2015

STATE OF THE REGION REPORT™

The Top of Europe – Striving for Direction in a Complex Environment

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Helge Pedersen

sustainable growth
innovation
competitiveness
Baltic
Development Forum

Published with support from

Ministry of Foreign Affairs of Denmark

NORDEN2015.DK
VISIONS AND VALUES - NORDIC COUNCIL OF MINISTERS - NS - NIB

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BALTIC DEVELOPMENT FORUM STATE OF THE REGION REPORT 2015

Since 2004, Baltic Development Forum has published the *State of the Region Report*, the annual analysis of the Baltic Sea Region's economic development and competitiveness. The report has become an important tool for decision makers in both the public and private sectors. It is widely acknowledged in the region and beyond as a snapshot of the region's growth potential. This year's report will be presented at the 17th Baltic Development Forum in Copenhagen on 23rd November 2015 and provide the setting for the Summit's discussions on sustainable growth, innovation and competitiveness.

The aim of the report is to provide decision makers with a comprehensive overview of the economies in the Baltic Sea Region. With facts and analysis of economic performances, strengths and weaknesses, the report provides further insight and knowledge about challenges, opportunities and risks. It is our hope that the report will inspire policy-makers and other stakeholders to deepen cooperation across borders and help realise the vision of the Baltic Sea Region as one of the most dynamic and prosperous regions in the world. With a new and more focused format for this year's report, we hope to reach out to a larger audience in business, government, academia and media, inside as well as outside of the region, stimulating debate, awareness and knowledge about the Baltic Sea Region as a frontrunner in many respects.

As the title of this year's report *The Top of Europe - Striving for Direction in a Complex Environment* indicates, the Baltic Sea region is also facing challenges. While the region continues to display solid macro-economic performance and still does well in terms of competitiveness, business climate and prosperity, there are also signs of concern in the medium and longer run. The report emphasises the need for decision makers to reinforce their commitment to the regional political cooperation and set ambitious new goals for the region in order to stay on the top of Europe. We hope that the discussions at the 17th Baltic Development Forum Summit will be helpful to this end.

While many of the challenges our region is facing are not unique to the countries around the Baltic Sea, solutions can often be found through stronger regional cooperation and innovative cross-border initiatives. With the vast number of public and private stakeholders actively engaged in regional cooperation at many different levels, the Baltic Sea Region is very well placed for finding regional solutions to "Europe-wide" challenges.

Again this year, we would like to express our sincere appreciation to the authors behind the *State of the Region Report* – Christian Ketels and Helge Pedersen – for their excellent and comprehensive analysis of how the Baltic Sea Region is performing in the global economy.

This year's report has been made possible thanks to the support of the Nordic Council of Ministers, the Danish Ministry of Foreign Affairs and the Danish Presidencies of the Nordic Council of Ministers and the Nordic-Baltic cooperation (N5 + NB8), as well as Dr. Ernst Wehtje´s Foundation. As always, the views expressed in the report do not necessarily reflect the views of the sponsors.

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Chairman

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Director

BALTIC DEVELOPMENT FORUM

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- Lenient monetary policies to be continued for longer due to stalled inflation

- Risks on the downside, due to heightened uncertainty regarding the development of emerging market economies

PROSPERITY

- The region remains strong relative to European peers; catch-up of the Baltics and Poland continues at a robust rate

- The 'New Normal' of slower prosperity growth has the Baltic Sea Region, as many other advanced macro-regions, firmly in its grip – labour market mobilisation is almost flat and labour productivity growth is down

GLOBAL TRADE AND INVESTMENT

- Erosion of world export market share continues at a slow but steady rate

- Inward FDI position continues to weaken, while outward FDI flows are stable

- Both partly a normal reflection of the weight of the global economy shifting to Asia; still posing challenges for the region

COMPETITIVENESS

- The region continues to rank highly in many assessments of overall competitiveness; particularly, the laggards in the region have been able to catch-up over time

- Despite the overall strong position there is a remaining set of mainly country-specific weaknesses in areas like regulations and the effectiveness of the innovation systems across the region

- Current policy attention across the region is not focused on competitiveness, but on a range of other again mainly country-specific policy priorities

REGIONAL COLLABORATION

- At the operational level the EU Strategy for the Baltic Sea Region functions well, with recent adjustments made in governance and priorities. The EU's new regional policy provides an improved context for the measures under the Strategy

- The political context for collaboration is difficult, affected by disagreements with Russia about the situation in the Ukraine, and among EU members about the appropriate response to the refugee crisis. A number of countries in the region also face difficult parliamentary situations with weak support for the sitting governments

IMPLICATIONS

- Not an easy time for stronger regional collaboration; currently neither the sense of pressure, willingness, nor political ability existing among key leaders across the region to set ambitious new goals

- Regional collaboration 'on auto-pilot' will work for the moment; the structures exist and are working

- But it will not be sufficient over time: it is not leveraging the opportunity to use the regional level as an additional lever for upgrading competitiveness

- And it runs the risk of undermining the foundations of the current collaboration structures if they are increasingly seen as outdated and not relevant for the key challenges the region and its parts are facing

INTRODUCTION

THE BALTIC SEA REGION IN 2015

As the participants of the 17th Baltic Development Forum Summit meet in Copenhagen in November 2015, they are discussing a Baltic Sea Region facing a complex environment.

There are reasons for optimism: growth in many parts of the region has reached a more solid pace, the economic outlook in Europe is somewhat improved, low energy prices and a highly expansionary monetary policy environment provide support, many of the traditional competitiveness indicators confirm the leading position of the region, and cooperation within the region proceeds in many policy areas – from energy to environment to economic development and many more – drawing on the EU Strategy for the Baltic Sea Region's revised action plan and the new Baltic Sea Region Interreg programme for support.

But there is enough to worry about as well: the 'New Normal' of lower prosperity growth has the region firmly in its grip, growth trajectories have become more heterogeneous within the region, the region's overall position in the global economy continues to slowly erode, other policy priorities have pushed aside coherent action on competitiveness upgrading in many of the region's countries, and the political climate does not look supportive for ambitious new regional collaboration initiatives.

In the short term, this results in a region that is still quite robustly at the Top of Europe. Competitiveness fundamentals build up over the last decades are supporting present levels of prosperity and innovation. The catch-up of the Baltic countries and Poland is continuing, even if at a lower rate than before the crisis. And growth especially in Denmark, Germany and Sweden is high in European comparison.

But is the region also taking the decisions and making the investments today that can sustain this strong position into the future? This 2015 *State of the Region Report*, again providing rich data and analysis tracking competitiveness and collaboration across the region, suggests that we cannot take a positive answer for granted: the region is striving for direction at a time where leadership is hard to find and exert.

THE BALTIC SEA REGION – A (SMALL) MACRO-REGION AT THE TOP OF EUROPE

For our analysis, we define the Baltic Sea Region – as in previous years – to include the Baltic countries (Estonia, Latvia and Lithuania), the Nordic countries (Denmark, Finland, Iceland, Norway and Sweden), northern Germany (Hansestadt Hamburg, Mecklenburg-Vorpommern and Schleswig-Holstein), northern Poland (Pomorskie, Warminsko-Mazurskie and Zachodnio-Pomorskie), and most parts of Russia's Northwestern Federal District (excluding the four regions least connected to the Baltic Sea Region: the Republic of Komi, Arkhangelskaya oblast, Nenetsky AO, and Vologodskaya oblast).

The Baltic Sea Region as defined here is a so-called 'macro-region', a cross-border grouping of countries and subnational regions. While this definition of the region is informed by economic data, it is ultimately a political choice to define the boundaries of a region where collaboration is meaningful. Macro-regions have become a new level of policy dialogue in different parts of the world, especially in Europe, because they combine two features: They include countries and regions that are through their proximity the most natural partners for trade and investment, and often also compete together for a position in global vale chains. And they are, through their cultural and political affinity, areas in which policy learning and collaboration for upgrading competitiveness is most likely to be effective.

The Baltic Sea Region is, in global comparison, a small, prosperous macro-region, characterized mostly by the small open economies that make up its Nordic and Baltic core. It is home to close to 60 million people; in population size this puts the region somewhere between Italy and the UK. About 45% of the region's inhabitants live in the Nordics, a share that has been steadily increasing over time as the Nordic countries gained population. 12% of the region's population live in the Baltics, and the remainder in the parts of Germany, Poland and Russia bordering the Baltic Sea. All of these latter countries and regions have seen their population numbers slowly decrease, a trend that is likely to continue given the current patterns of demography. The region generated in 2014 an annual GDP (current prices and exchange rates) of around €2,066 billion ($2,320 billion). This is 1% more than in 2013 and represents about 12% of the EU-27 economy. The Nordic countries dominate with about 70% of the total, followed by Northern Germany at roughly 12%, Northwestern Russia at 9%, the Baltics at 4.5% and Northern Poland with the remaining 2.5%. Prosperity levels differ significantly across the region, despite the Baltics, Poland, and Russia, catching up over recent years. The Nordic countries and Germany register GDP per capita levels well ahead of the European Union average, while the region overall falls somewhere between the performance of the EU-27 and the EU-15.

A DIFFICULT CONTEXT: THE GLOBAL ECONOMIC CLIMATE, POLITICAL DYNAMICS ACROSS THE REGION, AND THE ARCHITECTURE FOR REGIONAL COLLABORATION

As a small, open macro-region the Baltic Sea Region is in its performance highly exposed to the economic environment in Europe and the broader global economy. Within the region, political dynamics at the national level as well as the structures for regional collaboration affect how much joint action for competitiveness is likely to occur.

The economic climate within the Baltic Sea Region, in Europe more broadly, and in the wider global economy are subject to divergent trends, a significant departure from the situation prior to and during the global economic crisis. In the Baltic Sea Region, Denmark, Sweden, Germany, Poland and the Baltic countries are registering robust growth, while Finland, Norway and Russia are dealing with – for different reasons – much more challenging economic conditions. In Europe, the agreement with the Greek government from July has at least reduced concerns about serious fractures in the Euro-Zone for now. The recovery remains weak but the forecasts point towards further cyclical 'self-healing' of the economies that are the main trading partners of the Baltic Sea Region. The most positive data globally is coming from the US, where the recovery has gained significantly more strength. The emerging economies, reliable growth drivers in recent years, have conversely lost a lot of their lustre: China's slowdown has already led to major repercussions on the country's notoriously fragile equity markets. And China's natural resource suppliers have been hit hard, from Brazil to South Africa and Canada.

Three trends reflect these complex global economic circumstances: First, world trade is developing much less dynamically than before. This gives pause to a region like the Baltic Sea that is traditionally highly trade oriented. Second, prices for energy and natural resources have dropped. This has a more differential impact on a region that is home to both energy consumers and some of the world's largest exporters. Third, monetary policy around the world remains lenient but the expected increase of interest rates in the US, driven largely by the country's domestic situation, could trigger growth-reducing capital outflows from emerging markets. Here the potential impact on the Baltic Sea Region, through exchange rate movements and potentially adjustments of monetary policy by the ECB and national central banks, is least certain.

These complex challenges in the economic environment that the Baltic Sea Region is facing coincide with a set of difficult political issues that affect the ability to mount effective collaboration within the region.

Relations between the West and Russia remain strained, creating tensions within the Baltic Sea Region. While the Minsk II agreement from February 2015 has stabilized the military situation in the Southeastern part of the Ukraine to some degree, the fundamental differences about Russia's involvement there and about its annexation of Crimea remain. Russia's increased military activity in the region, routinely testing the borders of its Baltic Sea neighbours, have triggered both increased NATO deployments to the Baltics and Poland and a new discussion about Nordic defence collaboration, potentially even leading up to Finland and Sweden applying for NATO membership. One practical casualty of this new political reality in the region has been the Council of the Baltic Sea States Summit at the level of heads of state; the last one occurred in 2012. From an economic perspective most critical have been the set of sanctions that were imposed on Russia by the US and Western European countries in response to Russia's actions in the Ukraine; Russia then responded with its own set of sanctions. The overall direct economic impact of these actions on the Baltic Sea Region economy is limited. But some countries and industries have been affected significantly more, not only by the sanctions directly but also by the broader slow-down in the Russian economy that has occurred. The deterioration in relations with Russia have, however, also provided a new impetus to integration within the rest of the Baltic Sea Region: on energy, for example, Poland and the Baltic countries have signed an agreement to build a new gas pipeline for limiting the Baltics dependence on Russian supplies.

The current refugee crisis has exposed significant differences of opinion among the EU member countries within the Baltic Sea Region. It has also created significant demands on the countries that have received the highest number of refugees to organise an appropriate response. The European level fault lines on a compulsory system to allocate refugees across EU member countries cut right through the middle of the Baltic Sea Region. Among the Nordic countries, too, policy approaches have diverged significantly, most visibly with disagreements between Denmark and Sweden on the handling of refugees on transit and demonstrations at the Finnish-Swedish border triggered by refugees crossing the border from Sweden. While these incidents mask a large degree of common values and policy approaches, they do reflect clear differences in public opinion about the appropriate balance of policies in response to the refugee crisis. Economically, the sharp increase in refugee numbers creates a significant short-term financial challenge for the countries hosting the largest number of refugees. However, most economic studies also point towards significant long-term economic benefits if integration into the labour market and society more broadly succeeds, especially in countries facing aging and shrinking societies.

These issues across the region come at a time when governments, especially in the Nordic countries, have to deal with a difficult political arithmetic at home. In Denmark, the June elections led to a change of government. Prime Minister Lars Løkke Rasmussen, who's own party Venstre had seen its share of the vote significantly reduced in the election, has to rely on the support of the larger Danish People's Party (Danske Folkepartiet) for his minority government. In Finland, April elections also brought in a centre-right government, with the populist 'True Finns' part of the ruling coalition. The new government's fiscal policy consolidation and its attempts to get employers and trade unions to agree on cuts in social benefits and pay have triggered nation-wide protest strikes. In Sweden, elections last year led to a change from one minority government to another. When the new government of Social Democrats and Green Party saw their first budget defeated in parliament in the fall of 2014, Prime Minister Löfven called early elections. These elections were cancelled after an agreement with the center-right opposition secured passage of the budget as long as the government worked towards broad consensus in a number of key policy areas. The purpose of the so-called "December Agreement" was to negate the populist Sweden Democrats, which had made support to any government contingent on changes in immigration policy and is seen as an unacceptable partner by all other parties, any leverage in the political process. The agreement has recently lost the support of the opposition, creating uncertainty about the political path ahead. Norway had seen its government change already the year before, when a center-right majority took over. Local elections in September 2015 saw the government lose its majority in national opinion as well as leadership of many local and city councils. With national elections due in 2017, the government has, however, a solid majority in the national parliament. In Poland, the sitting government is facing a challenging October election after losing the Presidential election in May 2015 to the opposition Law and Justice Party, which has commanded a significant lead in the polls since then. These issues that sitting governments are facing domestically across the region do not have to affect regional collaboration, which tends to be supported across party political lines. But, in practice, it limits governments' ability and willingness to mount more ambitious efforts in this area, specifically because it does not promise much popularity and political gain in the short-term.

The final important contextual factor is the structure for regional collaboration. At its core, the EU Strategy for the Baltic Sea Region has, since 2009, provided overall direction to the many existing cross-border organisations, projects, and initiatives. At the 6th Annual Forum of the EU Strategy for the Baltic Sea Region, this year organized in Jurmala, Latvia, a revised action plan was announced, and more of the organisational ownership of the Strategy was shifted from the European Commission to the region. A core set of instruments the EU Strategy uses are the cross-border EU programmes financed under the umbrella of the EU structural funds. With the start of the new 2014-2020 programming period the respective Interreg programme for the Baltic Sea Region has now be fully aligned with the EUBSR. The programme mobilises roughly EUR 350m (with about EUR 280m from the programme budget) over the entire seven year period. Importantly, the new EU's regional policy also commits all national structural fund programmes to take macro-regional aspects into consideration.

THE 2015 *STATE OF THE REGION REPORT*: TAKING THE TEMPERATURE OF THE REGION'S ECONOMY, ASSESSING ITS FUNDAMENTAL COMPETITIVENESS

Against the background of this mixed and challenging environment the 2015 *State of the Region Report* continues to focus on delivering key facts and analysis to put the region's economic performance into context. Helge Pedersen, Chief Economist of NORDEA group, discusses the current economic climate across the region, and gives his view on the trends that are likely to shape the region's economy in the short- to medium-term. Christian Ketels, member of the Harvard Business School faculty and lead author of the *State of the Region Report* over the last couple of years, then assesses the region's economic competitiveness, i.e. the factors that are driving underlying trends in performance over the medium to long-term, and the evolution of the EU Strategy for the Baltic Sea Region as a key platform for collaboration across the region.

This year's report aims to provide a more compact discussion than the reports published in previous years. We hope that this format will make it even more useful and accessible for decision makers across the region, while still providing a comprehensive picture of the many aspects that are influencing our region's economic performance.

ECONOMIC OUTLOOK

Short-term growth dynamics
Weak capital formation growth
Small, open economies depend on trade
Labour markets and public finances
Outperforming peers
Economic sentiment
Assessment
Monetary policy of the Baltic Sea Region

ECONOMIC OUTLOOK

SHORT-TERM GROWTH DYNAMICS

Until the Great Recession, the Baltic Sea region grew at rates close to the global average. After a dramatic drop in economic activity during the crisis, the region recovered more quickly than its peer regions in 2010, but since then developments have been relatively weak influenced by the generally difficult situation in Europe. Furthermore, the mutual sanctions by the EU and Russia have led to lower trade in the region, and the dramatic fall in oil prices has resulted in a significant decline in economic activity in Russia. The recession in Russia affects especially the neighbouring Baltic countries and Finland. Falling oil prices have also meant that after many years of extremely high growth, Norway has during 2015 been hit by a severe economic downturn. Conversely, growth has been consistently high in Germany, Poland and Sweden, and Denmark seems to be heading towards a self-sustaining economic recovery after a number of lean years.

FIGURE 1

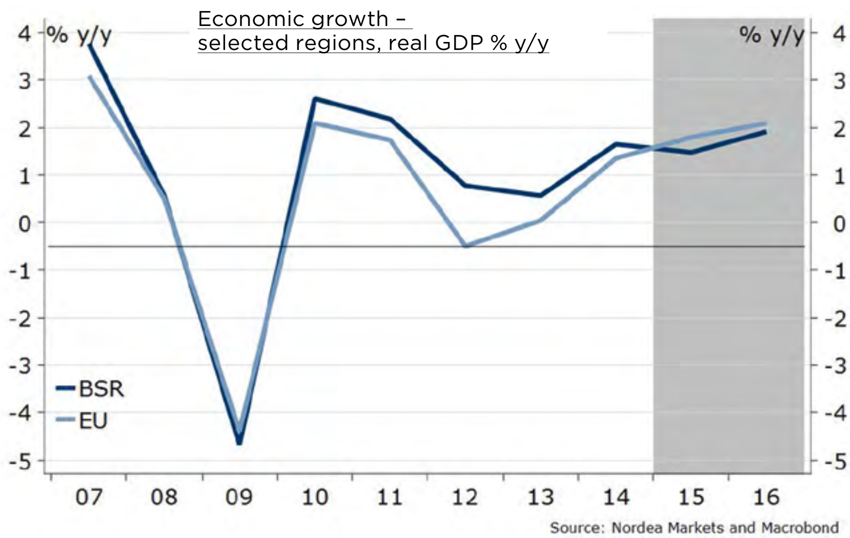
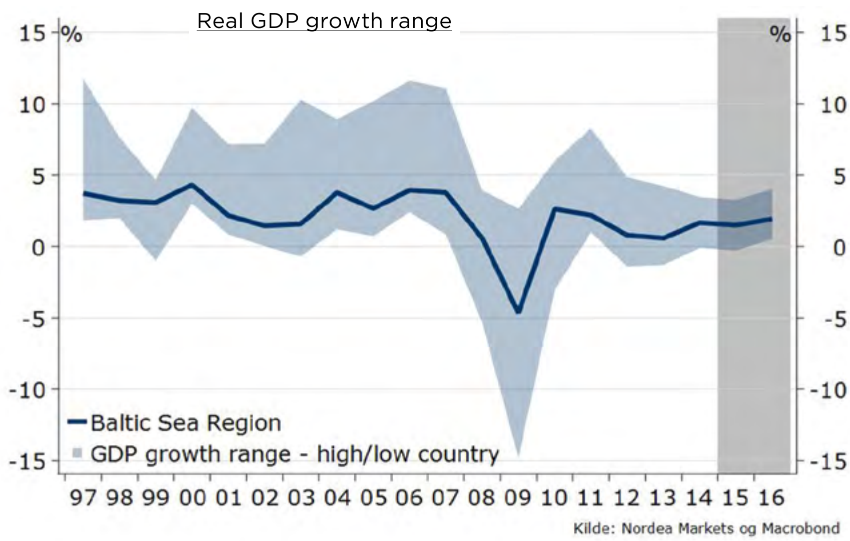


FIGURE 2



In the Baltic Sea region, variations in growth rates narrowed further in 2014. While the gap between the fastest and the slowest growing economies in the region was 17.4% points in 2009, it dropped to 7.3% in 2011 and 3.5% in 2014, see Figure 2. In 2015 the growth gap widened again, however, primarily as a result of the recession in Russia. Poland recorded the highest growth rate in the region, see Table 1 in Appendix.

Over the past years, growth in the Baltic Sea region has to a large extent been driven by domestic demand and not least consumption. Private consumption rose by 1.6% in 2014 and is expected to grow by around 2% this year and next. Current growth rates are held in check by a large setback in Russia's private consumption, stemming partly from high inflation and resulting real wage reductions, whereas most of the other countries in the region will experience significantly higher growth rates. Especially the Baltic countries are expected to experience strong growth in private consumption, along with Iceland and Poland.

Public consumption is expected to grow by around 1.6% this year and next, or the same rate as in 2014. Growth will be strong especially in Latvia, Lithuania, Poland, Sweden and Norway, compensating for a weak performance in Denmark, Finland and Russia.

WEAK CAPITAL FORMATION GROWTH

Fixed investment has over the past few years been the weak spot in many countries. This holds also for the Baltic Sea region. Since 2011 investment growth has fallen from 8.0% to 1.7% in 2014 only to stagnate this year.

The weakening is mainly due to a slowdown in the growth rates of the Baltic countries and Russia, but also Finland and Germany are facing much slower growth rates than a few years ago. Add the recent drop in oil investment in Norway and Russia, and the investment picture looks rather bleak for 2015. In light of the better global outlook and political initiatives, like the Juncker plan for Europe, fixed investment activity is expected to pick up during 2016.

Concerns about the medium-term economic outlook are very likely to have affected companies' investment decisions since the weakening investment dynamics are remarkable given the current extremely lenient monetary policy environment with sub-zero rates in many countries (see box). Part of this might be the result of a financial system increasing margins and deleveraging to improve balance sheets; a behaviour encouraged by regulators. But there are also signs that companies that are not constrained in their access to capital – large companies have been able to tap into bond markets at favourable rates – have been reluctant to invest. This suggests that the main culprit is the heightened uncertainty about the medium-term economic outlook.

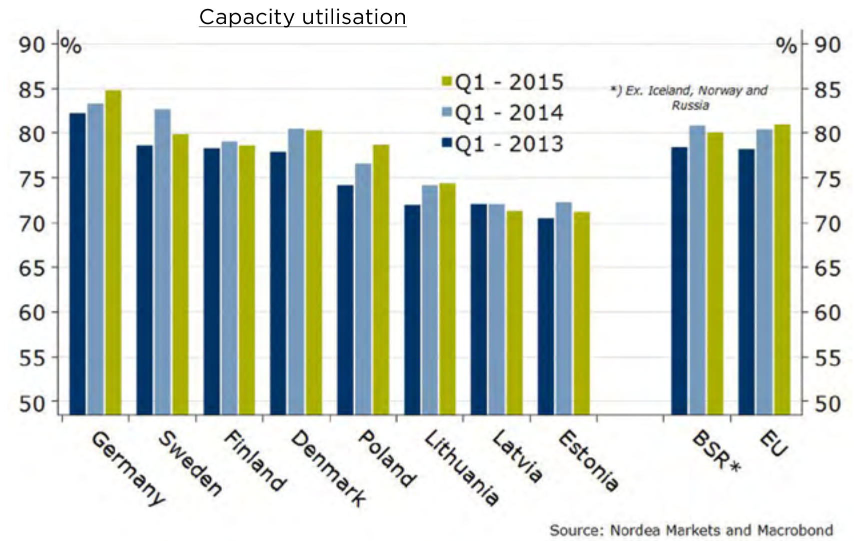
A short-term factor that may have weighed on companies' investment decisions is the level of capacity utilisation in manufacturing. The Q1 2015 figures point to a minor slowdown in 2015. Utilisation is falling or stagnating in most countries, except in Germany and Poland, where capacity utilisation has risen by more than 1% point. The investment prospects for 2015 are therefore bleak – albeit the setback is small in nature. That said, this indicator excludes Russia whose capacity utilisation is relatively low compared to the region as a whole, and it has fallen since the start of 2013 according to OECD figures.

SMALL, OPEN ECONOMIES DEPEND ON TRADE

Many countries in the Baltic Sea region are small, open economies that by nature are very dependent on foreign trade. However, after a strong recovery in the aftermath of the Great Recession, economic activity has been relatively modest since 2011 and also disappointing due to an unexpected drop in world trade this year. Exports are expected to grow by a modest 2.3% this year, while imports will only increase by 1.7%. It is a combination of weak growth in the emerging economies, declining commodity prices and the reciprocal sanctions by the EU and Russia that is causing the weakness in trade. Next year trade is expected to show stronger growth due to an expected international recovery.

The Baltic Sea region continues to post a current account surplus of 4-6% of GDP; a rate that has remained remarkably stable over the past decade. Not least the Scandinavian countries and Germany are running huge current account surpluses – a factor which, combined with solid public finances, has been of great significance to their status as safe havens in the financial markets.

FIGURE 3



LABOUR MARKETS AND PUBLIC FINANCES

Unemployment and public debt were two of the key casualties of the global crisis. They remain critical dimensions to understanding why the Baltic Sea region has done significantly better than the rest of Europe.

Unemployment, traditionally a major concern in the Baltic Sea region, increased quickly during the Great Recession. But while unemployment continued to increase in the rest of Europe, pushed up by the sovereign debt crisis and austerity programmes, it relatively soon fell back in the Baltic Sea region and has stabilised at around 6%, while it is close to 10% in the EU.

TABLE 1

GDP growth rate components – selected regions

	BSR		EU		OECD	
Real Growth, % y/y	2014	2015E	2014	2015E	2014	2015E
GDP	1,6	1,5	1,4	1,9	1,8	1,9
Consumption						
Private	1,6	2,0	1,5	2,1	1,7	2,4
Government	1,6	1,6	1,1	0,8	1,0	0,9
Fixed investment	1,7	0,6	2,6	2,7	2,7	2,3
Trade						
Exports	2,5	2,3	3,9	4,4	3,9	3,9
Import	3,3	1,7	4,5	4,8	3,8	4,8

Source: Nordea Markets, OECD, EU

As regards the individual countries in the Baltic Sea region, performance again varies. The lowest unemployment rates are found in Iceland, Germany and Norway where less than 5% of the labour force was out of work by mid-2015. However, while the unemployment rates have continuously been declining in Iceland and Germany over the past years, the labour market has deteriorated seriously in Norway over the past year as a consequence of the dramatic fall in the oil price.

The highest rates are found in Latvia, Lithuania and Finland where unemployment hovers around 10%. This indicates that the structural problems have not been overcome and that these countries are neighbouring crisis-stricken Russia.

A key challenge in many parts of the Baltic Sea region is the high level of youth unemployment. In Finland, Poland, Sweden and Lithuania, the youth unemployment rates are above or close to 20%, whereas Germany, Iceland and Estonia are the best-preforming countries in the region with youth unemployment below 10%.

In Sweden, the youth unemployment rate is around three times as high as the labour force average. In Europe, only a handful of countries have wider unemployment rate differences across these segments of the labour market. In the Baltic Sea region, Poland, Norway (at much lower absolute levels), Estonia and Finland follow with youth unemployment rates that are two to two and a half times as high as overall unemployment.

OUTPERFORMING PEERS

In terms of government deficits and debt, the Baltic Sea region continues to outperform its peers. Due to a significant surplus registered by big petroleum exporter Norway, the Baltic Sea region again ran an overall budget surplus in 2014. Denmark, Germany, Estonia and Iceland also had a budget surplus in 2014, while Poland had the largest deficit in the region of around 3.5% of GDP. The budget surplus is expected to drop to 0.4% of GDP in 2015 as lower oil prices make a dent in the public budgets of Norway and Russia.

While debt levels of the Baltic Sea region have stabilised since 2011, they have continued to grow in the EU. In Southern Europe, spending cuts are hard pressed to keep pace with falling tax receipts and

FIGURE 4

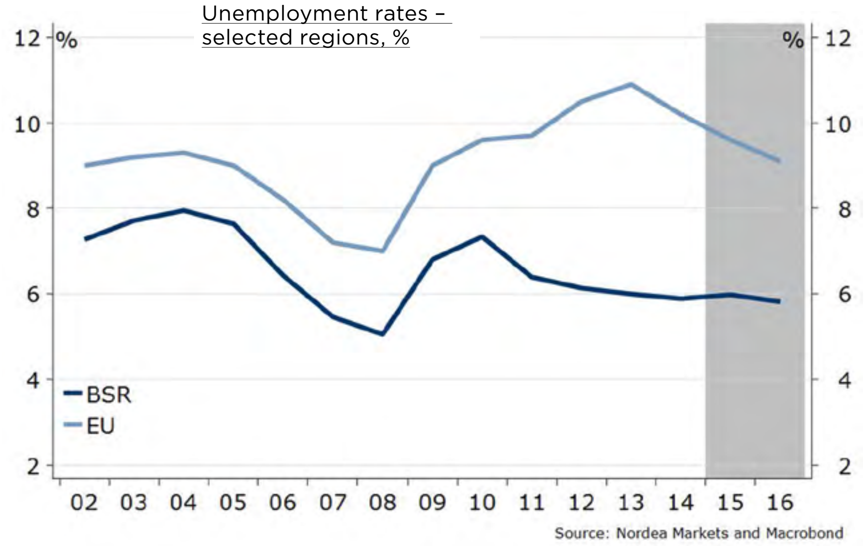


FIGURE 5

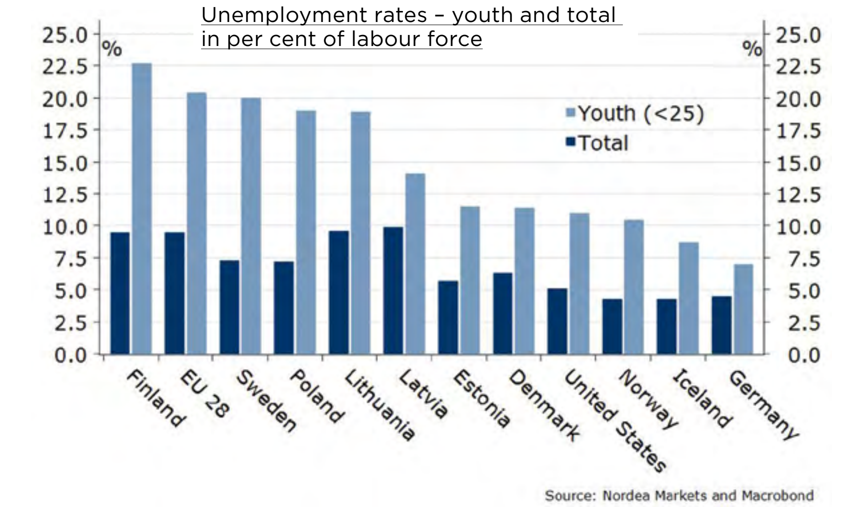
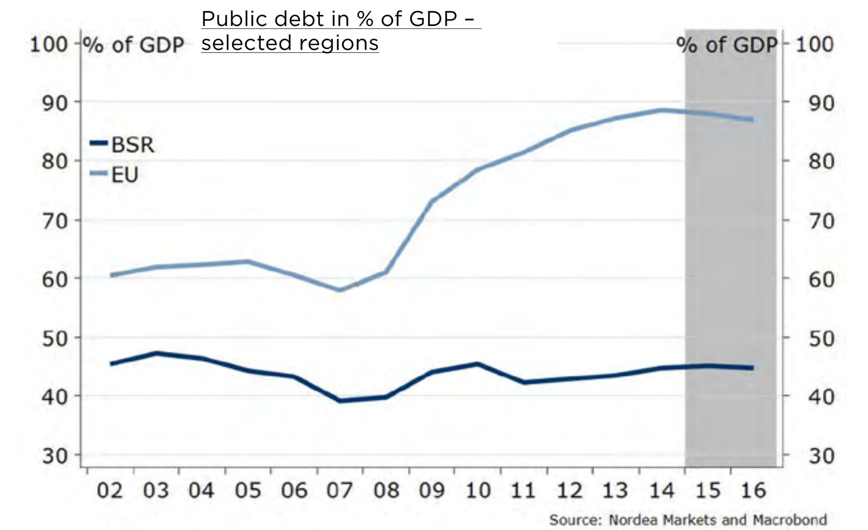


FIGURE 6



rising social security expenditures in the wake of contracting economies.

Iceland continues to have the highest public debt level in the Baltic Sea region as a result of the financial sector collapse in 2008/09. In 2012 the country's debt ratio began to fall for the first time after the crisis; a trend that continued in 2014 and is expected to continue in 2015. At slightly above 70% of GDP, Germany's public debt burden is the second highest in the region. Since 2010 German debt levels have stabilised, and the constitutional balanced budget rule aims at a gradual reduction of current debt levels. Finland was the country in the region where debt levels increased the most in 2014, rising by about 4% points to 60% of GDP. Estonia has the lowest gross debt level in the region of just 10% of GDP. Among the countries in the Baltic Sea region, only Germany and Finland are likely to exceed the 60% debt-to-GPD threshold set by the EU in 2015. This makes the region one of the best performing in the world when it comes to national economic governance. Germany, Denmark, Norway and Sweden belong to the small group of nine countries in the world, which have been assigned a AAA rating by the three large rating agencies Moody's, Standard & Poor's and Fitch.

ECONOMIC SENTIMENT

Since the latest *State of the Region Report* was published in 2014, economic sentiment in the Baltic Sea region has dwindled; a different pattern from the rest of Europe. And after a long period with sentiment above the European level, the roles have switch over the past year. **This is to a large extent due to the much improved economic sentiment in Southern Europe, which escaped the recession at the beginning of 2013, as well as the recent outright decline in sentiment in the Baltic Sea region, possibly as a consequence of the conflict between Ukraine and Russia, which obviously has a larger impact on the economies of the Baltic Sea region than on those of south-west Europe**.

Still, the overall economic sentiment indicator remains steadily above 100, which is the dividing line between expansion and contraction. The threshold was passed during the spring of 2013, and overall sentiment is now on a par with the level during the autumn of 2011.

FIGURE 7

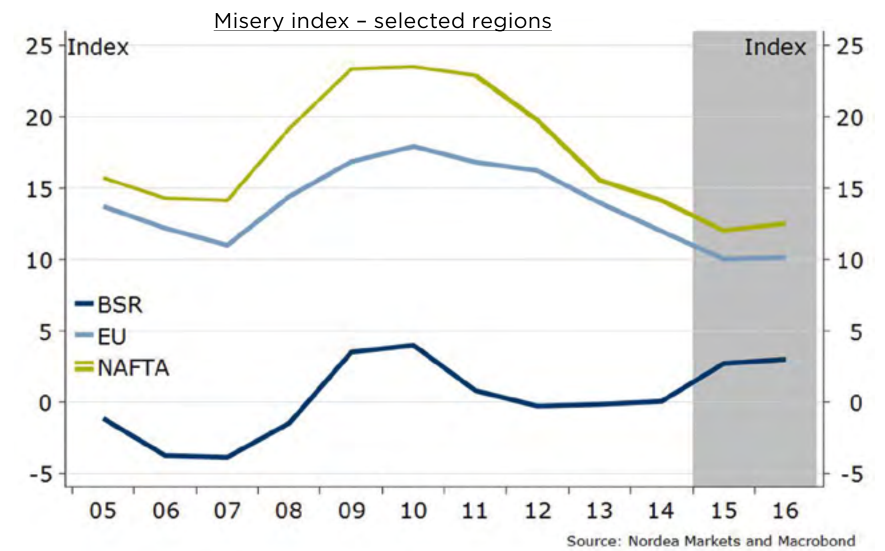
ASSESSMENT

The Baltic Sea region's post-crisis recovery slowed down significantly during 2012 and the trough was reached by mid-2013. Since then a fragile recovery has begun. However, while the Baltic Sea countries have remained ahead of their European peers, regions elsewhere in the world, including North America, have shown a stronger performance when it comes to economic growth and labour market progress.

Still, overall, the Baltic Sea region remains in a significantly better shape than the rest of Europe and to a certain extent also North America. This is – despite the challenges affecting the region – due to solid government finances, combined surpluses on the current account and relatively low unemployment rates. Also inflation (often seen as a bad thing in economics) is low compared to that of the region's peer group of countries, and the so-called economic misery index[1] paints a much better picture of the Baltic Sea region than of the EU and North America, see Figure 8.

Despite these stabilising domestic dynamics, the Baltic Sea region is clearly not immune to the international business cycle. Most of the countries are small, open economies heavily dependent on global trade, making them vulnerable to changes in the international economic

FIGURE 8



[1] The misery index is an unweighted sum of the inflation rate in per cent, the unemployment rate in per cent, the current account deficit in per cent of GDP and the budget deficit in per cent of GDP.

and political environment. Based on the assumption that an international recovery is under way, the baseline scenario for the Baltic Sea Region remains a gradual pick-up in economic activity throughout 2015 and 2016, but for the moment the risks are skewed to the downside. This is not least due to risks to the increasingly important Chinese economy, but also the ongoing conflict between Russia and Ukraine.

Although the economic recovery in the region, which primarily can be attributed to an increase in consumption, may also lead to increased investment activity as employment and capacity utilisation increase, the uncertainty about growth prospects may dampen investment activity. This will in turn slow down the recovery and not least reduce the region's long-term growth potential. In this light, it is desirable that monetary policy remains extremely accommodative, as the so-called Juncker plan for investment in the EU can catalyse growth in business fixed investment.

However, it is also possible that the weak investment activity should be attributed to structural factors such as demographic trends and the service sector's rapidly increasing importance to the economy, as capital intensity is significantly lower in this part of the economy than in manufacturing. If so, it is important that the area's growth potential is promoted through structural reforms to raise productivity growth sufficiently to compensate for the demographic decline in the growth potential.

Finally, it needs to be stated that the long period of historically low interest rates increase the risk of bubbles for example in the stock or real estate markets. If so, the latter can and should be addressed through an increased use of macroprudential tools.

MONETARY POLICY OF THE BALTIC SEA REGION

The monetary policy objective of the countries in the Baltic Sea region is different from country to country. A group of countries have chosen to join the Euro area and are therefore subject to the monetary policy of the ECB. This applies to Germany, Finland, Estonia, Latvia and Lithuania. The other countries, by contrast, have maintained their own currency and most with a monetary policy objective to deliver price stability as defined by an inflation target, close to the Euro area's, see table.

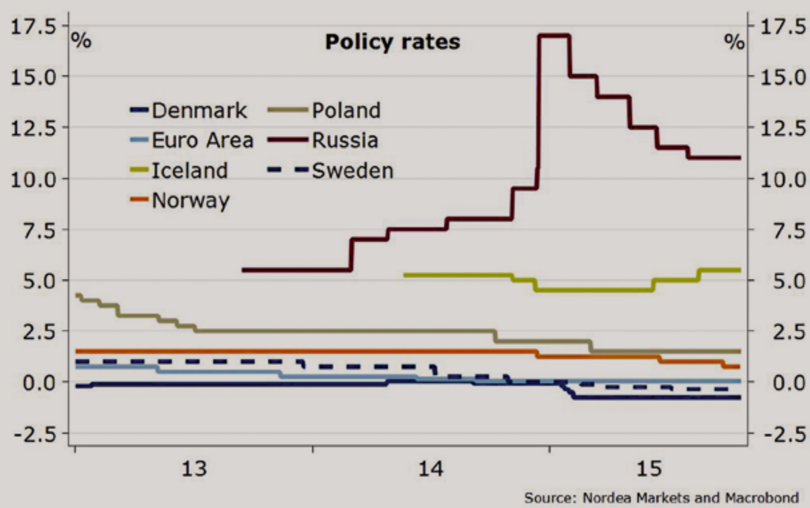
TABLE **1**

Monetary policy in the BSR

	OBJECTIVE	TARGET
Euro area	Inflation	Close to, but below 2%
Denmark	Euro peg	7,46038 +/- 2,5%
Norway	Inflation	2,5%
Sweden	Inflation	2%
Russia	Inflation	4% by 2017
Poland	Inflation	2,5% +/- 1%-point
Iceland	Inflation	2,5%

FIGURE **1**

Low rates in most of the region



The Great Recession started what has now become the new normal at the ECB – an extremely lenient monetary policy stance comprising sub-zero interest rates and ample funding liquidity for the financial sector. The most recent of these monetary policy initiatives is the quantitative easing (QE) programme announced in January that includes bond and security purchases amounting to EUR 60bn per month. This programme will be carried out at least until end-September 2016 and will in any case continue until a sustained adjustment in the path of inflation that is consistent with the aim of achieving inflation rates below, but close to, 2% over the medium term is seen.

One of the well-known challenges of the Euro-area single monetary policy is that the participating countries are not necessarily at the same stage of the business cycle. That holds for the two 'old' Euro-area countries Germany and Finland. The German economy is currently in a boom, while Finland is in recession. While Germany therefore practically needs monetary policy tightening, Finland still needs an accommodative monetary policy line to get the economy going.

All the Baltic countries are benefiting from low rates amid geopolitical uncertainties. However, particularly the governments of Latvia and Lithuania have benefited from much lower refinancing costs due to their higher government debt ratios relative to Estonia.

Denmark is associated with the euro through its participation in ERM II. Therefore, the objective of monetary policy is to maintain the fixed exchange rate against the euro. After strong upward pressures on the DKK after the decision by the Swiss central bank to abandon its currency peg, the Danish central bank reacted by lowering rates repeatedly until the leading rate reached its current level of -0.75%. Additionally, the central bank temporarily suspended government bond issuance, which was not resumed until October.

In Sweden and Norway, both controlling monetary policy via inflation targeting, not least the dramatic decline in commodity prices but also relatively low wage growth meant that inflation is well below the target. Therefore, central banks have responded with marked easing of monetary policy in the form of record-low interest rates, and like the Euro area, Sweden has introduced a QE programme.

Although the low interest rate level has been a contributing factor to the sharp increase in house prices in Norway and Sweden in recent years, the central banks of both countries indicate that further easing may be on the way in efforts to meet the inflation target.

The issue of rapidly increasing house prices amid the low interest rate environment is, however, not just a phenomenon in Sweden and Norway. Also a number of other countries in the region, notably Estonia and Iceland, have experienced marked increases in house prices over the past few years, see figure. This is why a warning is warranted: a too easy monetary policy line could lead to new real estate and equity market bubbles all over the world.

The economic situation in the other BSR countries is very different and monetary policy has been adapted accordingly. Iceland's challenges in terms of monetary policy have differed significantly from those of the rest of the region. Following the financial crisis, production and employment have grown steadily, bringing about substantial wage increases. This, coupled with an impending closing of the output gap, has led the central bank to increase rates, which it will likely continue to do in the coming years.

The Polish economy has enjoyed uninterrupted growth since the early 90s and domestic demand growth remains relatively strong. Thus, the National Bank of Poland (NBP) has stopped cutting its policy rate at 1.5% despite negative inflation and no significant help from fiscal easing.

In the wake of the dramatic fall in oil prices, the Russian rouble weakened sharply. But at the time of writing, the Central Bank of Russia (CBR) has stopped intervening to support the RUB and hence left the exchange rate to absorb the bulk of the oil price shock.

As a consequence of the pass-through from the RUB weakening to consumer prices on top of already elevated prices of sanctioned goods, inflation has exceeded the CBR target and left the bank with no choice but to keep its key policy rate at a double-digit rate.

FIGURE **2**

House prices on the rise

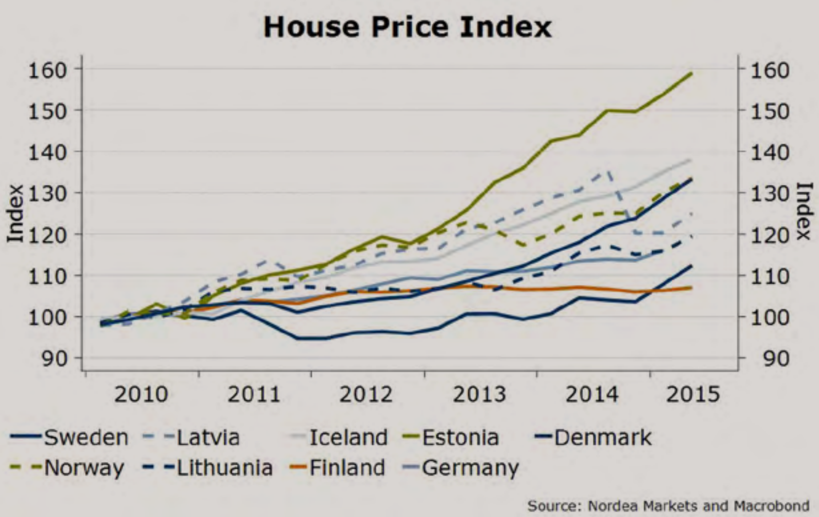
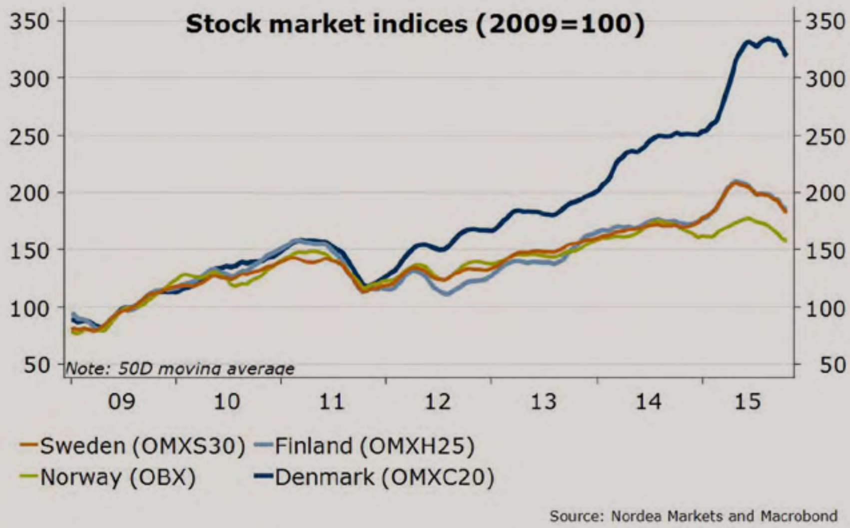


FIGURE **3**

Nordic stock markets



COMPETITIVENESS OF THE BALTIC SEA REGION

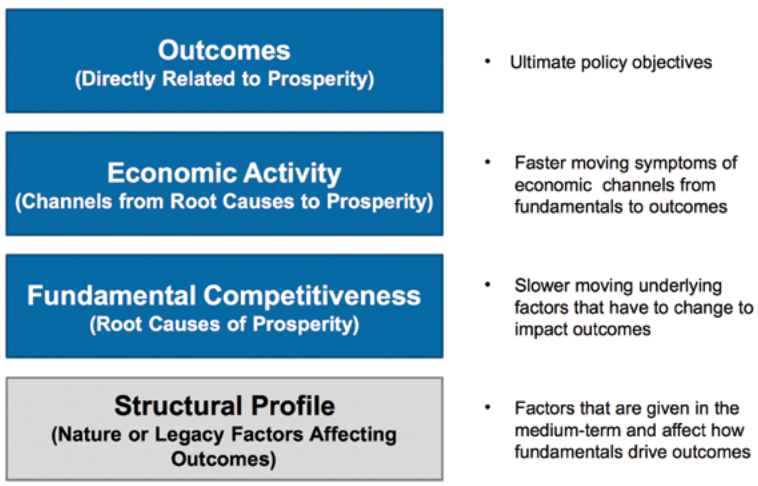
Prosperity across the Baltic Sea Region in 2015
Performance beyond GDP – Social Progress in the Baltic Sea Region
The Baltic Sea Region in the Global Economy: Trade and Investment
Entrepreneurship across the Baltic Sea Region
The Foundations of Baltic Sea Region: Measures of Underlying Competitiveness
Collaboration in the Baltic Sea Region: The EU Strategy for the Baltic Sea Region

COMPETITIVENESS OF THE BALTIC SEA REGION

What is the level of prosperity that the Baltic Sea Region can sustain for its citizens given its attractiveness as a place to do business? This is the key question that our analysis of competitiveness across the region puts into focus. While the previous section discussed the short-term movements of the economy that are often cyclically driven, we are here concerned with the underlying trends that drive prosperity outcomes over the medium to long-term.

In line with previous editions of this report, we measure competitiveness through indicators at three different levels: First, *prosperity outcomes* give a sense of how competitiveness is reflected in the standard of living, the ultimate objective of economic policy. Second, indicators of *economic activity* track the translation of competitiveness into ultimate prosperity outcomes, with short-term changes often significantly affected by cyclical factors. And third, *competitiveness fundamentals* are the root causes of these higher level outcomes and observed indicators, and are the level at which economic policy can most effectively intervene. Because the relationships between individual fundamentals, indicators, and outcomes are multifaceted and complex, an integrated view of all three layers provides more robust insights than overreliance on one individual dimension of data. In addition, the structural profile of the region – capturing natural conditions that policy makers have to take for given – also has an impact on outcomes and competitiveness dynamics.

How to Measure Competitiveness?

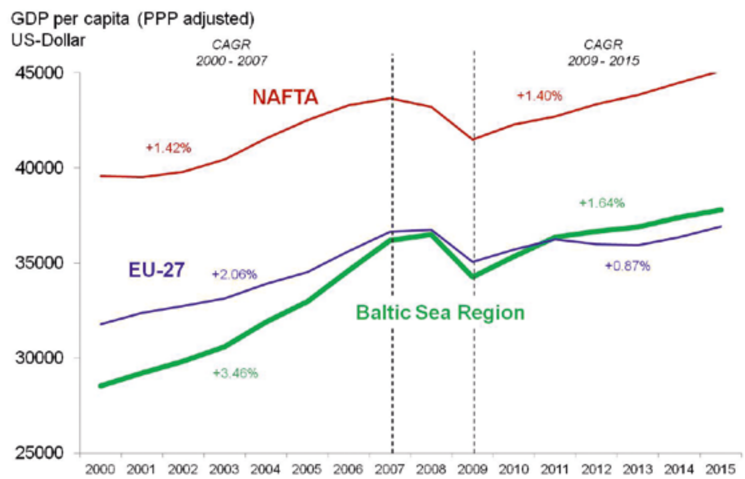


We focus in this report on aggregated data for the entire region as well as on national data. The main reason is our desire to profile overall patterns of competitiveness in this part of the world, and to provide policy makers with a focus on the entire macro-region factual support for the decisions they face. Both firms and policy makers need, however, to be aware of the significant heterogeneity across the region: Standards of living differ widely, as do the conditions under which companies operate. These differences are most pronounced between the Nordics and Germany on the one hand and the Baltics, Poland and Russia on the other hand. But even within these groups the differences are significant, even more so in the more detailed profile of economic activity and competitiveness fundamentals than on headline GDP outcomes. Previous editions of this report have also shown that subnational regions within countries differ significantly on all of these dimensions.

PROSPERITY ACROSS THE BALTIC SEA REGION IN 2015

Average prosperity, measured by GDP per capita (adjusted for purchasing power), in the Baltic Sea Region is high in international comparison and continues to grow at a solid rate. The region had already by 2012 surpassed its pre-crisis prosperity level, a feat that the NAFTA region achieved only in 2013 and the EU-27 in 2015. Despite these positive trends, the data reveals how the crisis has left an on-going mark on growth performance in Europe: while the NAFTA region has essentially returned to its pre-crisis growth path, both the Baltic Sea Region and the EU-27 are now on a significantly lower growth trajectory. The Baltic Sea Region is still growing faster than both NAFTA and the EU-27, but the gap has decreased with the region at less than half the growth it registered before the crisis. Looking only at the period since 2011, the region's annual average prosperity growth has dropped below 1%.

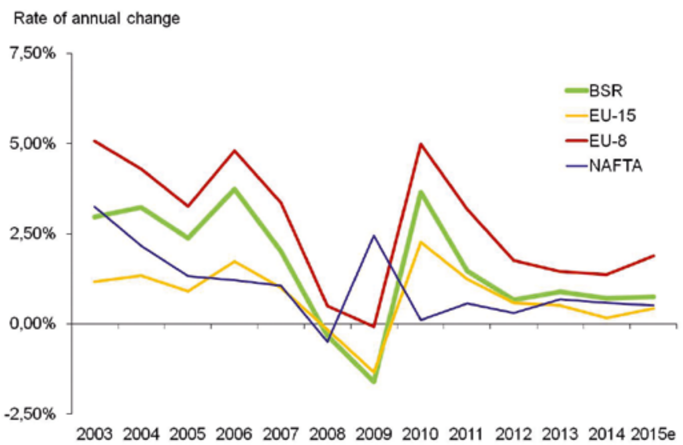
The New Normal: Prosperity Trajectories



Source: Conference Board (2015) *State of the Region Report 2015*

Labour Productivity Growth over Time

GDP (PPP-adjusted) per hour worked



Source: Groningen Growth and Development Centre and The Conference Board (2015), authors' calculations

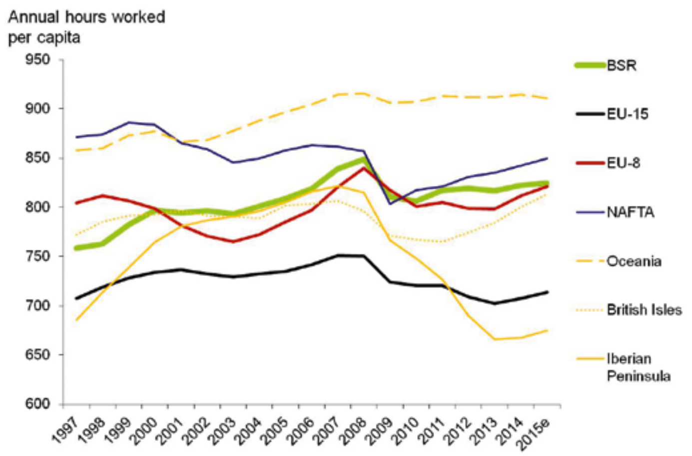
What drives this slow-down in prosperity rates? A decomposition of prosperity outcomes into labour productivity and labour mobilisation, its two components, provides a closer perspective. **Labour productivity growth** has flattened at a low-level since the crisis. While the Baltic Sea Region register around 2.5% annual productivity growth before 2007, this measure has now dropped to less than 1%. As the data reveals, this slow-down is not unique to the Baltic Sea Region; it has affected also NAFTA, the more advanced EU-15 countries, and even the Central and Eastern European EU-8 countries on their path to catch up with Western Europe.

Different hypothesis have been proposed to explain this slow-down in productivity, with no clear consensus emerging yet. One likely factor, also identified in the recent work of the Danish Productivity Commission, is the structural shift from sectors with higher productivity dynamics like manufacturing to sectors with lower productivity like retail and health care services. Another, more specific to Europe, could be firms' hesitance to invest as a result of macroeconomic uncertainty and remaining imbalances in the financial markets.

The other component driving improvements in prosperity is **labour mobilisation growth**, capturing changes across areas like demographics, unemployment, and working hours. Here, too, the data shows a clear flattening. In the decade prior to the crisis the Baltic Sea Region had added almost 10% hours per capita, outperforming all other macro-regions in our sample. Since then, labour mobilisation has been essentially flat, and the region remains below its pre-crisis level of labour mobilisation.

While labour mobilisation is 'bounded above', i.e. there is an upper level beyond which it cannot grow (and as an economy is approaching this level, further growth is likely to get harder), labour productivity is not limited in this way. This gives labour productivity a critical role for long-term growth. In the short-term, however, labour mobilisation has proven to be faster to change. And it is

Labour Utilization over Time / Selected Regions



Source: Groningen Growth and Development Centre and The Conference Board (2015), authors' calculations

important not only at the aggregate level as a contributor to overall prosperity but also at an individual level where work is an important contributor to inclusion in society even at low levels of pay and productivity. The slow-down of both productivity and of mobilisation are thus issues that policy makers across the region should be concerned about.

Looking more closely at the remaining (significant) prosperity difference across countries within the Baltic Sea Region, the dominant role of productivity levels becomes obvious: while a number of the Central and Eastern European countries register significantly higher labour input per capita, this is not enough to overcome their large productivity disadvantage relative to their neighbours in the north and west. Compared to other European regions, the Baltic Sea Region continues to stand out for its higher labour mobilisation. The data for NAFTA shows that there is no inevitable trade-off between high labour productivity and high labour mobilisation - prosperous countries have found ways to achieve both.

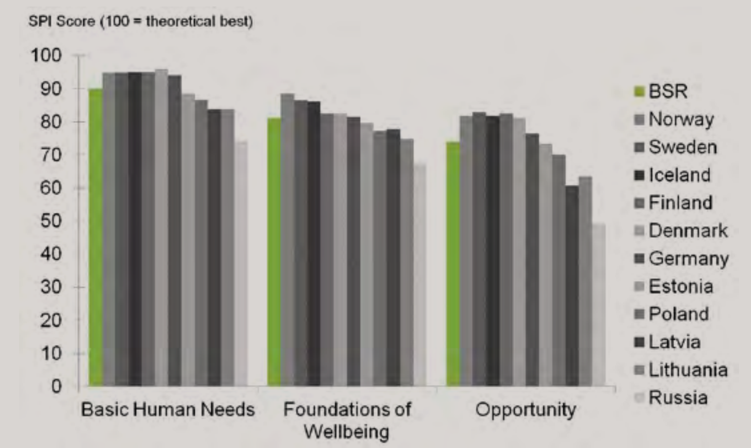
Prosperity Decomposition

Baltic Sea Region Countries and Global Regions, 2015

GDP per Capita (PPP)	=	Employment-Factor	x	Productivity-Factor (PPP)
Norway		Russia		Norway
Sweden		Iceland		Germany
Germany		Estonia		Denmark
Iceland		NAFTA		Sweden
Denmark		Poland		EU-15
NAFTA		Baltic Sea Region		Finland
Finland		EU-8		NAFTA
EU-15		Latvia		EU-27
Baltic Sea Region		Sweden		Iceland
EU-27		Finland		Baltic Sea Region
Estonia		EU-27		Lithuania
EU-8		Germany		EU-8
Poland		Denmark		Estonia
Russia		EU-15		Poland
Lithuania		Lithuania		Latvia
Latvia		Norway		Russia

Source: Groningen Growth and Development Centre and The Conference Board (2015), authors' calculations

Social Progress Index / Baltic Sea Region Countries, 2015



Note: BSR scores are calculated as population-weighted sum of regional scores

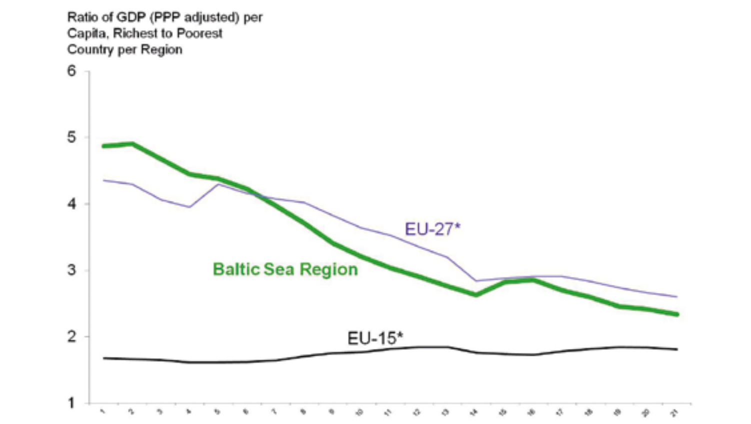
Source: Social Progress Index (2015) *State of the Region Report 2015*

PERFORMANCE BEYOND GDP – SOCIAL PROGRESS IN THE BALTIC SEA REGION

Measures of prosperity that move beyond average GDP per capita are getting increasing traction in the policy debate. This is partly due to concerns about inequality, which make averages less meaningful, and partly it is due to pick up progress in areas that are not directly related to GDP like environmental sustainability, social cohesion and freedom of expression. The Social Progress Index focuses on the latter category, tracking countries' performance on meeting basic human needs (basic health care, shelter, personal safety), providing the foundations for well-being (basic education, access to information, sustainable environment), and offering opportunities (personal rights, inclusion, higher education). More background information is available at *http://www.socialprogressimperative.org/data/spi*.

The Baltic Sea Region continues to rank high on the Social Progress Index: Norway, Sweden, and Iceland rank 1, 2, and 4 globally; Finland and Denmark follow on ranks 7 and 8. The region's overall stronger performance on basic human needs ahead of foundations for well-being and opportunities matches the global trends; if anything, the region is relatively strong on opportunity indicators. Within the region, the Nordics and Germany form one relatively homogenous group, followed by the Baltics and Poland; Russia comes behind at some distance. This pattern is consistent with a range of other assessments of both beyond-GDP performance and of economic inclusiveness of prosperity.

Prosperity Dispersion Within Cross-National Regions / 1995 - 2015



Note: Norway and Russia levels adjusted for natural resource sector; Luxembourg excluded
Source: Conference Board (2015)

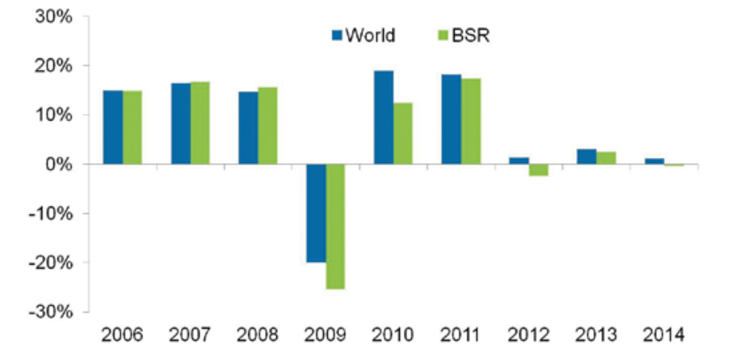
Europe and the Baltic Sea Region have over the last two decades experienced an impressive catch-up with the Central and Eastern European countries. This trend has continued, resuming a path that was temporarily interrupted by the crisis. The turmoil on global financial markets had hit catch-up economies relying on external finance especially hard.

Analysing how the slow-down towards the 'New Normal' has affected different groups of countries in the region provides insights into how the catch-up process has changed. In the Nordics and Germany the drop in prosperity growth from about 2% per annum to less than 0.5% was driven by a reduction of labour productivity growth from 1% to 0.5% and labour mobilisation growth that dropped from 1% to 0. In the Baltics and Poland, prosperity growth dropped from close to 7% to about 2.5%, driven by labour productivity growth slowing down from about 5% to below 2% and labour mobilisation growth from slightly below 2% to about 1%. The convergence speed, i.e. the rate at which the Baltics and Poland are reducing the prosperity gap to the Nordics and Germany has dropped from 4% to 2% annually. This moves the (theoretical) time period by which convergence has been achieved from about 15 years to between 25 and 30 years. Russia's catch-up performance before the crisis was broadly comparable to the Baltics and Poland but has come to a total stop since 2011.

THE BALTIC SEA REGION IN THE GLOBAL ECONOMY: TRADE AND INVESTMENT

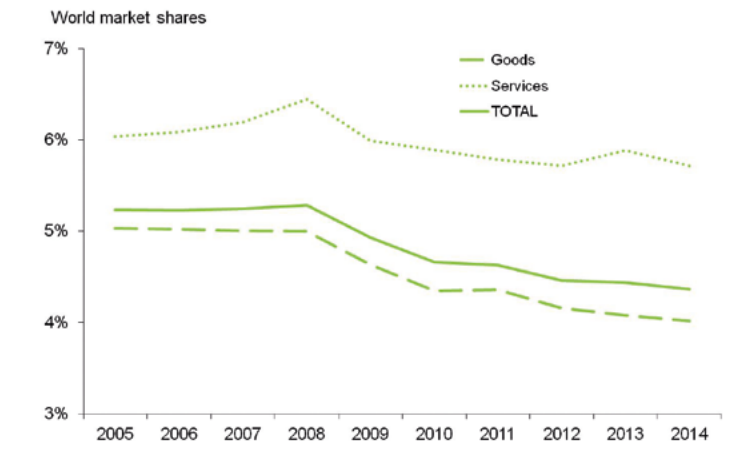
As a macro-region dominated by small open economies, the Baltic Sea Region is especially reliant on its position in the global economy. The dramatic growth of world trade in

Trade Dynamics / Annual Growth of Export Value



Source: WTO (2015) *State of the Region Report 2015*

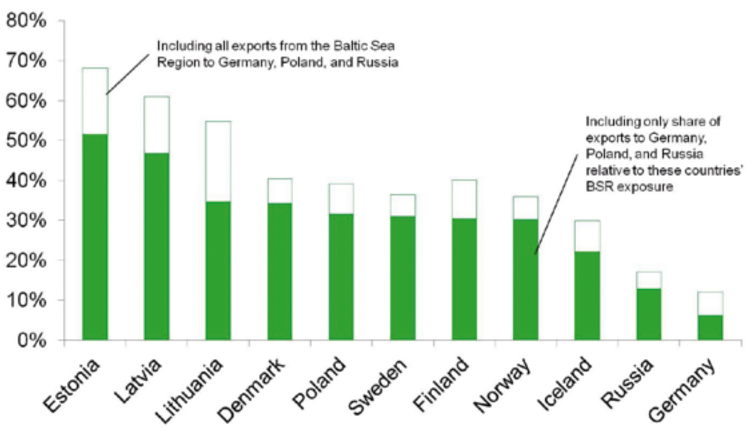
World Export Market Shares / Baltic Sea Region, 2005-2014



Source: WTO (2015) *State of the Region Report 2015*

Trade Integration in the Baltic Sea Region

Share of Exports to the Region by Country



Source: UN Comtrade (2015) *State of the Region Report 2015*

the period prior to the global crisis created significant opportunities for the region.

This growth, however, seems to have come to a rather abrupt halt. While 2010 and 2011 saw a recovery of global trade that had been disrupted by the crisis, the past three years have seen trade values essentially remaining flat. Lower demand for natural resources, a shift from investment to domestic consumption in some emerging economies, and 're-shoring' of activities to some advanced markets have all been suggested as likely explanations for these new patterns. Whatever the specific triggers are, the shift towards an environment where export growth is not automatically to be expected represents an important structural change for the Baltic Sea Region.

A second worrisome observation is the slow but still continuing loss of global world market export share that the Baltic Sea Region is experiencing. This process started as the global crisis hit, and has so far not shown any signs of reversal. Part of the explanation is likely the shift of global trade patterns towards more south-south trade, especially in Asia. Given its geographic position the Baltic Sea Region will not participate directly in this trade, but this does not have any negative implications for prosperity in the region.

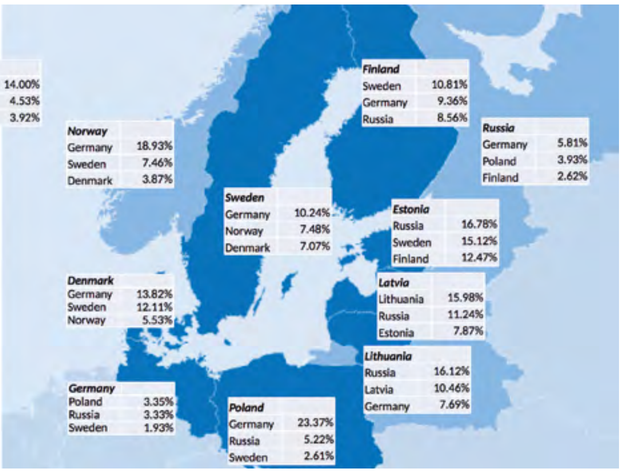
Exports dynamics are driven both by the geographical markets served and the product and service areas in which firms from specific countries are active. In terms of geography, the Baltic Sea Region is, due to its location, strongly reliant on European markets, including those markets that are within the region itself. This is not a surprise and will remain the case in the future; neighbours are the most natural trading partners for any country. But it does signal limitations to the potential for further export growth: European markets seem unlikely to grow at a fast rate for the foreseeable future. And while increasing trade integration within the region has allowed especially the Baltic countries to grow exports significantly in recent years, this is unlikely to provide major opportunities for the larger economies in the region.

A closer look at the data reveals that the Baltic countries are particularly integrated with their Baltic neighbours, Russia and the Nordic countries. Overall, Germany is the dominant trading partner for the region, ranking as the largest export market for all countries in the region except Finland and the Baltics. This has helped the region as Germany outperformed the rest of Europe more recently. However, structurally it is far from certain that Germany will be able to retain such a strong performance.

One important aspect relevant to future export growth that has recently gained traction in academic literature is the notion of 'economic complexity'. The intuition is that the more products a country exports, the broader the set of capabilities with which it can enter additional markets. Importantly, some industries, e.g. automotive, require a set of capabilities that have applications in many other industries as well; whereas others say oil and gas, require capabilities that have much fewer alternative uses. Based on this logic a team at the Center for International Development has assessed the complexity of

Trade Integration in the Baltic Sea Region

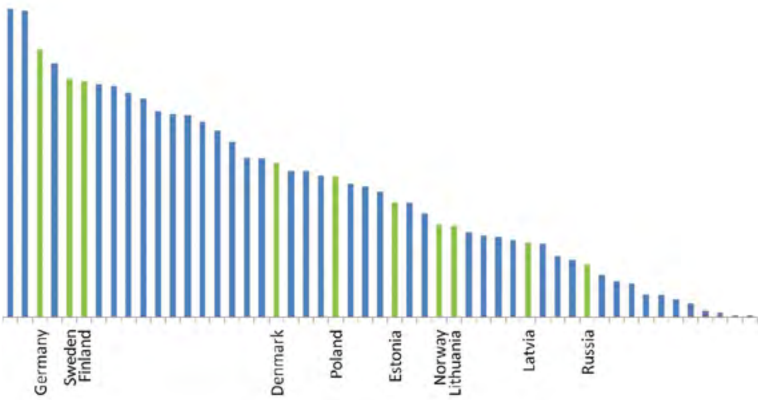
Share of Exports to Top Three Countries in the Region



Source: UN Comtrade (2015)

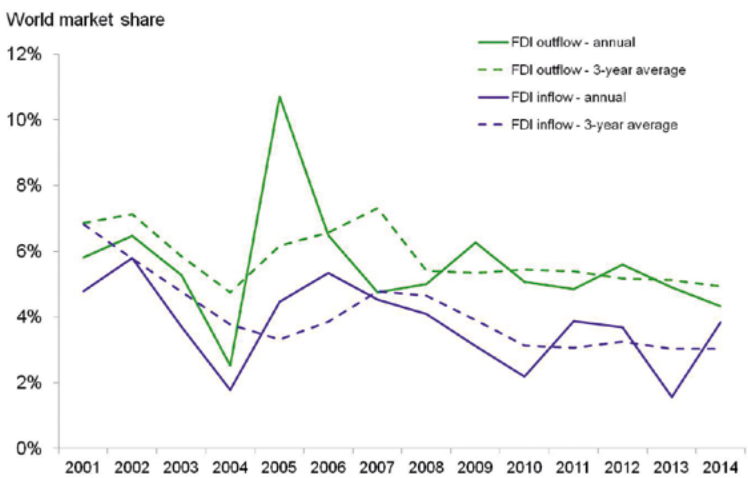
Complexity of Export Portfolios

Top 50 Countries Globally, 2013



Source: Atlas of Economic Complexity (2015) *State of the Region Report 2015*

Baltic Sea Region FDI Flows



Source: UNCTAD (2015), author's analysis. *State of the Region Report 2015*

countries' export portfolios, a measure that is strongly correlated with actual GDP per capita levels.

The countries of the Baltic Sea Region rank well on the economic complexity measure, with three of them among the top ten countries globally. Norway and Russia rank somewhat lower than they do on prosperity; the focus on natural resource exports is seen to limit their export potential. Coincidentally, these two countries have also registered negative export growth over the last three years. The recent collapse of oil prices is likely to have further negative impact on their position in global export markets. Finland is the only other Baltic Sea Region country that has seen exports drop between 2012 and 2014. It is also the country in the region that has the highest concentration of country exports across firms; the ten largest exporters accounted for about 30% of all Finnish exports in 2011. Nokia's exit from the mobile communication handset business is thus one possible driver of the country's weak export performance. Other countries in the region with a top ten firms' export concentration of more than 25% are Lithuania, Estonia and Sweden.

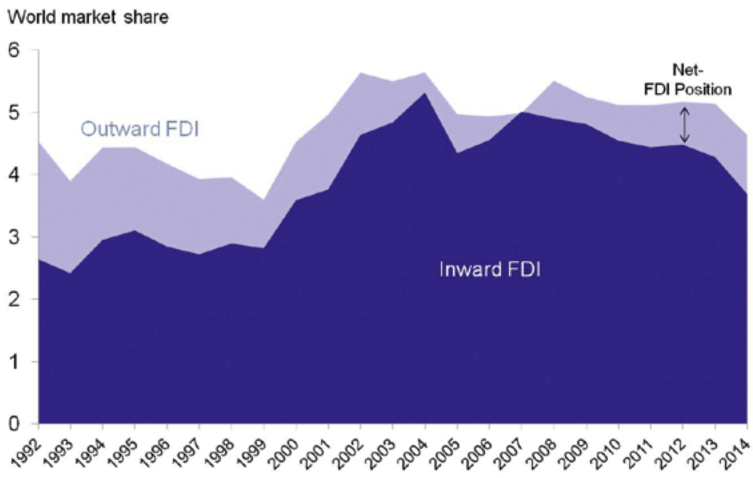
Many large firms have shifted from an export-focused internationalisation strategy to one that also relies heavily on foreign direct investment (FDI). Previous years' State of the Region reports have documented how this shift from trade to FDI has been evident especially for the Nordic countries.

FDI flows are highly cyclical; global FDI activity reached a peak in 2007 after almost tripling over the previous five years, collapsed during the crisis, recovered to about 80% of the 2007 level by 2011, before dropping again to reach about 60% of the 2007 benchmark in 2014. The Baltic Sea Region has over the past five years attracted around 3% of all global FDI inflows; this is higher than its share of global GDP (PPP adjusted) at 2% but below its share of 4.4% in global trade. In nominal terms (current prices and exchange rates) inflows to the region have been roughly stable over the past five years; last year's inflows of roughly US-$ 37bn (EUR 33bn) were, however, the lowest since 2005.

Annual inflows tend to fluctuate significantly due to the effect of large individual transactions. In 2014 inflows to the region were particularly high as Microsoft closed its acquisition of Nokia's handset business in the first quarter of that year. As a result, Finland accounted for 40% of all inflows into the region that year, far ahead of its usual share in the recent past. Without this exceptional transaction, total 2014 inflows into the region would have been about 1/3 less, resulting in a drop of the three-year moving average world market share from 3% to 2.5%. Apart from Finland, Poland, Denmark, and Sweden registered 2014 inflows that were up relative from the recent past. Russia, Germany, and Norway saw in contrast lower inflows; The Baltic countries, too, attracted lower inflows than before.

The slowly eroding relative attractiveness of the Baltic Sea Region as a destination for FDI is also visible in the data on FDI stocks: the region's global market share dropped from 5% in 2007 to 3.7% in 2014, with even the absolute level of inflows measured at current prices falling since 2011. The share of outward FDI

Baltic Sea Region FDI Stocks



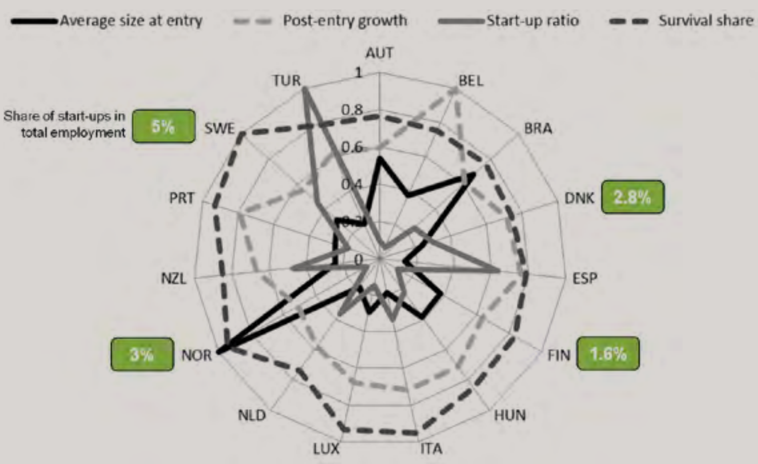
Source: UNCTAD (2015), author's analysis. *State of the Region Report 2015*

has remained more stable but saw also a drop in 2014, now reaching 4.6%. This might have been affected by the ownership of Nokia's foreign investments shifting to Microsoft in the US. Previous *State of the Region* reports have documented that FDI linkages are also strong with in the Baltic Sea Region; the Nordic countries in particular are important investors in the Baltics.

Countries across the Baltic Sea Region differ significantly in terms of the role inward FDI plays relative to the size of the domestic economy. Estonia and Sweden top the list, with the inward FDI stock valued at 75% and 56% of domestic GDP respectively. At the opposite end of the spectrum are Russia and Germany at about 20% of GDP – maybe not as surprising given the size of these economies – but also Denmark and Lithuania with inward FDI stocks at 25% and 30% GDP. Most countries in the region have seen their inward FDI stock shrink relative to GDP over the last few years; the exceptions are Finland, Latvia, and Poland. This suggests that economies' growth dynamics are more oriented towards domestic demand, while foreign investors are looking to countries in the region largely as a platform to serve global markets.

Germany and the Nordic countries (Denmark in particular) have higher outward than inward FDI. The opposite is true for the Baltics and Poland, much in line with what is to be expected during their economic catch-up. Estonia has remarkably built up an FDI stock abroad that is equivalent to almost 25% of its domestic economy, much ahead of its peers. Russia continues to underperform on FDI given its stage of development and natural resource assets.

Entrepreneurship Dynamics



Note: Average of 2001, 2004, and 2007

Source: OECD (2015) *State of the Region Report 2015*

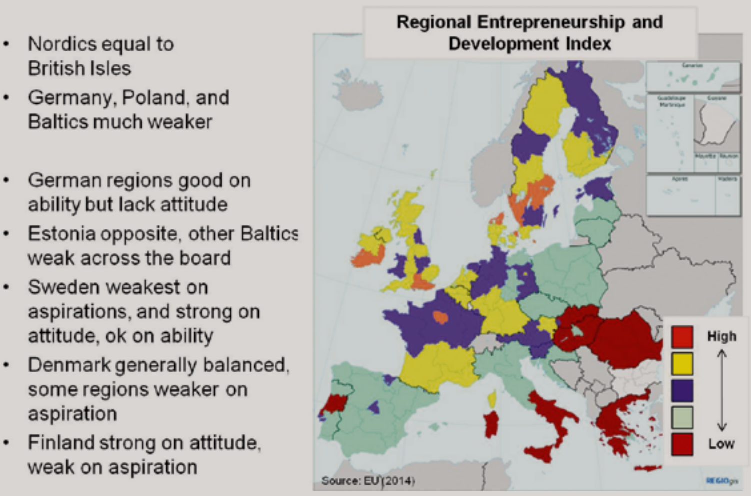
ENTREPRENEURSHIP ACROSS THE BALTIC SEA REGION

Entrepreneurship has become an increasing focus of policy makers, both as an indicator of economic dynamism and as a field to mobilise. Measurements of entrepreneurship remain, however, difficult: the economic potential of new firms differs significantly depending on the motivations of the founders and the sector they are launched in. And their economic impact, like job creation, depends not only on entry, but also on initial size, survival rates, and growth.

A recent study by the OECD has provided some more granular insights, and has covered a few Baltic Sea Region countries. For the time period covered, three years before the recent global economic crisis, Sweden registered the strongest entrepreneurship dynamics in terms of the share of employment that new companies have created. Key drivers were relatively high entry and survival rates, while initial size and growth of companies was only moderate. Norway and particularly Finland had much lower start-up rates. More data will be needed to track more countries and the impact of the crisis on start-up activity. For Sweden other work suggested a strong slow-down in start-up activity during the crisis.

A related set of studies has tried to link entrepreneurial activity to different sets of underlying conditions. The motivation is to identify levers that government can influence to support entrepreneurship and raise its economic impact.

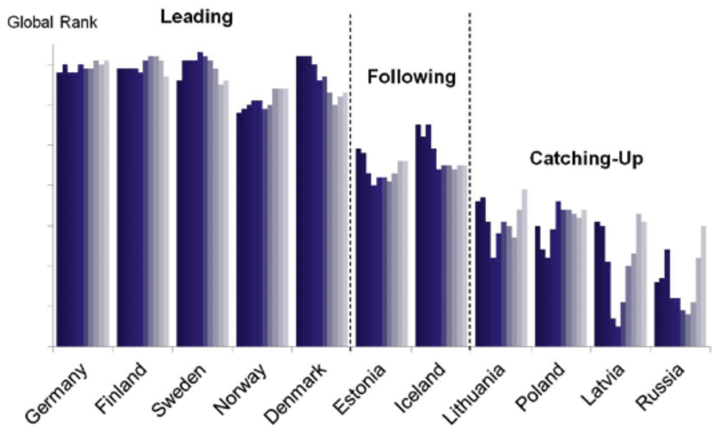
Regional Entrepreneurship



The European Union's Regional Entrepreneurship and Development Index shows especially the Nordic EU member countries as providing some of best conditions for entrepreneurship in Europe. A closer look at the drivers of overall performance reveals that Sweden and Finland rank highest on the individual attitudes of their entrepreneurs while registering less strongly on their ambitions to turn these into economic results.

Global Competitiveness Rankings over Time

Baltic Sea Region Countries, 2006-2015



Source: World Economic Forum (2015)

THE FOUNDATIONS OF BALTIC SEA REGION: MEASURES OF UNDERLYING COMPETITIVENESS

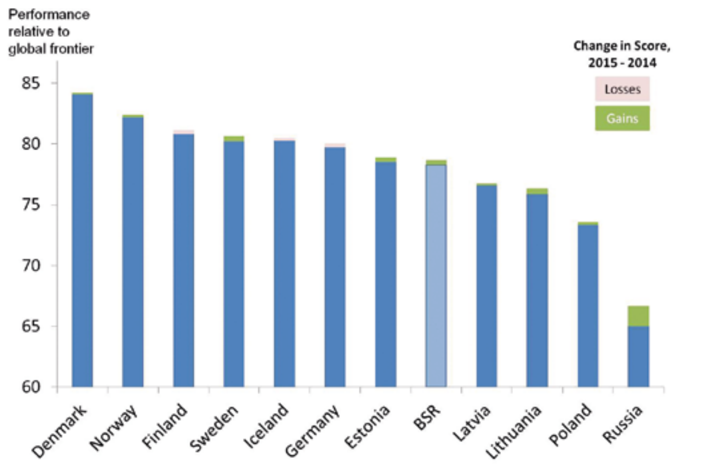
Underlying competitiveness, the aspects of business environment quality, cluster presence, and firm sophistication that together determine the level of prosperity that a location can sustain, is a concept that is inherently difficult to capture. It includes a wide range of factors that often interact in systemic ways to influence productivity and prosperity. Competitiveness rankings that aggregate these factors in often simplistic and somewhat arbitrary way can provide two types of insights: They can capture the relative quality of a location as a place to do business versus other locations. And they can help understand whether the balance between prosperity and wages on the one hand and competitiveness fundamentals on the other hand has shifted, potentially signalling imbalances that can threaten the sustainability of prosperity or signal growth opportunities.

The Baltic Sea Region countries continue to rank highly in the *Global Competitiveness Report*, the most widely used ranking of national competitiveness. Germany has claimed the top spot in the region, ranking 4th globally. Finland has lost some ground but ranks still slightly ahead of Sweden, which has seen its decline of the past years stop. Norway and Denmark are just outside of the global top ten, with Denmark regaining some ground after a few years of eroding its position. Estonia and Iceland rank 29th and 30th respectively, both unchanged from last year. Their distance to the remaining four countries has been significantly reduced; both Lithuania at 36th and Russia at 45th have continued to climb. Poland (41st) and Latvia (44th) have been roughly stable. Overall, these rankings suggest that the region is well placed to compete successfully in the global economy. It also does not signal major issues in terms of the sustainability of current levels of prosperity.

One important aspect of competitiveness across the region is the cost of government rules and regulations that companies face. While Baltic Sea Region countries rank somewhat lower on this measure than on overall competitiveness, their position is overall solid. The countries lagging most behind have in particular made up ground. The highest differences within the region remain in areas relating to the handling of permitting and receiving public services, like construction permits, trading across borders, getting electricity, and resolving insolvency.

Doing Business across the Baltic Sea Region

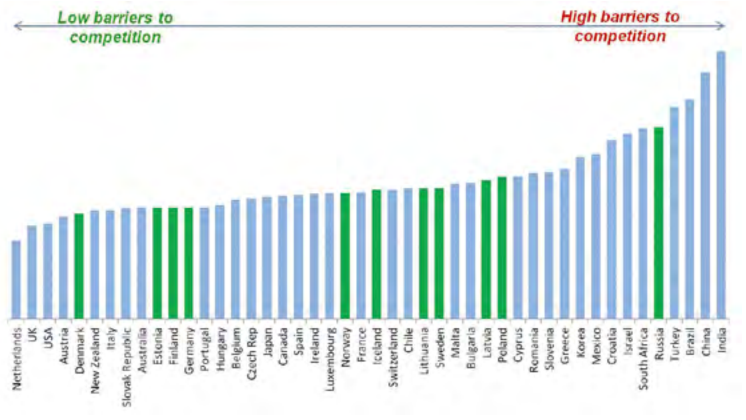
Country Performance, 2015



Source: Doing Business (2015)

Product Market Regulations

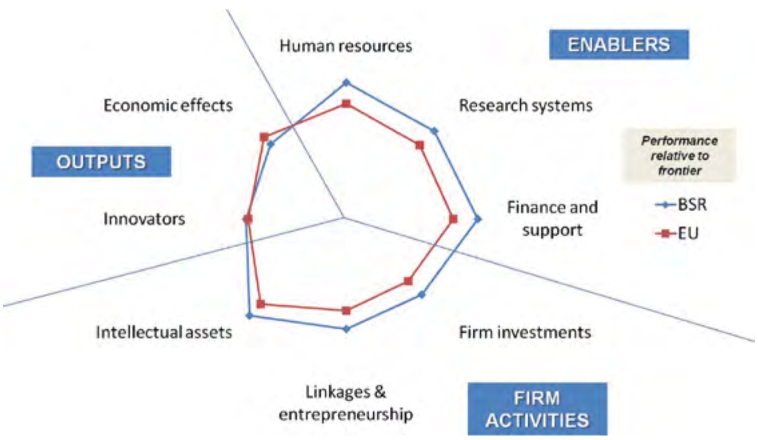
Presence of Polices Enabling Competition, 2013



Source: OECD – PMR Database (2015)

Innovation Scoreboard 2015

Performance Profile of the Baltic Sea Region



Source: European Innovation Scoreboard (2015) , author's calculations

While the World Bank's 'Doing Business' analysis focuses on the cost implications of government regulations, the OECD is in its 'Product Market Regulation' database looking at their impact on competition and rivalry. Both perspectives present a relatively similar view of the region. The OECD data shows the high openness of the EU/EFTA countries to trade and investment, but also the relatively large role of government in the economy in countries like Poland. Russia ranks significantly lower on competition-friendly regulations than on regulations driving the cost of doing business.

As a prosperous region, the Baltic Sea countries offer an environment that supports innovation and entrepreneurship. In the most recent European Innovation Scoreboard Baltic Sea Region countries continue to do well, with Sweden leading the overall ranking and the region's average score about 10% above the EU average. However, there are signs that the region's dominant position at the 'Top of Europe' cannot be taken for granted. While Denmark has been improving, Sweden's score is gradually eroding, and the performance for both Finland and Germany is essentially flat. Estonia and Norway, too, have seen their improvements peter out. And there is little sign that Poland, Lithuania and Latvia are catching up on innovation.

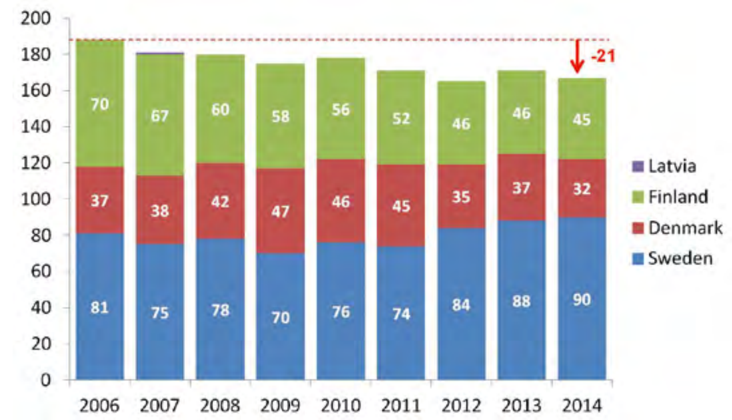
A particular structural concern that continues to affect the region with no indications of change is the relative weakness on innovation outputs. While the region clearly outperforms the European average on innovation enablers and firm activities, the level of outputs in terms of innovation and economic benefits they create is only in line with the rest of Europe. This issue cuts across the region: the imbalance between inputs and outputs is comparatively stronger in both Norway and Lithuania. The only exception to this overall pattern is Germany, which reports its strongest relative performance on firm activities followed by outputs.

An indicator that shows both the strength but also the disappointing dynamics of the Baltic Sea Region's performance on innovation is the presence of companies from the region among the top 1000 R&D spending companies in the European Union. While the region remains strongly overrepresented – it accounts for about 17% of these firms relative to a GDP share of roughly 10% in the EU – it is losing ground. Finland in particular has seen the number of firms on this list consistently drop over the last decade. It is important to note that companies are listed by their headquarter location; while R&D often happens close to headquarters, many Nordic companies have strengthened their R&D investments outside of the region in recent years.

While firm R&D is one important step in the innovation process, especially in terms of translating knowledge into economic activity, it often builds on the underlying foundations of the academic system for providing access to skills as well as conducting fundamental research. The Baltic Sea Region is well represented among the leading universities of the world, counting more than 25 among the top 500 according to a recent listing. But it remains the case that even the best universities in the region are some way behind the leading academic institutions globally and even in Europe.

Innovation Scoreboard:

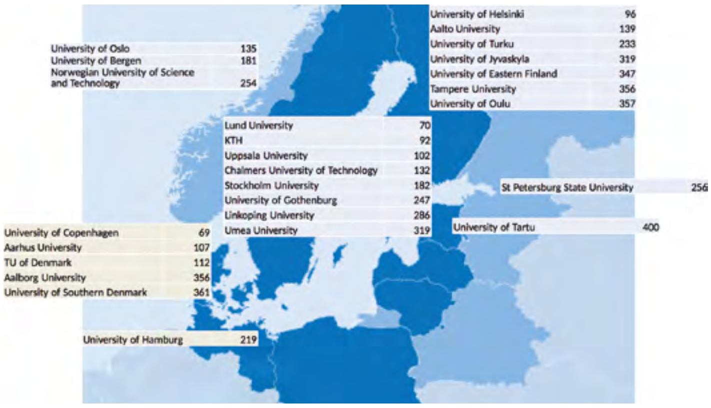
BSR Companies among TOP 1000 EU R&D Spenders



Source: European R&D Scoreboard (2015)

Leading Universities in the Baltic Sea Region

Global Ranks, 2015



Source: QS University Rankings (2015)

Key Competitiveness Assets/Challenges by Country

Baltic Sea Region - Nordics

Source: World Economic Forum (2015)

A significant number of students from the region are studying in universities elsewhere in the region. Many of them use the existing national or EU programmes that support student mobility. There are also multiple connections among universities in the region, for example in the Baltic University Programme.

In terms of more country-specific competitiveness issues and policy actions, priorities have significantly diverged across the region. This is a reflection of differences in short-term economic conditions but likely also of differences in political objectives.

In the Nordic countries, labour market structures, in particular the duality between those in full-time employment with access to strong protection and those looking for jobs facing high hurdles to get in, remain a topic of policy discussion. This is a particular challenge facing the integration of a rising number of refugees. Another challenge that has been triggered by the recent economic crisis is access to finance for SMEs. While interest rates are low, many SMEs have been reporting difficulties in getting loans and equity finance. Although conditions have improved and governments across the region have taken steps to open new channels for financing, this remains an issue.

In Denmark, policy action had in the recent past been focused on managing a sluggish recovery and stretched public finances. On both dimensions the situation has improved as the economy gained strengths. Structural challenges, like the issues in translating high education spending into high educational attainment, as well as the weak integration of especially non-EU migrants into the labour market, should be gaining more attention. A key competitiveness challenge has been the rise in cost relative to productivity growth. The crisis has led to some adjustment in costs but for productivity-enhancing measures, especially in domestic services where job growth has been concentrated, the proposals put forward by the Danish Productivity Commission in 2014 warrant attention.

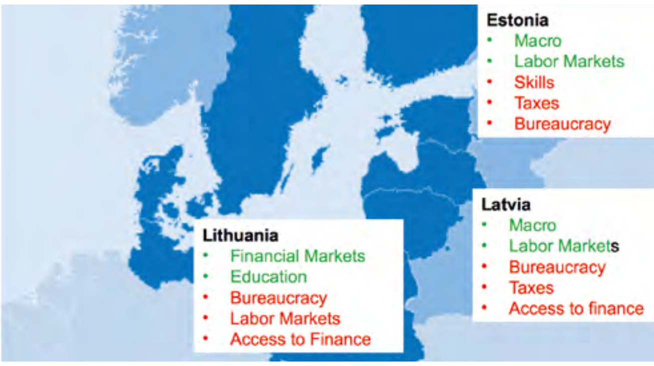
Finland remains in the grips of a difficult cyclical and structural slow-down. Short-term, cost levels out of line with productivity growth and the weakness of the Russian economy created challenges. Longer-term, Finland has to deal with weaknesses in traditional core industries, both pulp and paper and the traditionally Nokia-led ITC sector. The newly elected government has been forced to implement painful budget cuts, including in areas that had been hitherto sacrosanct, like innovation policy. It also leaned on unions and employers to reduce wage costs, triggering widespread strikes.

Norway has been hit hard by the collapse of energy prices. Investments in the oil and gas sector have been severely cut both domestically and globally, hurting the strong Norwegian offshore supply industry. The government has been forced to draw more on the resources of the Norwegian Oil Fund. Nevertheless, the country has plenty of resources to deal with at least the cyclical effect of lower energy prices. The most recent budget puts forward a number of tax reductions to stimulate economic activity. A falling exchange rate might provide better opportunities for exports outside of energy related products and services.

Sweden's economy is on a solid path of recovery, proving resilience in the face of external uncertainty. Macroeconomic risks are seen in rising real estate prices, fuelled by low interest rates and a lack of willingness by the political parties to reduce tax exemptions for households' interest rate payments. The Swedish Central Bank is facing demands from some to tighten policy in view of the housing market, while others are concerned that rising rates could lead to a further strengthening of the Swedish Krona with negative labour market implications. The government aims for the best labour market performance within the European Union. Spending on active labour market policies has increased and investment programmes on infrastructure and housing have been launched. With other expenditures rising, especially on sick leave, there has been a renewed debate on whether the fiscal target of a structural surplus of 1% of GDP over the course of a business cycle should be adjusted. The government has increased taxes, including those for young employees and for household services, an area that had seen strong firm and job creation in recent years. Another area that had seen solid growth is health and social services provided by private firms on behalf of the public sector; a political debate about limiting their profits has put a lid on further expansion. Sweden has received suggestions from the World Bank on reducing the burden of regulation, including labour market regulations that are seen as a driver of a 'dual labour' market with high entry barriers for outsiders. The Swedish government has announced new organisational structures or policy reviews related to innovation, industrial policy, risk capital, and export promotion.

Key Competitiveness Assets/Challenges by Country

Baltic Sea Region - Baltics



Source: World Economic Forum (2015)

In the Baltic countries, export-led growth has started to give room to growth that is more driven by domestic consumption. Key issues remain the limited capacity of government administrations and, especially in Estonia and Latvia, a tax system that creates high entry barriers at the lower end of the labour market. Low marginal rates of income tax in combination with high social security taxes and low base exemptions create a regressive income tax structure. This might have driven the significant emigration of low-skill employees that has been evident over the last few years. These trends are further deepening the demographic challenges that the Baltic countries are facing in coming year.

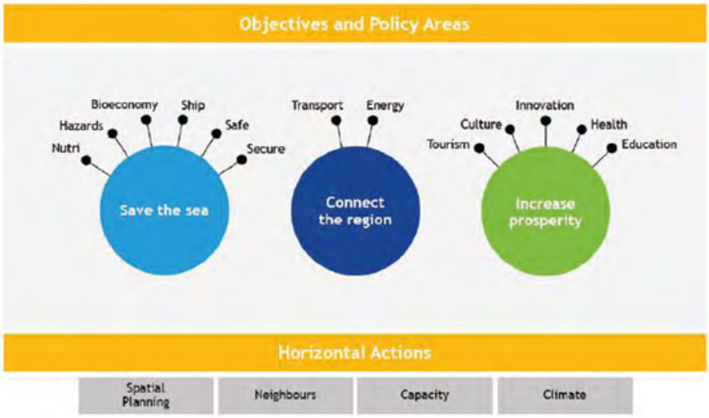
Estonia ranks higher on many dimensions of competitiveness than its Baltic peers. However, the ITC and R&D intensity that has become the nation's 'brand' reflects the reality of only a small share of the country's business community. Latvia has managed a strong recovery from the deep crisis it experienced. But more recently foreign observers warned about a slow-down in reforms, especially in the run-up to the elections in late 2014, and rising unit labour costs. Lithuania's development has been assessed as solid, benefiting from its relatively large home market and strong ties to the Polish economy.

COLLABORATION IN THE BALTIC SEA REGION: THE EU STRATEGY FOR THE BALTIC SEA REGION

The Baltic Sea Region is home to a dense network of projects, initiatives, and organisations dedicated to cross-border collaboration. Previous *State of the Region* reports have profiled key activities and organisations, including core actors like the Council of Baltic Sea States, the Nordic Council of Ministers, the Baltic Sea States Sub-regional Cooperation, the Union of Baltic Cities, and the Baltic Development Forum. While the range of issues addressed in these activities is wide, a fair share of them focus on issues related to competitiveness.

Since 2009, the EU Strategy for the Baltic Sea Region has provided overall direction to many cross-border projects and initiatives. This process continues in the structures that have been successful established over time. At the 6th Annual Forum of the EU Strategy for the Baltic Sea Region, this year organized in Jurmala, Latvia, a revised action plan was announced. Based on consultations across the region, the number of priority areas

The Updated EU Strategy for the Baltic Sea Region



Source: EU (2015) *State of the Region Report 2015*

Governance system of the EUSBSR

Source: EU (2015) *State of the Region Report 2015*

was reduced from 22 to 17. The focus of the Strategy remains unchanged, resting on the three pillars of 'Saving the Sea', 'Connecting the Region', and 'Increasing Prosperity'.

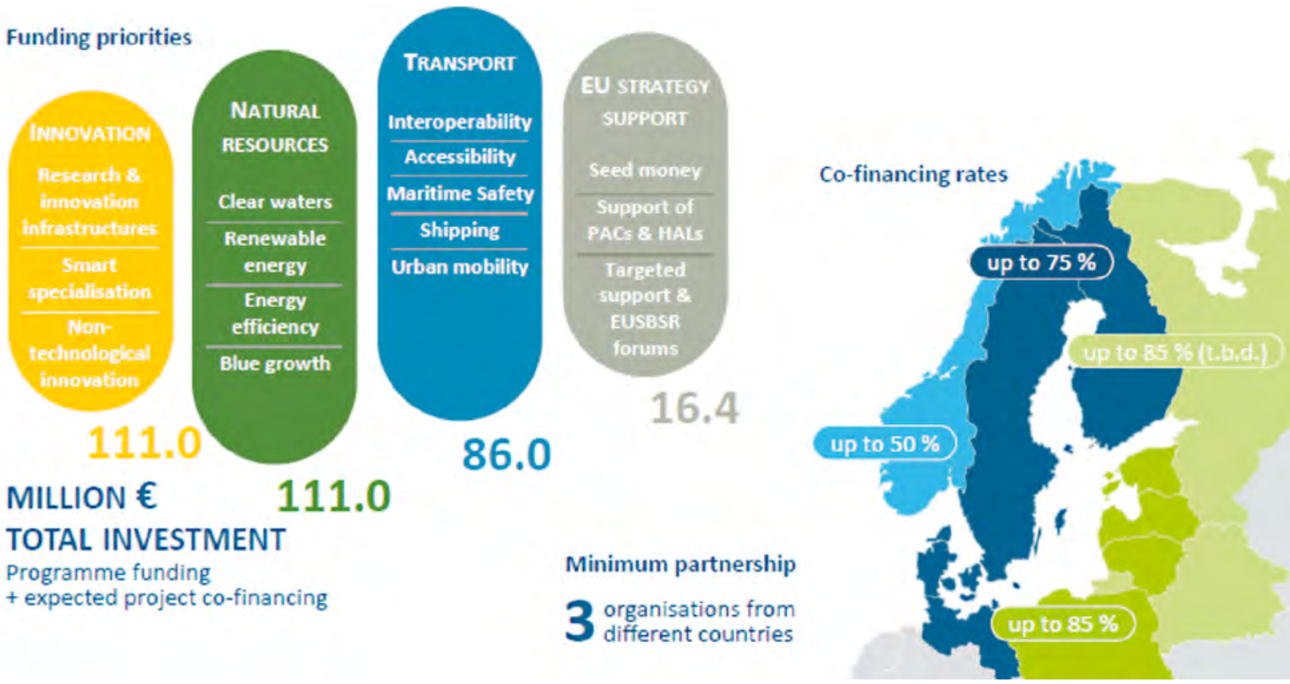
Most of the activities from the four policy and one horizontal areas that were cut in this last revision were subsumed under the remaining action lines. There have also been some adjustments in the governance of the Strategy, building on the experience over the last few years. Responsibilities for administrating and coordinating the strategy process have been shifted from the European Commission to the EU member states in the region. This reflects the central role of the European Commission in launching these type of regional processes; something that now keeps the Commission staff focused on new macro-regions in other parts of Europe. A critical role is now played by the group of national coordinators in the EU member countries of the region.

The EU Strategy for the Baltic Sea Region has the ambition to influence a broad set of policies and activities at different levels of government and in the private sector. It provides an important reference point for many activities by other public institutions, e.g. for the lending programmes by the Nordic Investment Bank and the European Investment Bank. Their activities have been the subject of previous *State of the Region* reports. Investments made in the context of the 'Juncker-plan', an ambitious plan by the European Commission to public and private funds for investment projects across Europe, will also have to be seen in this context.

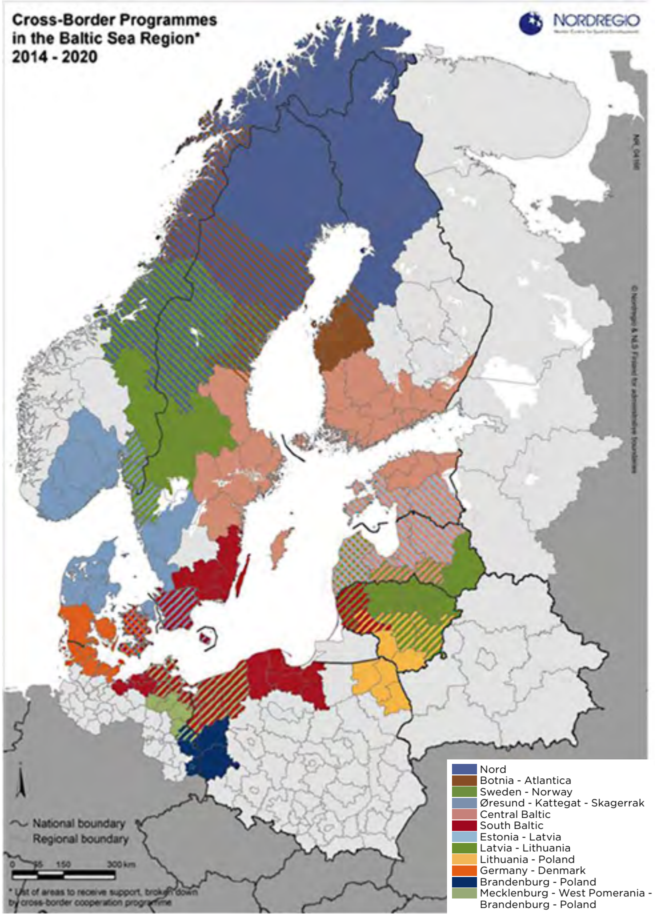
A core set of instruments it uses are cross-border EU programmes financed under the umbrella of the EU

Interreg Baltic Sea Region Programme

Co-financing for local, regional and national level public authorities, research & training institutions, sectoral agencies & associations / NGOs, eneterprises



Source: EU (2015 *State of the Region Report 2015*



Source: Nordregio at www.notdregio.se

structural funds. When the Strategy was launched, the multi-year programming period for the structural funds had already started and alignments with the new macro-regional strategy were not always possible. With the start of the new 2014-2020 programming period the respective Interreg programme for the Baltic Sea Region has now be fully aligned with the EUBSR. The programme mobilises roughly EUR 350m (with about EUR 280m from the programme budget) over the entire seven year period. In line with the overall ambitions of the new structural policies in the EU, the focus of investments has shifted from physical infrastructure to innovation. An important new aspect will also be the presence of 'smart specialization strategies' that regions and countries had to develop to be eligible for structural funds. These strategies lay down priorities in terms of sectors, technologies, or domains that individual regions aim to address.

Overall, cross-border programmes account for about 3% of the entire EU structural funds budget. The key impact of macro-regional strategies like the one for the Baltic Sea Region thus depends on its ability to influence action in other areas with Interreg focused on key connecting and strategic activities. This has not been easy in the past, with significant differences across countries in the region in terms of their ambition to involve parts of government and policies not directly engaged with Baltic Sea Region collaboration. The new EU regional policy commits all national programmes for the use of structural funds to explicitly consider the aims and activities of macro-regional strategies like the one for the Baltic Sea Region. This could mark a significant transition in the linkages between national and cross-regional activities.

CONCLUSIONS

The Top of Europe – a title (still) well deserved
A strong Region facing a complex set of challenges
Standing together to meet the challenges of the future?
Regional collaboration on auto-pilot is not enough

CONCLUSIONS

THE BALTIC SEA REGION IN SEARCH FOR DIRECTION: WHAT'S NEXT FOR THE TOP OF EUROPE?

THE TOP OF EUROPE – A TITLE (STILL) WELL DESERVED

The Baltic Sea Region has much to be proud of: At an average level of GDP close to EUR 35,000 it is among the most prosperous macro-regions not only in Europe but also globally, combining strong economic results with a high degree of social cohesion and environmental sustainability. It has provided an environment in which the Baltics and Poland were able to embark on an impressive catch-up path, growing their GDP per capita level from 30% of the Nordics/Germany in 1995 to 45% in 2005 to 55% now. It has shown the ability to deal with serious economic crises and structural weaknesses, taking many difficult policy choices at different times across all parts of the region. Its competitiveness fundamentals continue to compare favourably with many other countries and regions, with three countries from the region in the top ten of the 2015 Global Competitiveness Index and five in the top fifteen. Many of its capabilities, for example in providing solutions to environmental and societal challenges but also in taking advantage of digitalization, meet large and growing global needs.

The region has a rich network of organisations, projects, and initiatives connecting the different parts for cross-border action that is unique among macro-regions. It was first in encouraging the European Commission to launch the EU Strategy for the Baltic Sea Region as an integrated strategy to better align and coordinate regional action. And it has taken advantage of these structures to mobilise and leverage its own resources devoted to regional actions that support competitiveness, environmental sustainability, and other shared objectives. These regional activities are fully aligned with the broader engagement of the countries from the region in the wider policy efforts undertaken in the EU context. All of these attributes rightly earned the region its position at the Top of Europe.

A STRONG REGION FACING A COMPLEX SET OF CHALLENGES

With these assets in place, the region is now facing a complex economic environment. In the short term, the outlook is not too bad: the cyclical recovery is moving ahead and the overall external environment is still mildly supportive, especially in Europe. But the differences across the region in terms of country-specific economic climate have somewhat increased. And the risks seems more heavily weighted to the downside, from the potential for real estate market overheating to a more dramatic slowdown in emerging economies – the nervous developments on the region's equity markets are one reflection of these concerns.

In the medium-term, the region has to adjust to the new normal of lower growth rates that seem to affect many advanced economies. Annual potential prosperity growth has dropped from 3.5% per year before the crisis to close to 1.5% now. Productivity growth is down, partly due to a structural shift towards less skilled and capital-intensive services. A simple focus on more innovation, traditionally in knowledge-intensive industries, seems unlikely to change this trajectory. And it might easily widen the gap in the labour market and in society between those in highly productive, high wage sectors and those in low wage, often domestic services-oriented activities. Labour mobilisation has reached levels at which further progress is increasingly difficult, and might force politically controversial actions on taxes, welfare systems, and labour market regulation. This is a particular issue for the Nordic countries and their welfare systems but also for the Baltics, Poland, and Germany given their demographic challenges.

In the longer-term, the Baltic Sea Region needs to evolve its position in a changing global economy. The relative weight of economic activity is shifting away from Europe and the Baltic Sea Region's most natural economic partners. Global trade and investment flows seem to be slowing down, possibility more permanently, which affects a small, open macro-region disproportionally. Many emerging economies, China chiefly among them, have significantly improved business environment conditions, reducing the gap towards the advanced economies of the OECD. This creates new market opportunities for the Baltic Sea

Region but also challenges some of the traditional advantages and absolute weight of the region in the global economy. The region has already seen its share in world trade drop by almost 1/5 over the last decade, now reaching less than 4.5%. The trend for Foreign Direct Investment (FDI) has been similar, especially for inward FDI where the region's share of the global stock is now at 3.7%, significantly below the peak of 5.3% reached a decade ago.

While none of these developments have to translate into an absolute reduction of prosperity, a context of relative decline with lower absolute growth rates is enough to create significant new challenges for political leaders across the region.

STANDING TOGETHER TO MEET THE CHALLENGES OF THE FUTURE?

Baltic Sea Region collaboration has been motivated at least in part by the conviction that joint action across the region can be an important complement to actions at the national and EU level addressing the challenges laid out above. This has led to the creation of a range of institutions and programmes, including the initiative taken by leaders from the region in 2009 that resulted in the creation of the EU Strategy for the Baltic Sea Region. The Strategy, which might as well have been called a Strategy *by* the region, ties in with a strong network of existing organisations and networks to support a degree of collaboration that by all indications works well at the operational level. It is also deeply embedded in broader EU policies in areas like transportation, energy, environment, research, and innovation that drive collaboration within and across the region.

As this *State of the Region Report* has argued, however, an important role of Baltic Sea Region collaboration cannot be taken for granted as countries in the region are facing up to the challenges that the current political and economic context imposes on them. For collaboration to retain its role, leaders in the region have to be sufficiently aligned on their ambitions, on the policies they see best fit to achieve these ambitions, and on their view of the benefits that regional collaboration can play in implementing them. On all of these dimensions the environment has arguably become more difficult.

Modernising the welfare model in the context of globalisation and integrating into the European Union system were key motivations for the Nordic and Baltic countries as key drivers of the economic dimensions of the Baltic Sea Region collaboration process. While these objectives remain in place other, often shorter-term concerns seem to have gained priority. For some countries this has to do with urgent cyclical issues, for others with the ambition to rebalance the way economic benefits are shared across different segments of society. In addition, there are competing demands from other policy areas like security and migration that dominate the agenda. All of these issues lead to a more tactically driven policy approach, focused on individual policy initiatives rather than a broader action agenda that makes it at least more challenging to collaborate on the basis of a shared assessment of priorities.

At the level of specific policies, the cross-country differences in opinion are if anything probably even wider than on broader ambitions. This is not so much the case in areas like innovation policy or trade where there is broad consensus. But it does affect the discussions about tax policy, labour market regulations and migration where different party-political orientations of the governments across the region are reflected in divergent views on what direction should be taken. Many of these issues are national in nature and are thus not the subject of regional collaboration in any case. But they still limit the extent to which collaboration is possible, can undermine the mutual trust so critical for joint action, and affect the broader perception of how the outside views the way policy shapes the region's attractiveness as a place to do business.

Finally, there is little visible appetite to use the existing structures for collaboration as a platform for launching ambitious joint action initiatives. Political leaders across the region seem content with the on-going activities of the established regional structures, where the government bureaucracies are operating under the broad political directions given in the past. With the difficult political situation that many governments face nationally it is probably not a surprise that there are few new initiatives at the level of the region. And the regional context itself is not particularly helpful either: The tensions between Russia and the West weigh heavily on this part of Europe. And the different ways in which individual countries and societies across the region are responding to the refugee crisis creates an additional set of political challenges.

REGIONAL COLLABORATION ON AUTO-PILOT IS NOT ENOUGH

The Baltic Sea Region has gone through periods of different levels of collaboration, also in its more recent history. It has the fundamental strengths both in its economies and its regional structures for collaboration to sustain performance and integration even when the support for regional action is more limited for some time. And with many issues competing for political attention it is quite natural that regional collaboration cannot top the political agenda all the time.

But leaders in the region need to be careful not to be complacent: the longer regional collaboration remains on auto-pilot, the more opportunities for benefiting from more ambitious joint actions are being missed. This matters, because the issues on the agenda of regional collaboration – from competitiveness to environmental sustainability – are without a doubt critical for all countries in the region.

An important challenge is that many of the current organisational structures underpinning collaboration have been created in a context quite different from the one the region is facing now. This does not make the old organisations obsolete but it creates a need to redefine their roles in line with the new realities. And this is a task that requires political leadership; it cannot be delegated or left to the organisations themselves.

Over time there is a danger that with a lack of political leadership the structures for regional collaboration themselves are going to be weakened and lose relevance. This is an outcome that the Baltic Sea Region could ill afford. Its spirit as the Top of Europe should be radically different: setting an example for effective regional collaboration that can help inspire the wider European Union as it is struggling to redefine its role and structures for a new era. This would not only be good for Europe but also provide the Baltic Sea Region with the supportive type of European context that is critical for its own development.

APPENDIX:

Real GDP growth, % y/y

	2010	2011	2012	2013	2014	2015E	2016E
Baltic Sea Region	2,6	2,2	0,8	0,6	1,6	1,5	1,9
Denmark	1,6	1,2	-0,7	-0,5	1,1	1,5	2,0
Estonia	2,5	8,3	4,7	1,6	2,1	2,0	3,0
Finland	3,0	2,6	-1,4	-1,3	-0,1	-0,3	0,5
Germany	2,1	2,0	0,4	0,1	1,6	1,7	1,6
Iceland	-3,1	2,4	1,3	3,6	1,9	2,8	2,5
Latvia	-2,9	5,0	4,8	4,2	2,4	2,2	3,5
Lithuania	1,6	6,1	3,8	3,3	2,9	2,2	4,0
Norway	0,6	1,0	2,7	0,7	2,2	1,2	1,3
Poland	2,9	3,8	1,8	1,7	3,4	3,3	3,4
Russia	0,4	3,2	3,4	1,3	0,6	-3,7	0,3
Sweden	6,0	2,7	-0,3	1,3	2,1	3,1	3,0

Source: Nordea Markets

Real Government consumption growth, % y/y

	2010	2011	2012	2013	2014	2015E	2016E
Baltic Sea Region	1,0	0,3	1,0	0,8	1,6	1,6	1,5
Denmark	1,3	-1,4	-0,2	-0,5	1,4	1,0	0,2
Estonia	-0,4	1,7	3,3	2,8	2,3	1,6	1,5
Finland	-0,1	-0,1	0,5	0,6	0,2	-0,2	-0,3
Germany	1,3	0,7	1,2	0,7	1,1	1,8	0,9
Iceland	-3,0	1,2	-1,7	0,7	1,8	1,5	1,3
Latvia	-8,1	3,1	0,4	2,9	3,4	2,8	2,4
Lithuania	-3,5	0,3	1,2	1,8	1,3	2,3	2,5
Norway	2,2	1,0	1,6	1,7	2,5	2,0	2,5
Poland	3,3	-2,3	0,2	2,1	4,7	4,2	3,3
Russia	-1,5	1,4	2,6	1,1	-0,1	0,0	0,0
Sweden	1,3	0,8	1,1	0,7	1,9	2,5	2,4

Source: Nordea Markets

Real Private consumption growth % y/y

	2010	2011	2012	2013	2014	2015E	2016E
Baltic Sea Region	2,4	2,2	1,5	1,4	1,6	2,0	1,9
Denmark	0,8	0,2	0,4	0,0	0,5	1,8	2,2
Estonia	-1,6	2,5	5,1	3,8	4,6	3,9	3,2
Finland	3,1	2,9	0,3	-0,6	-0,2	0,3	0,2
Germany	0,6	2,3	0,7	0,8	1,2	1,9	1,5
Iceland	-0,2	2,6	2,0	0,5	3,7	3,5	3,0
Latvia	3,1	2,9	3,0	6,2	2,3	3,6	4,0
Lithuania	-3,4	4,6	3,6	4,2	5,6	4,0	4,3
Norway	3,8	2,3	3,5	2,1	2,1	2,5	1,5
Poland	2,7	2,9	0,9	1,2	3,0	3,4	3,6
Russia	5,5	6,7	7,7	4,9	1,2	0,5	1,5
Sweden	3,9	1,9	0,8	1,9	2,4	2,1	2,3

Source: Nordea Markets

Real Import growth % y/y

	2010	2011	2012	2013	2014	2015E	2016E
Baltic Sea Region	9,9	8,0	2,0	1,7	3,3	1,7	3,8
Denmark	0,9	7,1	0,9	1,5	3,8	2,1	3,5
Estonia	21,2	26,5	11,8	3,3	2,7	0,9	4,2
Finland	6,5	6,0	1,6	-1,6	-1,4	-1,1	2,1
Germany	12,9	7,1	0,0	3,1	3,4	5,5	4,8
Iceland	4,3	6,9	4,7	0,3	9,9	8,3	7,9
Latvia	12,4	22,0	5,4	-0,2	1,6	1,2	5,0
Lithuania	18,7	14,2	6,6	9,0	5,4	5,8	5,0
Norway	8,3	4,0	3,1	4,3	1,6	2,7	1,6
Poland	14,0	5,5	-0,6	1,8	9,1	8,5	7,7
Russia	25,8	20,3	8,7	3,8	-7,9	-35,0	2,0
Sweden	12,8	7,3	0,5	-0,7	6,5	2,6	4,9

Source: Nordea Markets

Real Investment growth, % y/y

	2010	2011	2012	2013	2014	2015E	2016E
Baltic Sea Region	3,3	8,0	2,1	0,2	1,7	0,6	3,2
Denmark	-4,0	0,3	0,6	0,9	3,7	0,5	2,9
Estonia	-2,6	32,7	10,9	2,3	-2,8	0,0	4,2
Finland	1,1	4,1	-2,2	-5,3	-5,1	-3,9	1,8
Germany	5,1	7,3	-0,7	-0,6	3,4	2,5	3,7
Iceland	-8,6	11,6	5,6	-1,0	13,7	12,0	9,0
Latvia	-20,0	24,2	14,5	-5,2	1,3	2,0	4,5
Lithuania	1,4	19,4	-1,6	7,0	8,0	5,8	6,0
Norway	-6,6	7,4	7,6	6,8	1,2	-0,4	2,4
Poland	-0,4	9,3	-1,5	1,1	9,2	6,9	5,0
Russia	28,5	21,0	3,1	-7,1	-7,3	-6,0	0,7
Sweden	6,0	5,7	-0,2	-0,4	6,5	4,2	5,0

Source: Nordea Markets

Real Export growth, % y/y

	2010	2011	2012	2013	2014	2015E	2016E
Baltic Sea Region	7,8	5,3	2,0	0,4	2,5	2,3	3,7
Denmark	1,9	7,3	0,1	0,8	2,6	2,3	3,4
Estonia	24,0	24,9	6,2	2,4	2,6	1,6	3,9
Finland	6,2	2,0	1,2	-0,7	-0,4	-0,7	2,3
Germany	14,5	8,0	2,8	1,6	3,9	5,6	4,0
Iceland	1,5	3,4	3,7	6,9	3,1	4,7	5,5
Latvia	13,4	12,0	9,8	1,4	2,2	2,6	4,5
Lithuania	18,9	14,9	12,2	9,4	3,4	2,5	4,5
Norway	0,7	-0,8	1,4	-3,0	1,7	2,6	1,7
Poland	12,9	7,9	4,3	4,8	5,7	6,3	6,7
Russia	7,0	0,3	1,1	4,6	-0,1	-25,0	6,0
Sweden	11,9	6,1	1,0	-0,2	3,3	3,5	4,8

Source: Nordea Markets

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Year:	2015
Published by:	Baltic Development Forum (BDF)
Contact:	Baltic Development Forum Nytorv 3, 1st Floor DK-1450 Copenhagen K, Denmark Phone: +45 70 20 93 94 Fax: +45 70 20 93 95 Email: bdf@bdforum.org
Designer:	Jānis Dripe, *www.dripe.lv*

ISBN: 978-87-996254-7-5
EAN: 9788799625475

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