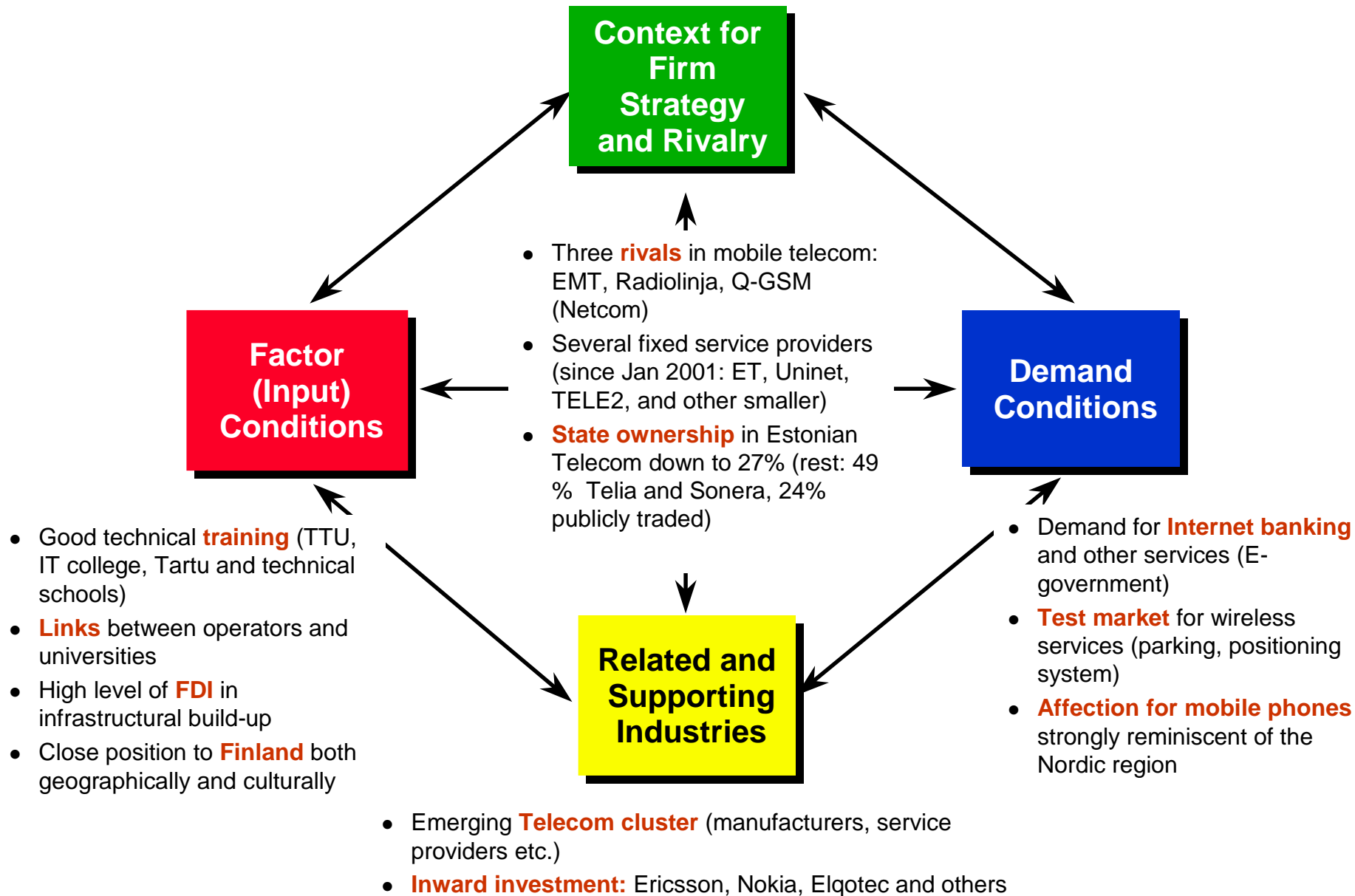


Productivity and the Microeconomic Business Environment



The Microeconomic Business Environment

Estonian Telecom/IT Cluster



Stages Of Competitive Development

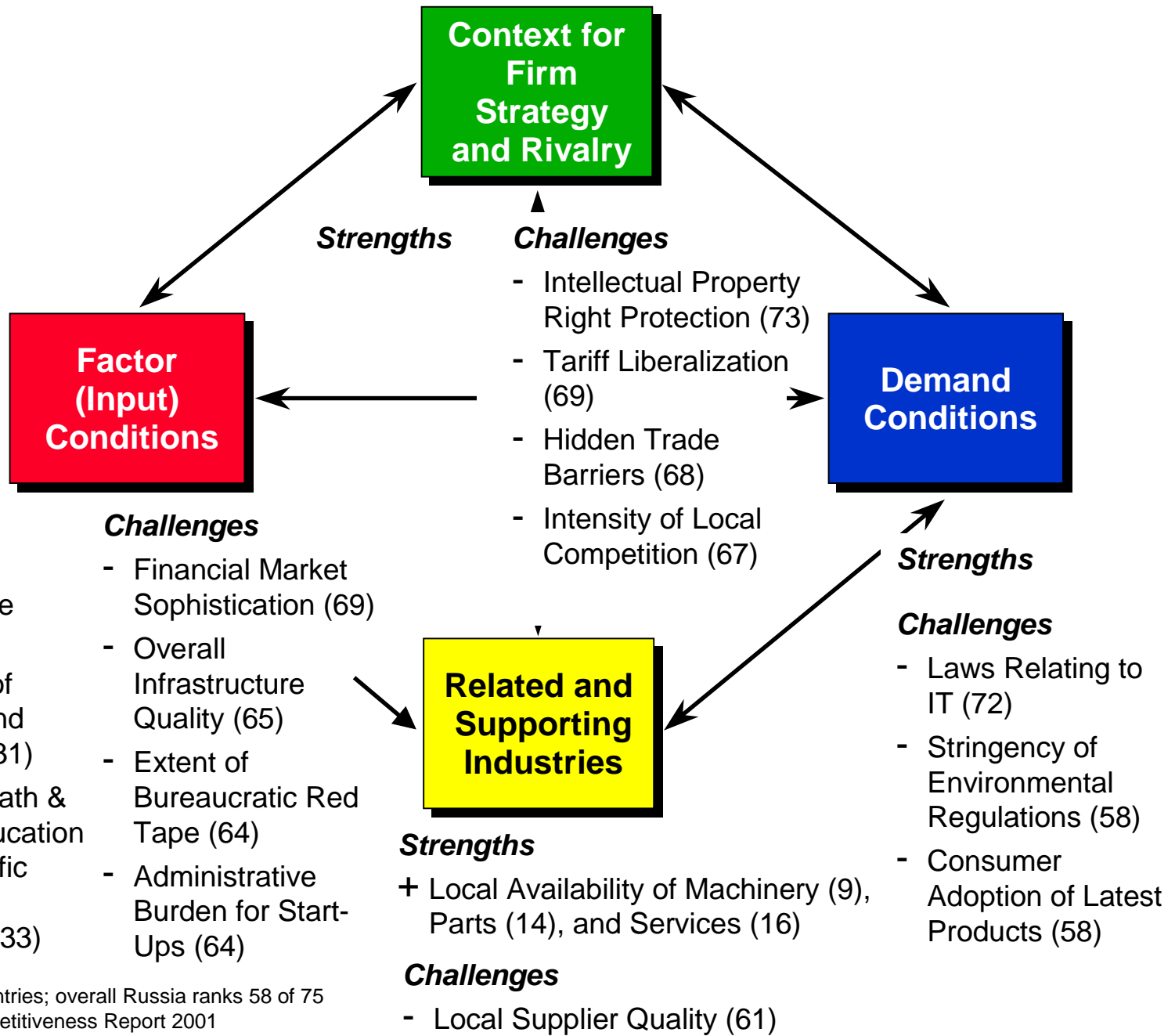


Baltic Rim Economic Challenges

Three Agendas

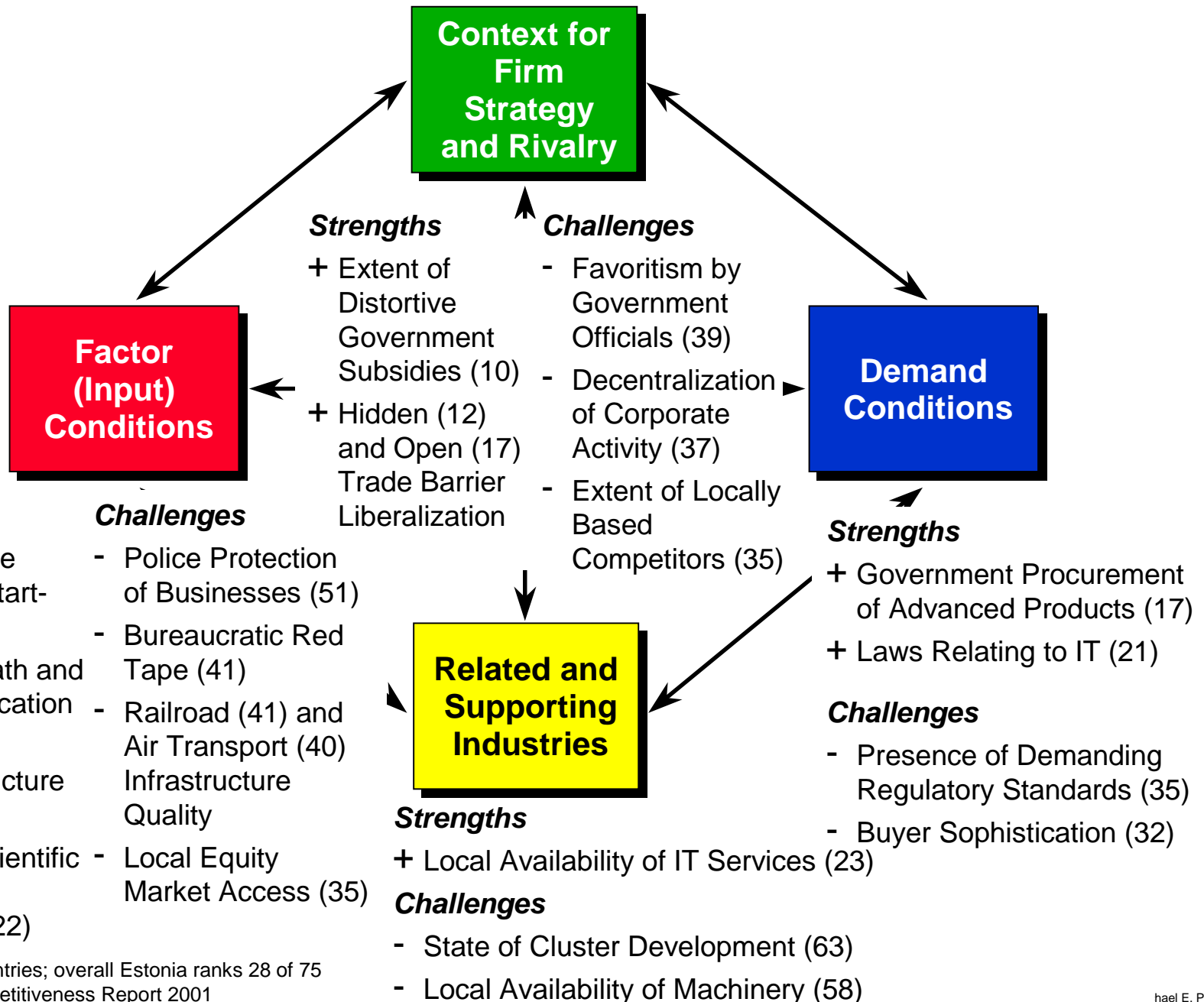
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Russian Competitiveness



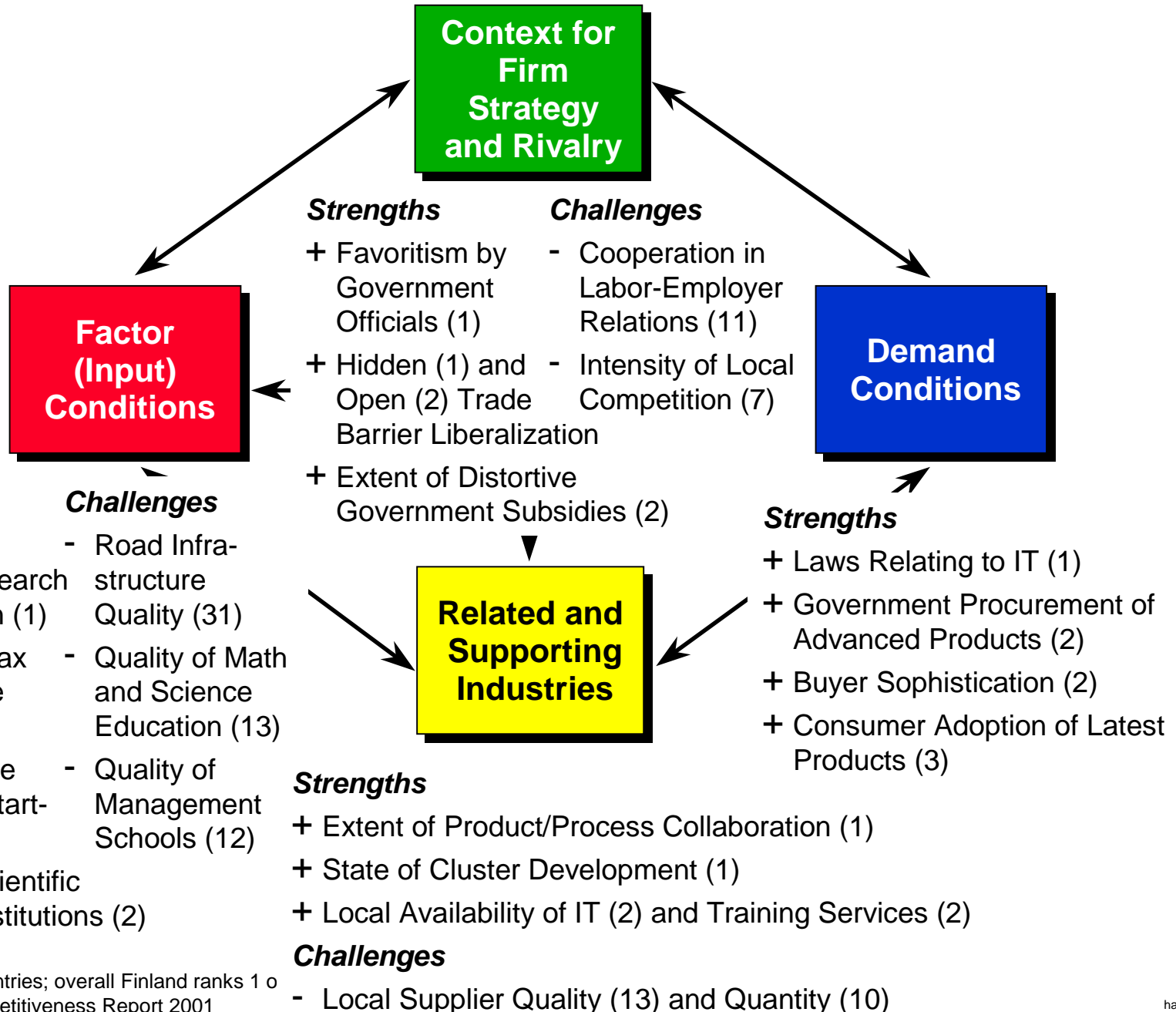
Note: Rank by countries; overall Russia ranks 58 of 75
 Source: Global Competitiveness Report 2001

Estonian Competitiveness



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

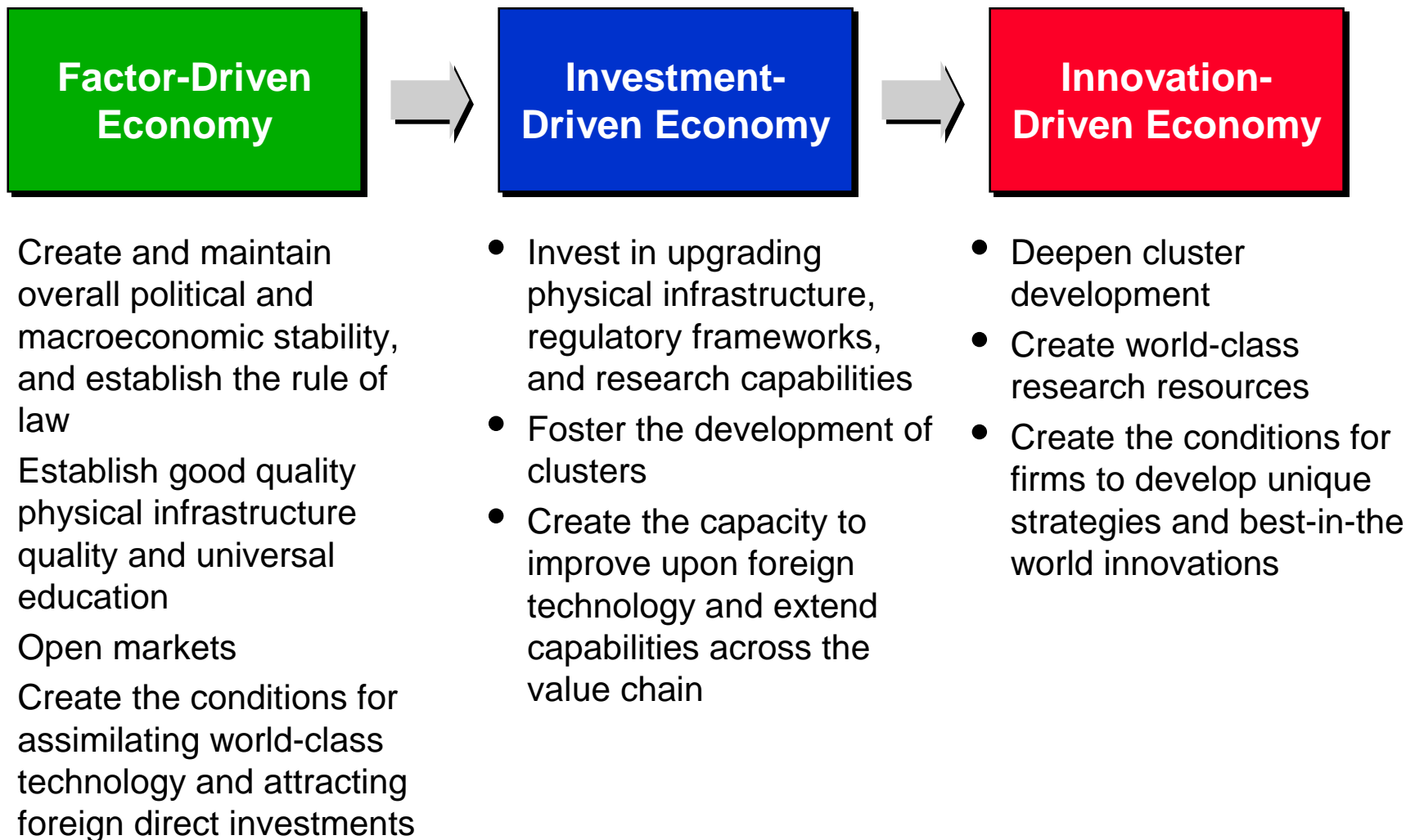
Finnish Competitiveness



Note: Rank by countries; overall Finland ranks 10
 Source: Global Competitiveness Report 2001

Stages Of Competitive Development

Policy Priorities

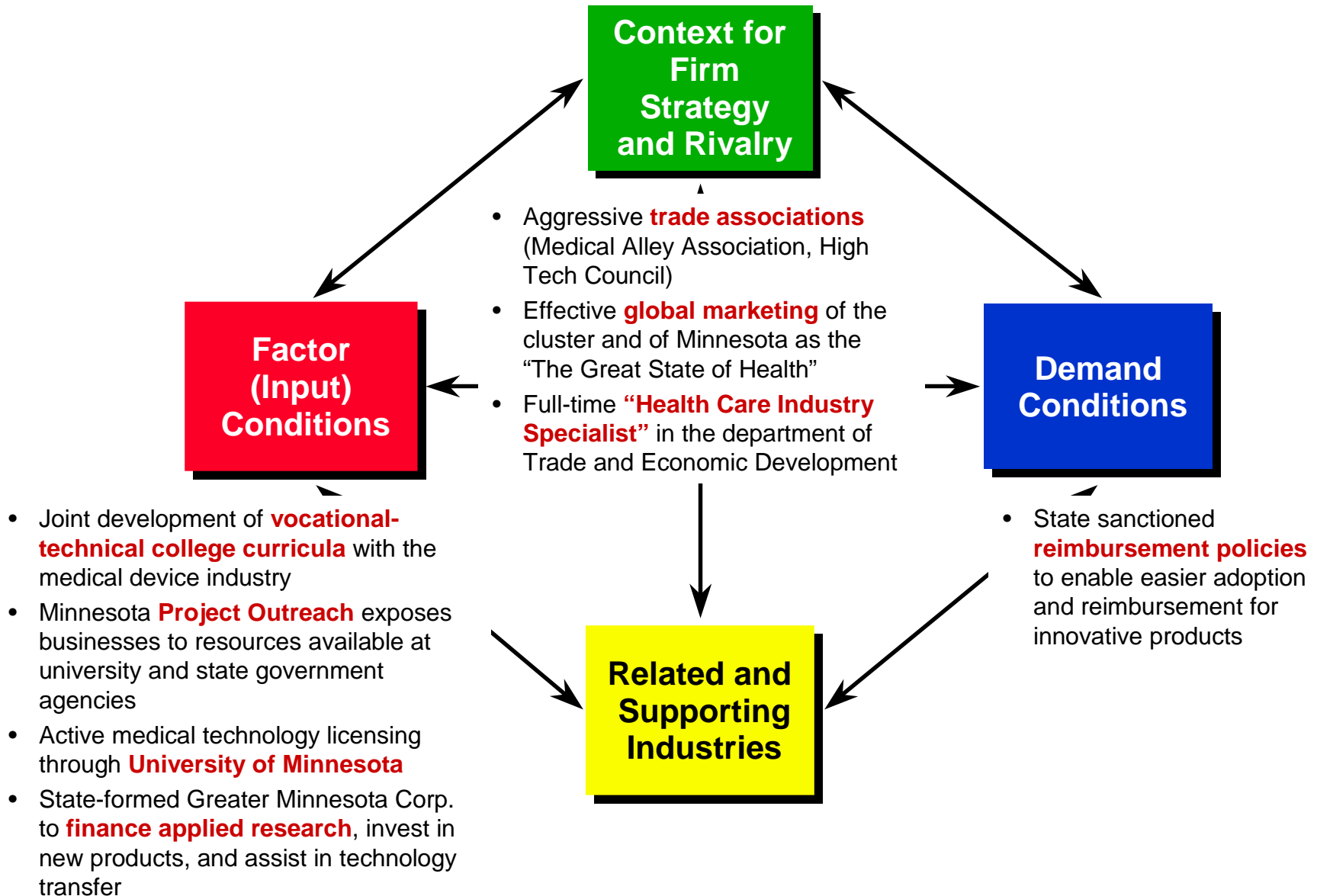


Appropriate Roles of Government in Economic Development

1. Establish a **stable and predictable** macroeconomic, political, and legal environment
2. Improve the availability, quality, and efficiency of **general purpose inputs, infrastructure, and institutions**
3. Set overall **rules and incentives** governing competition that encourage productivity growth
4. Facilitate **cluster development and upgrading**
5. Create an explicit, ongoing **process of economic change** and competitive upgrading which informs citizens and mobilizes the private sector, government at all levels, educational and other institutions, and civil society.

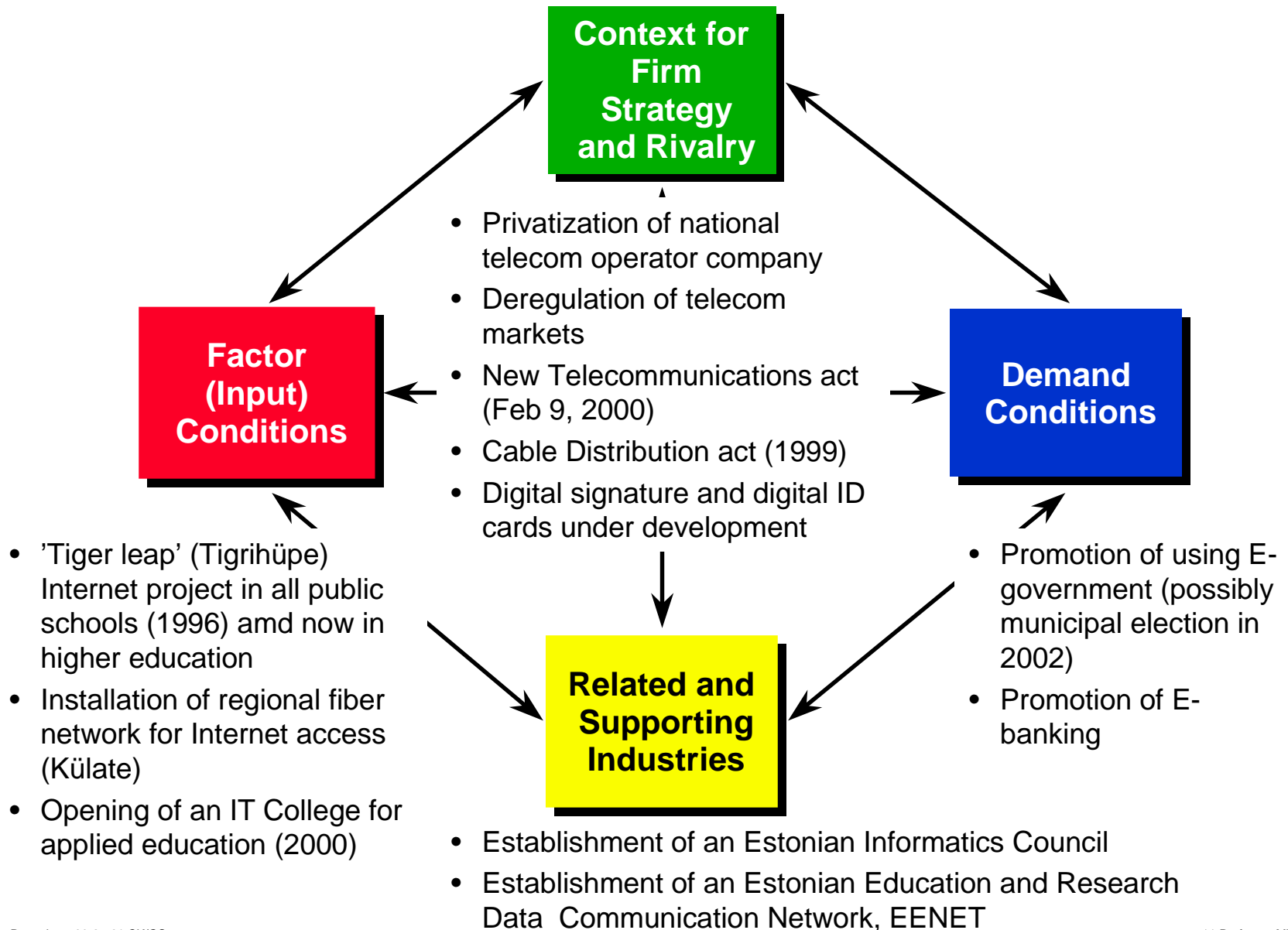
Public / Private Cooperation in Cluster Upgrading

Minnesota's Medical Device Cluster



Government Policy for Cluster Upgrading

Estonian IT Society Initiative



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

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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

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**
- Agree on foreign **investment promotion guidelines** to limit forms of investment promotion that do not enhance productivity
- Coordinated **competition policy**

Demand Conditions

- Set minimum **environmental standards**
- Set minimum **safety standards**
- Establish reciprocal **consumer protection laws**

Related and Supporting Industries

- Establish ongoing upgrading process in **clusters that cross national borders**, e.g.
 - Tourism
 - Agribusiness
 - Textiles and Apparel
 - Information Technology

Regional Governance

- 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

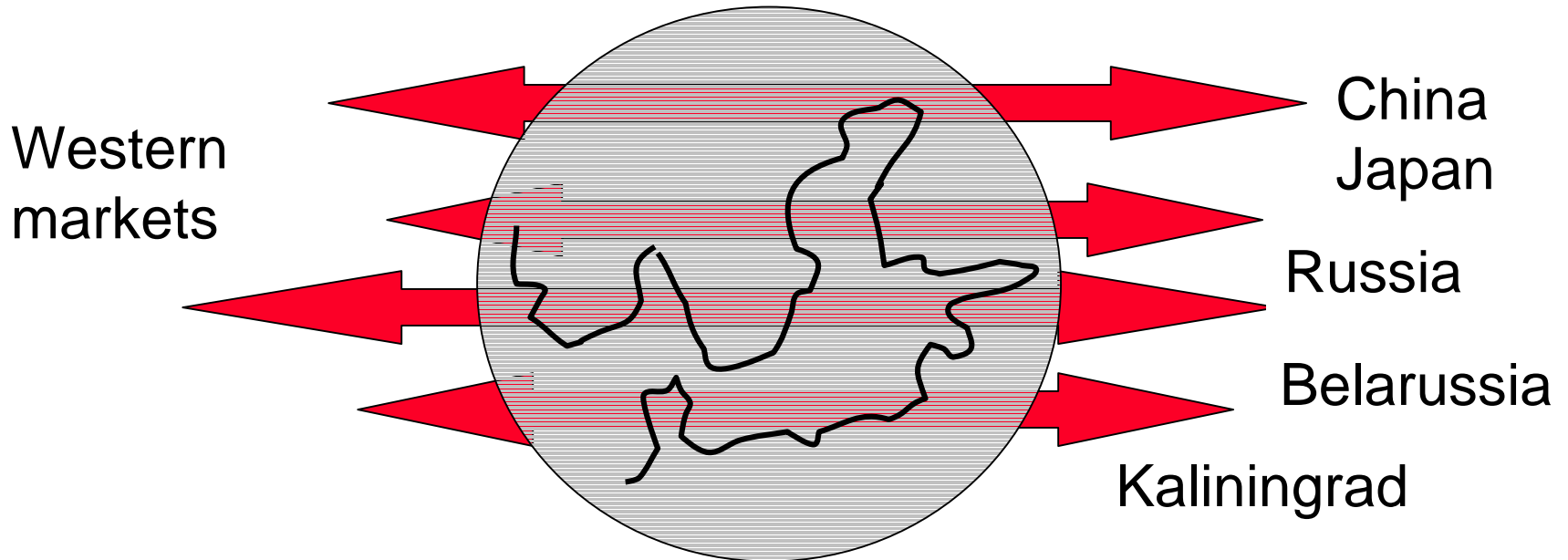
- **Access to larger markets for goods and especially for services**
- **Efficient specialization along the value chain**

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**

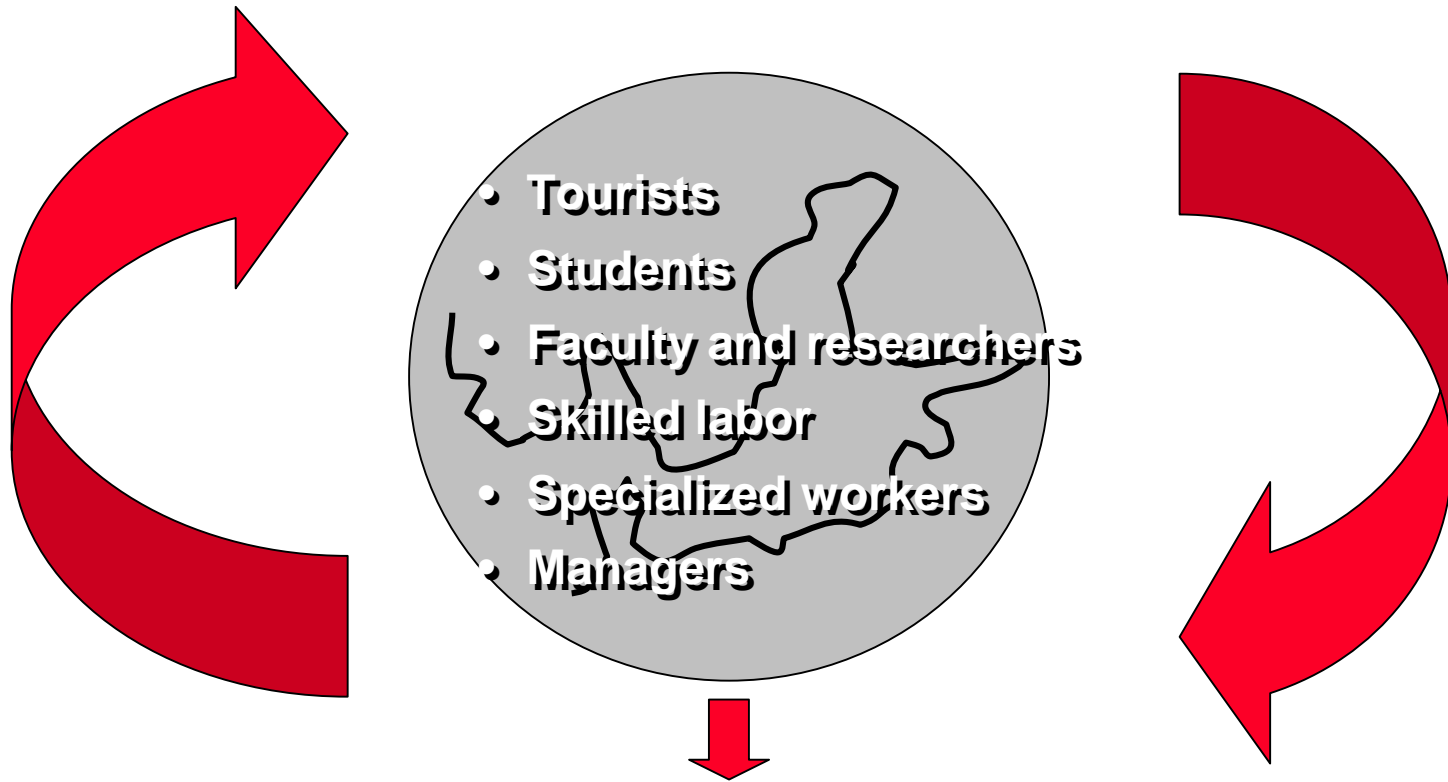
Logistical Infrastructure

East-West Links



- 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

Brain Circulation



- 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)



Sweden	39,2%
Finland	31,1%

US	4,5%
Norway	4,3%
Denmark	4,1%
Germany	2,7%
Great Britain	2,6%
Netherlands	2,1%
Russia	1,4%

Source: Dagens Industri 010127

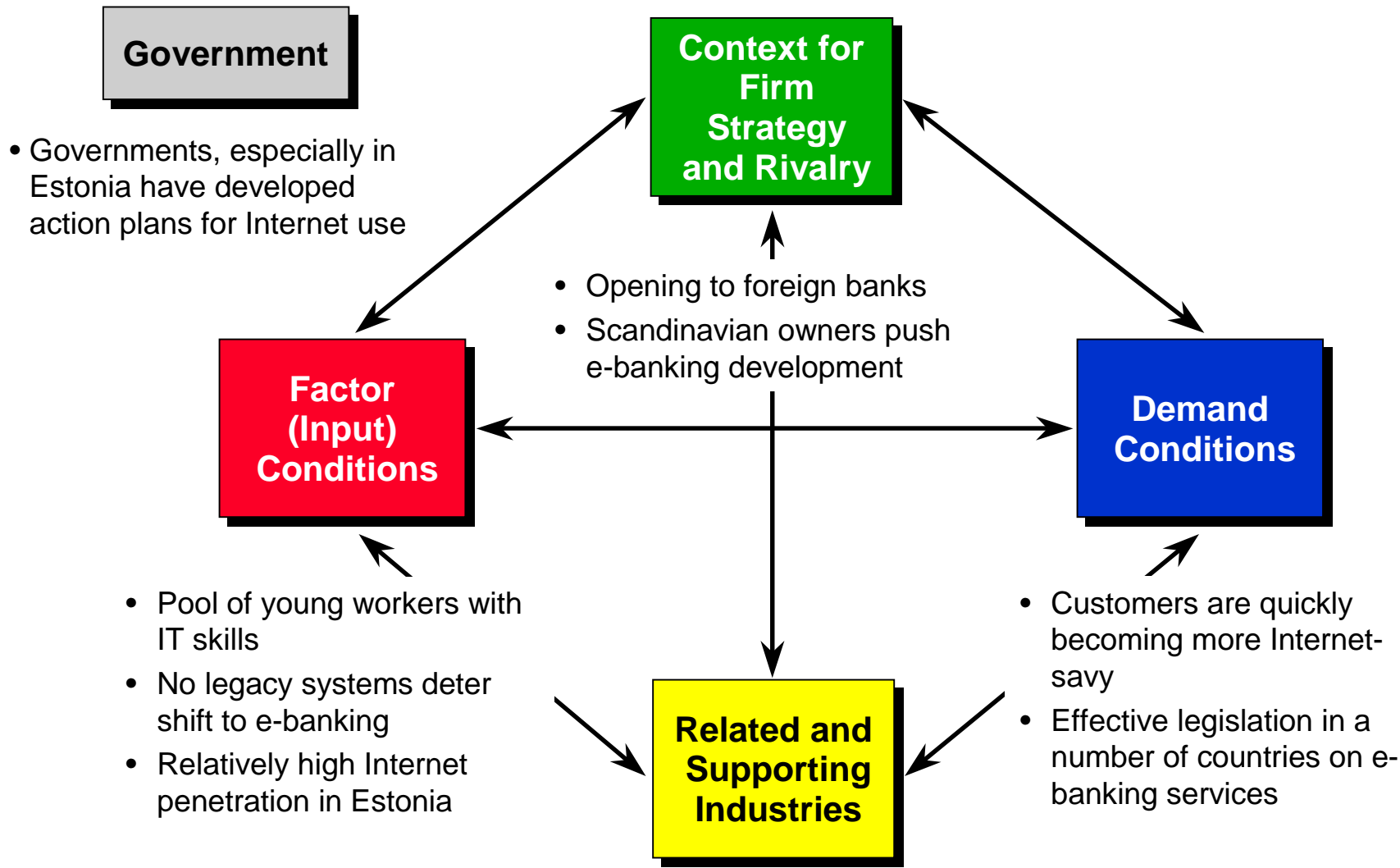
Total of 21,3 billion SEK (1990-2000)



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

Cluster Integration

E-Banking in the Baltic Countries



- 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

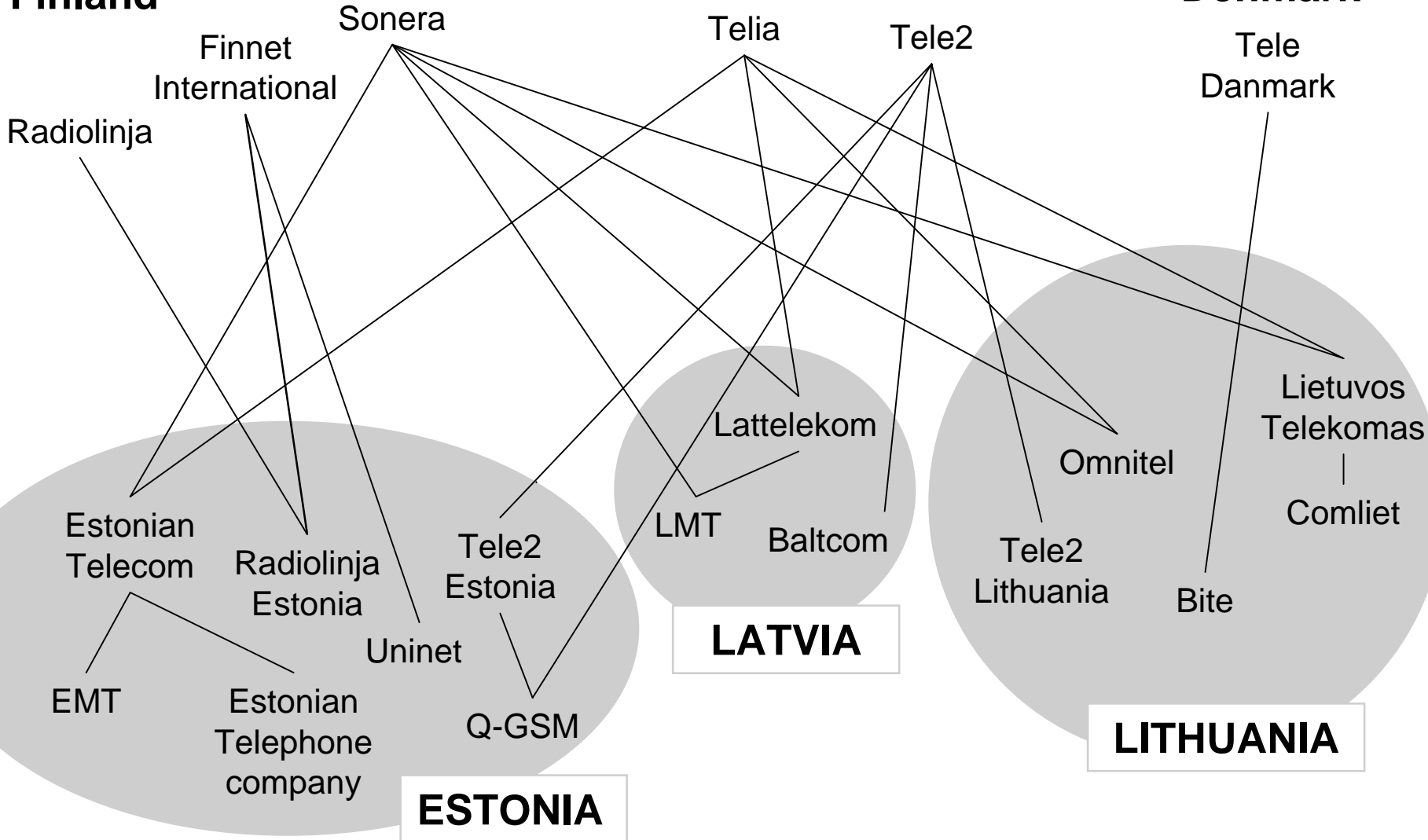
Cluster Integration in Telecommunications

Ownership of Telecom Operators in the Baltic Countries

Finland

Sweden

Denmark



Cluster Integration in IT/Telecom

Effects across the region's countries

- Nordic telecom operators haven't 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

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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

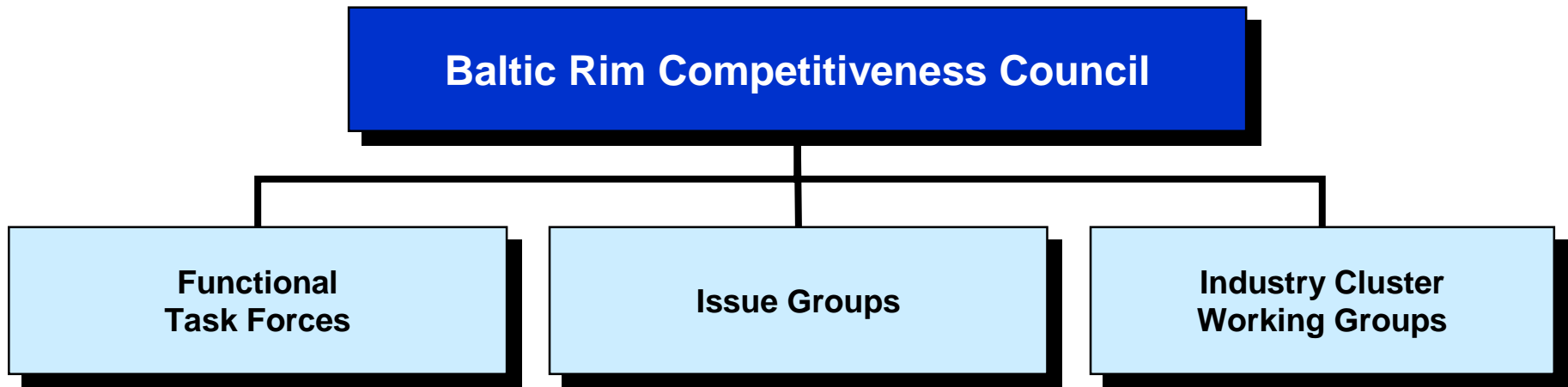
- EU Northern Dimension
-
- OECD Baltic Programme
 - EBRD
 - World Bank
 - IMF

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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