I wish to thank all who supported and participated in Baltic Development Forum's second annual Summit 17-19 September 2000 in Malmö.

In Malmö we launched the Baltic Sea Region as the most promising region worldwide.

A sense of purpose was found and a sense of family was born: It is easier to choose the way forward when you know with whom you are walking! The network of decision-makers from politics, business, media, academia was enlarged and the ties between them made stronger.

This Summit report shows how much energy, vitality and creativity the Baltic Sea Region can foster and Baltic Development Forum is committed to continue pursuing the goals which were set during the Summit together with the family of decision-makers in this unique region of ours.

From Malmö, Sweden Baltic Development Forum goes to St. Petersburg, Russia. 23-25 September 2001 we will hold the third annual Baltic Development Forum Summit in St. Petersburg focusing on Russia - in the Baltic Sea Region and in Europe.

Yours sincerely,

Uffe Ellemann-Jensen
Chairman

Summaries written by Izabela Butenko-Olsen, Kasper Elbjørn and Viktor Makarovs

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The 2000 Baltic Development Forum Summit in Malmö, Sweden on 17 - 19 September 2000 marked the second time that more than 350 of the Baltic Sea Region’s leading politicians, business, academics and media executives convened for intense cross-sector networking and for setting new agendas for our region.

The Baltic Sea Region has an enormous potential to develop further and become an economic regional driving force in Europe. However, to release that growth potential the Region needs a comprehensive strategy.

The Summit launched by the recommendations quoted below the first building blocks of a regional strategy for political stability and economic growth in the Baltic Sea Region. One of the main building blocks of the strategy is the Baltic Rim Regional Agenda presented by Prof. Michael E. Porter, Harvard Business School and Prof. Örjan Sölvell, Stockholm School of Economics at the Summit. A new agenda to promote a truly innovative and cooperative mind set in the Region to further business development.

The other elements of the strategy are to appear in this report summarising and putting into perspective the discussions and messages brought forth at the summit, as seen by Baltic Development Forum’s secretariat.

**Recommendations of the 2nd Baltic Development Forum Summit**

*A comprehensive, political vision for the Baltic Sea Region covering two parallel tracks:*

- A speedy accession of the four candidate countries: Estonia, Latvia, Lithuania and Poland to the EU;

The speedy accession places a special responsibility on:
- the EU and its Member States to keep up the momentum, all the time focusing on the fact that a united Europe within the EU is the only guarantee for peace and prosperity in Europe as a whole. The EU members of the Baltic Sea Region recognise a special responsibility in this regard
- the candidate countries to keep the reform process going in a focussed and sustainable manner.

- A speedy integration of Russia into Europe, making full use of the Action Plan on the Northern Dimension from today till 2003;

The integration of a democratic Russia into Europe, this being the major strategic challenge, demands:

- all possible support for the Action Plan on the Northern Dimension. A concerted approach from the Baltic Sea Region to the Action Plan is necessary
- that Russia makes all possible efforts to make the integration into the European Union with its free and open economies a success.
A regional agenda for business development:

- A new regional agenda for business development focusing on the region's underlying microeconomic environment to promote a truly innovative and cooperative mindset in the region. This implies a continued follow-up to the Baltic Rim Regional Agenda presented by Prof. Michael E. Porter, Harvard Business School and Prof. Örjan Sölvell, Stockholm School of Economics at the summit.

Objectives following from the Baltic Rim Agenda:

- Formation of a regional cluster economy taking full advantage of nation-specific uniquenesses
- Becoming a leader within IT making the necessary investments within the communication infrastructure
- Allocation of more funding to the educational sector thereby giving priority to developing the human capital resource base
- Promoting a higher level of regional societal integration to ensure a higher degree of mobility of labour force and students

- Focusing the bilateral business related assistance on the development of the common competences and strongholds of the whole region

- Changing the charter of existing international financial institutions (IFI's) in order to enable these institutions to fill the institutional gap in the transition economies.

- Developing a legal and regulatory basis of internationally oriented stock markets in the Baltic Sea Region. Small and medium-sized countries should implement the rules that are gaining international acceptance since the time for a local policy as to the rules and regulations has past.

- Marketing a branding of the Region in order to develop ties with the outside world

- Implementing further institutional reforms and reduce bureaucratic barriers to attract trade and investments in the region.

- Securing a predictable and transparent business climate.

Visions for the Baltic Sea Region

A speedy accession of Estonia, Latvia, Lithuania and Poland to the European Union was seen as the single most dominant objective to secure peace and prosperity in the Baltic Sea Region. In his opening address, Mr. Pehr G. Gyllenhammer, Chairman of CGNU and former Head of Volvo AB, stressed the importance of the Enlargement of the European Union. In particular, he pointed to democracy with rule of law as a the fundamental prerequisite for wealth creation.
"In my view, the real drivers for growth and wealth creation are peace, democracy and open trade. The Baltic Sea is now open for free navigation, the air space is accessible and national borders are no longer barriers. It is fair to say that the Baltic Sea is a sea of peace.

The European Union is a peace project based on the assumption that economic growth is a precondition for our citizens to benefit from democracy. Therefore, the most important criteria for joining the European Union are democracy with rule of law and the key institutions that form its foundation. Vital elements are a constitution with free elections, a juridical system with complete integrity and a central bank.

The candidate countries are mostly coming from authoritarian rule but they are now cooperating with the European Union to qualify for membership. That is one of the most remarkable transformations the world has witnessed in recent history. And, it is all happening at a very high pace, even if the process is testing the patience of the candidates.”

These opening remarks from Mr. Gyllenhammer were echoed in the end note address on the Summit’s first day by the Swedish Minister for Trade Leif Pagrotsky who urged the EU to realise that many of the candidate countries — not least the ones around the Baltic Sea — have rushed through a modernisation process that has taken several decades for Western Europe to complete. “In many cases, it is fair to talk about a ‘tiger’s leap’ straight into what we call the new economy”, the Minister said, stressing the importance of keeping in mind that today’s candidate countries are tomorrow’s Member States. Mr. Pagrotsky acknowledged the responsibility of the outside world during the last ten years while at the same time making it clear that the achievement of transition has been the task of the people of the transition countries.

He also said that the cooperation across the Baltic Sea Region has become mutually beneficial — a clear win-win situation, where both the developed and the less-developed economies have been able to learn from each other. In this regard, Mr. Pagrotsky especially pointed to the Nordic model as role model for the Eastern Baltic Sea countries. “We combine a well developed welfare state, financed through the highest taxes in the world, with flexibility and economic progress”.

The remarks of Mr. Gyllenhammer and Mr. Pagrotsky touched the very essence of this year’s Summit theme "Shaping a larger and stronger Europe with Business and Finance as Drivers of Transition" where more than 50 speakers and moderators provided an educating and entertaining background for discussion and new agendas for the Baltic Sea Region.

Innovation meets transformation

Major changes have taken place since the 1999 Baltic Development Forum Summit and the future scenario for the Baltic Sea Region has never before in history been more promising. Estonia, Latvia, Lithuania and Poland have all become equal partners of the Enlargement process and the EU’s adoption of the Action Plan for the Northern Dimension will help to secure the integration of Russia into Europe. Optimism reigns in the region.

In that context Member of the Managing Board of LB Kiel, Peter Pahlke stressed that it was not the size of the Region in economic terms or in terms of population size that made the Region so interesting. "What makes the Region so special in our view is the combination of three factors: Integration, innovation and transformation. Economic integration has already reached a high level but what makes this Region fairly unique
compared to other regions of the world is the fact that here, innovation meets transformation."

The media experts agreed with this message. **Hans Månson**, Chief-Editor of Sydsvenska Dagbladet concluded that, "the word Region has its origin in Latin and means to rule, to reign - and the man that finds this Region will have a very important role in the years to come". **Deputy Editor-in-Chief Matthias Nass** of Die Zeit, supported this statement by declaring "How is it possible not to be optimistic? Europe today has a unique chance to secure peace and political stability in Europe, which we are about to seize. The best case scenario is definitely the most realistic one."

These comments were upheld by the Chief-Editor of Handelsblatt, **Rainer Nahrendorf**. He believed that the EU would indeed be ready for accession by 2003 and by the year 2010 all the countries of the Baltic Sea Region except Russia would be member of the EU. "The Enlargement will increase economic growth in the Baltic Sea Region at a rate of 0.5 percent and Estonia, Latvia, Lithuania will be a strong trade bridge to a recovering Russia" Mr. Nahrendorf predicted, before adding that a best case scenario included Denmark and Sweden as members of the Euro, which in 2010 would be a strong currency even against the US-dollar.

**Latvian journalist Juris Kaza** of Dienas Bizness gave a highly entertaining intervention describing Latvia in 2010 in a best case scenario: Latvia would be a relatively new member of the EU and in the middle of a major investment boom. Great spending on education was started in 2002 after the final privatisation of the large state-own companies and with a government formed in 2006 consisting of politicians of no more than 25-30 years of age mostly educated in the West and with the Soviet time only as a distant childhood memory. This government took Latvia into the EU, Mr. Kaza anticipated.

**A delay of the Enlargement process will be detrimental to the region**

However, though a positive future scenario seems by far the most likely a backlash cannot be ruled out. **Margarita Starkevičiūtė** of Lithuanian Banking Insurance & Finance Institute pictured a worst case scenario where some countries for different reasons had become the Region's backyards. With this in mind she urged the participants of the Summit to pay more attention on building prosperous neighbourhood or else this scenario could come true.

Following in this vein Mr. Kaza foresaw in his worst case scenario that by 2010 the Latvian government had entered another decade of stagnation and indeed had become the backyard of not only the Region, but of Europe. "The privatisation policies of the 1990's have in the last decade been replaced by de-privatisation implemented by populist governments and the EU countries are still more worried about the protectionist economy, the political instability, corruption and irrationality. In 2010 there is some talks that 2015 might be considered a year for membership talks or whatever", Mr. Kaza foresaw but beseeched the participants to remember, "that it isn't 2010, yet. So we still have a chance to make the right choices".

**Mr. Nahrendorf feared that the EU would fail to make the so-called flexibility-clause more effective, allowing avant-garde nations to go ahead with a closer cooperation. "The process of deepening the European integration parallel to the Enlargement will loose its momentum. The same could occur if Denmark, Sweden and Great Britain will stay out of the Eurobond for a longer time", Mr. Nahrendorf warned.**

Another risk would be if the Enlargement of the EU were completed without the Copenhagen criteria being strictly fulfilled by each new member state. "As we say in Germany: Good things takes time" Mr. Nahrendorf stated. Chief Editor of Dagens
Industri Hasse Olsson seemed to agree with this statement. He said that his hope for the Region was that it would reach the level of the best case scenarios in ten years time. “And that is possible”, Mr. Olsson stated, “but we shouldn’t be surprised if it takes maybe 15 to 20 years. This is probably more realistic”.

**Shaping a larger and stronger Europe**

The process of the Enlargement is by far the most challenging issue facing the region. The four candidate countries have success in preparing for membership of the European Union but need to keep the reform process going in a focussed and sustainable manner. Readiness is a responsibility of the candidate countries.

However, the general sentiment among the candidate countries was that the process is losing momentum and that the pro-European momentum that lasted until the Helsinki Summit in December 1999 is being eroded. The political will in the EU to enlarge seems to have diminished in a Europe suffering from lack of political leadership. Consequently, the rhetorical question emerged during the Summit: Is the EU ready for the Enlargement?

**The aspiration to join seems to exceed the will to expand**

A delay of the Enlargement process will be detrimental to the interests of not only the candidate countries but also to Europe as a whole. This was the simple and unequivocal message from the candidate countries.

Andris Bērziņš, the Prime Minister of the Republic of Latvia stressed that the EU on its part should not commit to a date for accession, but rather to a date of decision making. This would strengthen the reform incentives and also put certain pressure on the European Union. Andrius Kubilius, the Prime Minister of the Republic of Lithuania took this statement even further saying that “talking about preparation for membership we often talk about the homework. It is an established custom already that we ourselves do our homework. However, the EU should also follow suit”.

Andrius Kubilius expressed a general concern that the aspiration to join seemed to exceed the will to expand. "The growing scepticism of people in the EU over the accession of new members adds to a certain concern. The Enlargement process is perceived as a one-way street, to put it otherwise - full of benefits for the acceding members and undesirable by current members". The Lithuanian Prime Minister urged the EU to avoid "sailing downstream with the wave of populism". He said that on the contrary it is a duty to find the arguments to persuade the public so that the actions planned and the decisions adopted are justified. Prime Minister Andris Bērziņš agreed with his Lithuanian colleague. He said that the citizens of both the member state countries and the candidate countries, have to be aware that the Enlargement is an investment, which will bring both new ideas and stability in the continent. "It is much like a business plan," Mr. Bērziņš said, “And believe me, the profit of the Enlargement will exceed the costs”.

Vice Prime Minister and Minister of Foreign Affairs of the Republic of Estonia Toomas Hendrik Ilves voiced a similar concern sensing a tendency of a growing fatigue in Western Europe with the issue of the Enlargement. Europe simply witnesses a sobering up from the euphoria that characterised the early 1990's during the liberation of Eastern Europe. "The initial blush of first love has disappeared" Mr. Ilves said, and expressed his fear that this could lead to a more esoteric Europe with new and more pronounced dividing lines.
Calling on the assembled policy makers to start pushing the Enlargement in an active way by leaving scholastic arguments that only slow down the process, Mr. Ilves sent a highly suggestive message to all of the participants: "A delay of the Enlargement is going to be a delay of Europe".

Minister and Under-secretary of State of the Republic of Poland, Štefan Urbaniak said that he was often asked why Poland is in such a hurry to join the EU. Mr. Urbaniak declared that of course there was the economical aspect: "When we join the European Union we will have the possibility to achieve additional economic sources, which we indeed are in need of". But he also said that the political aspect was just as important. "We would like the influence and also, we would like to feel secure. However, we are now a member of NATO but the EU is another way of feeling secure as a country."

False preconceptions dominate the Enlargement debate

In his key note address, the Estonian Minister of Foreign Affairs Toomas Hendrik Ilves offered possible explanations of why the political will to enlarge has diminished pointing out five specific false preconceptions dominating the Enlargement debate in the EU:

- Cheap labour will flood into the EU and cause unemployment;
- The Common Agriculture Policy will fail;
- The costs of Enlargement will be enormous given the physical constraints to the EU;
- The EU has to be reformed and only then will it be possible to take in new countries;
- The overall problem of simple prejudices towards the Eastern European candidate countries concerning alleged different national traditions, difference in value judgements, different democratic values etc.

Mr. Ilves said that he feared that these prejudices and preconceptions would postpone or seriously threaten the Enlargement and he urged for the accession to be based on objective criteria and the performance of each of the candidate countries. “The Enlargement has become too big a headache for too many people, and we end up getting too many not very good arguments for delaying it. We lack the dynamism of the creation of the Coal and Steel Community, the creation of NATO and so forth, when clear bold decisions were made quickly” Mr. Ilves said before turning from the political sphere to the business oriented sphere, urging the business industry to take on a more prominent role in the Enlargement process.

Mr. Ilves stressed in this regard that companies that have based their decisions in the Region on stereotypes will lose out and not do well in the future. On the other hand, companies that have a realistic and adequate understanding of what is going on - especially on the Eastern shore of the Baltic Sea - will be the winners.

“Preconceptions and prejudices will hurt you when doing business. The many new knowledgeable Estonian businessmen, successful in the West, have, to put it mildly, become impatient with the patronising they has encountered throughout the last ten years”, Mr. Ilves advised before urging the business community to push for the Enlargement and make clear, that the preconceptions have little reflection on reality. "If you do that, you will get yourself a very good market and a very large market".

Building a stable relationship with Russia - a Russian view
A stable, long-term relationship between the EU and the Russian Federation is fundamental to achieving political and economical stability in the Baltic Sea Region. One important step to ensure a stable relationship is the Northern Dimension initiative, EU’s policy on cooperation with the Russian Federation. It is anticipated that also the United States and Canada will be involved in parts of the implementation of the action program.

The Northern Dimension was warmly welcomed by former Vice President of the European Commission Henning Christophersen as a timely and constructive initiative - “indeed more than a title and more than a vision”. He asserted that it is a very substantial policy document made by the EU and with full support from the Russian Federation, Poland, Estonia, Latvia, Lithuania and also Norway and Iceland. In accordance with the EU’s founding principles, the Northern Dimension was discussed and advanced during the Finnish Presidency in late 1999 to contribute to the reinforcement of positive interdependence between the EU, Russia and the other countries in the Baltic Sea region.

As the personal representative of the Deputy Minister of Foreign Affairs of the Russian Federation, the deputy Russian Representative to the EU in Brussels Viatseslav Stefankin stressed in his key note address that the Russian Federation truly supported the Northern Dimension programme. He foresaw that regional cooperation could play a major role to avoid that the European Union becomes a mighty fortress. And that is exactly why the Russian Federation fully supports the Northern Dimension - the most promising regional cooperation. Moreover, he explained that it is through mechanisms of the Northern Dimension that a synergetic effect can be achieved by combining efforts on regional, national and multinational level. "We will seek to ensure that this kind of cooperation will be profitable for everybody", he said.

The Northern Dimension is an important step to the unification of a Europe including Russia. Politically, historically and emotionally, Russia's great concern has always been and still is to avoid a new dividing line between Russia and the European Union. "A general feeling in our country is that with the collapse of the Soviet Union such dividing lines ceased to exist forever and a new Iron Curtain, which might become a Final Curtain, is impossible," Mr. Stefankin stressed. He believed that excluding parts of Europe, isolating some countries or marginalize parts of the population could be harmful not only for those concerned - but for the mere idea of European integration and the Enlargement of the EU.

**Russia welcomes the Enlargement**

Viatseslav Stefankin welcomed the Enlargement of the EU. Despite certain difficulties and the complexity of the task, he predicted that the Enlargement slowly but steadily would become a reality. "And this offers new opportunities to the nations of Central and Eastern Europe - including Estonia, Latvia and Lithuania - and introduces common borders between Russia and the EU. And we wish all the candidate countries and you, Ministers, all the success in timing and terms of accession" Mr. Stefankin said.

Despite being positive towards the Enlargement of the EU, Russia does have concerns regarding the effects on trade flows. "The Enlargement must resolve in trade creation not trade diversion" Viatseslav Stefankin said urging the EU to ensure that the Enlargement will lead to increased trade and economic cooperation with not only the new Member States but also with Russia.

**Business - a win-win situation**
The Summit’s business theme had “The Baltic Rim Regional Agenda” developed by Prof. Michael E. Porter, Harvard Business School and Prof. Örjan Sölvell, Stockholm School of Economics as point of departure. Focusing on the underlying microeconomic environment it promotes new ways of thinking about economic growth, innovation and cooperation in the Baltic Sea Region.

The Baltic Rim Regional Agenda makes up one of the main building blocks of a regional strategy to further business development in the region.

**Baltic Rim Regional Agenda - Developing a new innovative and cooperative mind-set**

Most regional agendas focus on macro-economic issues. Regional agendas, also, typically focus on large infrastructural projects in which the political sphere is deeply involved. While taking these issues into account Prof. Michael E. Porter, Harvard Business School, and Prof. Örjan Sölvell, Stockholm School of Economics, have developed the Baltic Rim Regional Agenda. The Baltic Rim Regional Agenda focuses on the underlying microeconomic environment: clusters, industries, firms, entrepreneurs and processes of innovation and change.

Speaking from Harvard Business School in Boston via interactive video, Prof. Michael E. Porter stated that the reality of modern competition is that the Region has become a very important economic unit that can make immediate and almost profound impact on each of the countries in the Region in question. This is happening all over the world, Prof. Porter told, arguing that the Baltic Sea Region is predestined for a great opportunity to truly exhilarate its development and its economic growth not only for the developed countries but also for the less-developed countries.

However, he explained that if the Region is going to get the full benefits of economic prosperity, a more sophisticated deal of the role of competition has to be developed. He proposed for a strategy that addresses a whole series of other opportunities way beyond the simple notion of a free trade zone and opening up investments. Instead the Region should encourage a regional cluster economy - meaning that the Region should strive to form integrated cross-border clusters as well as specialised clusters within each country.
A cluster is made up of different units that support the development of a given mode of production. The units at the same time cooperate and compete with each other creating a dynamic environment. Together the different units make up a whole - a cluster. The different units are usually located in geographic proximity due to the mutual dependency among the units.

**Need for a coherent regional approach**

Much more attention should be paid to the underlying microeconomic environment to strengthen the region’s competitiveness in a concerted regional effort. “If you have a coherent regional approach - if you have a regional vision - all of a sudden everybody in the world takes notice”, Porter underlined pointing to the fact that often it is not understood that the productivity of the business environment of each country can be greatly influenced by the ability to coordinate certain very focussed policies across regional borders.

The Baltic Rim Regional Agenda recommends to:

- start on the economics. The social aspects can come later when everyone is more confident.

- keep focus on national policy and view regional strategy to enhance or speed up the national improvements. A regional vision allows all countries within the Region to take the steps they need to take in their own economic policies. Regional policy is not a way to slow down but a way to speed up.

- take full advantage of the nation-specific uniquenesses and let each country feel free to move further at any point.
From brain drain to brain circulation

In addition, Prof. Örjan Sölvell, moderating the session, highlighted the importance of promoting a more positive view on integration as a whole. If we want to go from vision to reality we must create a new mind-set where the people of the Region acknowledges that this is a win-win situation - we can all win from trade, investments and societal integration. But we need “to change the mind-set from brain gain and brain drain to brain circulation. Thinking in terms of brain circulation will create a better chance for the Region to go from vision to reality” Prof. Örjan Sölvell said.

To push the process from vision to reality, the Region should start out working in areas where the potential for the Region is obvious, e.g. within IT and mobile telecom, Sölvell urged. The number of companies and the sophistication on both sides of the Baltic Sea generates an enormous potential for cross-border investments, flows of people, flows of technology etc.

Huge growth potential

The Danish Ministry of Trade and Industry had conducted a study of the development potential in the Baltic Sea Region. The report substantiates the huge growth potential in the region. The Danish Minister of Trade and Industry, Pia Gjellerup thus strongly believed that the Baltic Sea Region is in a good position to become one of the World's new powerful regions.

GDP in Poland will almost double and the GDP in the three Baltic countries might increase up to 60 pct. in the next decade, according to the report And if Estonia Lithuania, Latvia and Poland become members of the EU in 2003 and continue their catching-up, it is estimated that GDP in the Nordic countries will increase by further 0,3 percent points each year for the next ten years.

“The increased integration between the countries of the Region will lead to even greater prosperity in the whole region. It will mean more jobs, more welfare and a better quality of living for the citizens of the region. We have the opportunity to create a more integrated and dynamic region. It is up to us to seize the opportunity – to realise the growth potential in the coming years” Ms Gjellerup recommended on behalf her Ministry’s report.

Rethinking bilateral assistance policies

Ms Gjellerup also drew attention to the financial assistance to the reform process from both multilateral and bilateral donors.

The business-related assistance should be more focussed on the development of the common competencies and strengths of the whole region. “Today, part of the financial assistance is too much dictated by the donor countries’ own business interests”, Pia Gjellerup said. Moreover, assistance should be clearly targeted at preparing the candidate countries for EU membership.

On that background The Danish Ministry of Trade and Industry would like to initiate a dialogue on the need for a co-ordinated regional approach on this matter. A substantial amount of no less than 1 pct. of the recipient countries’ gross national product corresponding to the level of the Marshall Aid received by the Nordic countries after the Second World War is transferred to the transition countries.
Developing competitive advantages

As Peter Pahlke noted during the morning session, what makes the Baltic Sea Region unique compared to other regions is the fact that here, innovation meets transformation. Two panels of business executives offered their assessment of what was needed to create a dynamic business environment to improve the competitiveness of the region. In the globalised knowledge economy the economies cannot stay competitive unless competitive advantages are developed.

The panellists pointed to further implementation of institutional reforms, reduction of remaining bureaucratic barriers and a more predictable and transparent business climate as necessary concrete steps to be taken to develop competitive advantages in the region. Equally important, markets should be opened.

The business community advised all governments of the Baltic Sea Region to make a genuine practical commitment to develop and to promote the vision of a prosperous integrated Baltic Sea Region. The business community expressed for its part, a clear commitment to translate that vision into reality. However, that commitment is dependent on the practical commitment of all individual government of the Region to make progress within this framework, Chairman Matti Vuoria, Fortum Corporation, stressed in his concluding remarks as moderator of one of the panels.

Demand-conditions must be further developed

Executive Vice President Ole Steen Andersen, Danfoss, offered a practical follow-up to the Baltic Rim Regional Agenda. He made a convincing argument that if the Region is to create a cluster within heating the demand conditions need to be further developed. "But to do this we need the governments to give it priority ... the driving forces are of course economic savings and environmental concerns but the politicians have to take the initiative", Mr. Andersen said.

Mr. Andersen voiced that if the conditions were put in place within a reasonable period of time things would start happening very soon. Well-known Danish companies like Rockwool, Velux, Grundfos and Danfoss have all moved in because part of those demand-conditions are already in place. And if they are further developed it becomes possible to create a real regional cluster within heating by linking already existing clusters in Denmark and Germany. This kind of development is exactly what the Baltic Rim Regional Agenda aims to enhance.

President and CEO Anders Narvinger, ABB Sweden likewise declared that the potential in the Region is great though some problems remain. However, in line of Mr. Andersen his experiences in the Eastern part of the Baltic Sea Region were indeed positive. He told that there is a much more open attitude today and that ABB has a very good dialogue in all the countries. Mr. Narvinger pointed to the Latvian Foreign Investors Council as one of the most positive examples of how to comply with problems meeting foreign investors.

Russia: Open up the Western markets

President and CEO Pavel M. Teplukhin, Troika Dialog Asset Moscow, sent a very clear signal in trying to help Russia overcoming the current problems, urging the politicians to liberalise trade between Russia and the West. A trade war is going on between Russia and the West. "On a bilateral level the Russian government has received a lot of support but on a microeconomic level we witness a war between European and US companies on one side and Russian companies on the other. And I think that it
would be better to stop the economic support, which is peanuts for a country like Russia, and instead let the Russian companies export what and how much they want. This would indeed support the private sector", Mr. Teplukhin said.

Securing a predictable and transparent business climate in the Eastern part of the Baltic Sea Region was seen by Mr. Teplukhin as a subject with special relevance in Russia predicting it would take a substantial amount of time before Russia would be able to sort out these issue. On the other hand, it was a general feeling that the newly elected Russian President was able to meet the many challenges facing the private sector in Russia. Mr. Teplukhin said that President Putin indeed has a chance to develop a stable Russian federation instead of an unstable Russian confederation.

**The role of Germany**

The role of Germany in the Baltic Sea Region was often touched upon. Former Member of the Board of Deutsche Bank Eckart van Hooven hoped that the peak activity regarding the integration of the Eastern nations into the EU in the future would take place in Berlin, requiring that the Baltic Sea Region would get a more prominent part in the strategic thinking of the German government.

Regardless, he called on the Nordic countries to take on a more leading role among the European nations to promote the Region and sell the vision of an integrated Baltic Sea Region. “The good reputation of Scandinavia in Central Europe offers every initiative a positive chance”, Mr. van Hooven said, “Scandinavia’s right to articulate and consequently sell its vision of the Baltic Sea Region to the other bordering countries is evident”.

Selling or branding the Region on a European scale might be of first priority but it is not enough. The Region must also be able to compete on the global market.

**Are Eastern companies prepared to meet the global challenge?**

The panel with business executives from the Eastern Baltic Sea countries, moderated by Elena Leontjeva, President of the Lithuanian Free Market Institute, believed that the Region had a good chance to capitalise on the openness and the exposure to the international markets. Nevertheless, to compete on the global - or at least the European market - the companies in the eastern Baltic Sea countries have to continuously restructure and develop their companies. Decisive factors are size of the company both in terms of shares in their home market and of capital resources as well as the ability to satisfy regulatory and quality requirements.

Pēteris Stupēns, Chairman of the Management Board of Grindex Pharmaceutical Company stressed the importance of holding a big market share at the domestic markets as a prerequisite for internationalization. Mr. Stupēns suggested a three step strategy if a company has to conquer the Western markets:

- determine the competitive advantages
- satisfy regulatory and quality requirements in the markets
- establish distribution networks.

Based on different company experiences on the US market Consul General Michael Metz Mørch, Danish Consulate in New York also came up with a set of strategic markers for going global:
• Size of the company - not too small
• Solid market share of the regional market
• Invest with long-term perspective
• Invest one's own money.

In return, as a result of being present on the US market, a company will get better at marketing, become more competitive and more innovative, Mr. Mørch concluded.

**Foreign investments part of restructuring**

During the last ten years of privatisation and acquisition deals, entire industries have fallen under Nordic control. Low productivity and the inability of the Baltic capital to support the enterprises made the companies easy targets for take-over by foreign companies. However, Allan Martinson, Chairman of the Board of Microlink, did not consider this a problem in the short term. The acquired companies receive capital, management etc. For example the banking sector is now safe thanks to the Nordic investments.

Foreign investments are often a necessary part of enterprise restructuring. Nevertheless, Mr. Martinson warned “that in the long run, there is a danger of becoming a corporate ghetto. This will mean weak influence for the Baltic managers and a disproportion of Baltic managers in the companies”.

The need for restructuring was also touched upon by Vice President of the Management Board Hubert Kierkowski, Stochna Gdynia S.A. He stressed in particular the need for investments into improved technology as a prerequisite for competing internationally.

As foreign investments are seen as part of the ongoing restructuring process in the transition economies, so are all countries in the Region dependent on foreign investments to become fully-fledged members of the global economy. A panel of investment experts moderated by Chief-Editor Dr. Heik Afheldt, Der Tagesspiegel offered an outside-in perspective on how to attract a higher level of foreign investment.

**Investments - the Region needs branding**

Active marketing, innovation, better access to information and compliance with EU legislation were seen as the critical factors to attract foreign investments.

One general problem is that the Region seems too heterogenous. For an outsider the Region displays a rather obscure picture that needs to be more transparent to attract future investors. Therefore, the Director of the Office of the Federal Commissioner for Foreign Investment in Germany, Urda Marteens-Jeebe urged the Region to pursue active marketing.

**New forces driving investments**

Deputy Secretary-General of the OECD, Seiichi Kondo approached the theme from a different angle. He pointed to the importance of taking into account corporate responsibility movement as a global trend representing a huge challenge for most companies. Consumers and investors have high expectations for corporate performance in the social and environmental fields, which indeed will foster investments in the long
run. However, according to Mr. Kondo companies have not abandoned their traditional objective of maximising company value in terms of profit. The main mission of business continue to be the development of promising investment projects.

Seiichi Kondo’s introductory remarks reminded the participants about the importance of global trends - a challenge not only to be met by the transition countries but also the developed countries.

Analyst Las Olsen of Unibank pointed out that what really drives an economy is increase in productivity and this can only come from innovation. Consequently, the catching-up effect in the transition economies creates high growth-rates but Mr. Olsen warned that the catching-up effect eventually might fade out and therefore the domestic situation in the transition economies has to be in order. "Potential is not enough in the years to come. It will be more and more important to maintain a progress on the legal and political areas in order to maintain a high level of investment inflow", Las Olsen said.

Key Sectors in the Eastern countries of the Baltic Sea

Richard C. Sheridan, President and CEO of the Baltic-American Enterprise Fund, voiced a positive attitude towards investing in the Region identifying five key sectors: business services; information technology; distribution and select retailing; and the trading industry. He strongly believed from his experience in the Region that if companies put in time, money, talent and practise, they would be rewarded in the long run.

Based on a report “American Corporate Investments in the Baltic Region” prepared by the American Chamber of Commerce in Denmark President and CEO of AmChamDenmark Lawrence B. Landman recommended to develop and implement systems to collect all relevant economic and business data. The data should include macroeconomic statistics, information about economic development plans and information about individual firms, including potential joint venture partners.

During the session both Mr. Landman and Mr. Sheridan also encouraged the countries to harmonise customs procedures, border controls, and business legislation with that of the EU.

Specialist Conference: Challenges facing the financial sector

The Summit’s second part on the financial sector dealt with the question of how to ensure an efficient and adequate capital allocation in the Baltic Sea Region. The question was set into a particularly interesting context of current events at the capital markets.

Firstly, a wave of mergers and acquisitions is taking place within the private banking sector in the Baltic Sea Region due to deregulation and liberalisation of the capital markets.

Secondly, the situation at the European stock markets is changing rapidly. New strategic alliances and other co-operative schemes are being formed. This reflects an uneven development in Europe. Capital markets are already to a large extent integrated whereas we have only seen a beginning of stock exchange integration. At the same time the stock
exchanges are challenged by new technology that alters the way securities are traded and open up new possibilities for alternative trading systems.

And finally, the needs of the transition economies with respect to multilateral financial assistance in the second decade of transition have changed. The transition countries have more or less achieved macroeconomic stability as one of the pre-conditions for economic growth. Hence the international financial institutions (IFI's) have to adapt to these new needs.

On this background key actors within the financial sector were asked to give their assessment of what the future financial landscape will look like.

Finance drives integration

The three key note addresses which introduced the specialist conference on Tuesday 19 September gave a good indication of the challenges facing the financial sector in the region. Both participants and the speakers agreed that the countries on the Eastern shore of the Baltic Sea had the possibility to develop much like the Nordic countries within a foreseeable future. Also, due to the fact that technology is one of the driving forces of capital markets it became clear that it will be beneficial for both the countries themselves and for private investors to participate in closing the technological gaps which exists between the Nordic and Baltic countries today.

National financial markets will not survive

Being a true regional player Nordic Baltic Holding’s CEO Hans Dalborg, started this session by envisioning that during the 21st century, the financial services industry of Europe is likely to contribute to integration of nations through financing, trade and cross-border investments. "And we in Nordic-Baltic Holding", Mr. Dalborg said, "will among others apply to business concepts based on and supporting the emergence of a Europe of regions". Mr. Dalborg emphasised that one should not expect any national financial markets to survive for any length of time. This change brings about a necessity to deregulate within countries and to re-regulate between countries.

Financial institutions are by necessity customer-oriented and one of the side effects of such an initiative as the EMU, is that it has allowed the financial markets to concentrate on more value added services. "In this environment of increasing demands for improving services we are, in our group, redefining value creation. The ultimate driving force of day-to-day business and the development of the industry, is the aspiration from every one of our customers, that we need to provide individual financial solutions for each customer". Also, he advised not to think of banks in the traditional way as branch offices only. Today, every major bank has a life insurance company and every major insurance company has a bank. The new products and distribution channels have changed the rules of the game, Mr. Dalborg said.

Do not protect the financial institutions

Turning to some structural effects of the trends of change that the financial sector experiences, Mr. Dalborg advised first and foremost the governments of the Region not to try to protect domestic financial institutions "When it comes to the question of foreign control I think that all should be positive towards all capital that is available because it is important to get capital", he said. "If we should rely only on our own capital we would have big problems. As long as someone is ready to invest in my country, I am happy. If nobody would invest, I would be very nervous. So I think we should be glad to see these
investors because all the money will be needed" Mr. Dalborg said during the sessions questions-answers period.

Mr. Dalborg also urged the politicians of the Region to prepare for the forthcoming cross-border mergers in the financial sector. "Get used to the idea that this industry will undergo the same consolidation as most other industries ending up with both global, regional and some minor national players." Mr. Dalborg said that in this respect he saw no future markets not regulated at all. The need to regulate the global markets in order to create a social acceptable world and world economy through international cooperation will rather increase than decrease. "But," he said, "this is more a global task than a regional."

Consolidation within the Baltic banking market

Chairman of the Board of Hansabank, Indrek Neivelt, Estonia turned to a more specific subject, namely the consolidation process taking place within the Baltic banking market. Mr. Neivelt told that today, "the Estonian market is actually following the advice from Mr. Dalborg in the sense that 98% of the market is controlled by foreigners and thereby very open". Mr. Neivelt furthermore said that he indeed was proud that the GDP growth figures of all of the three countries were so high. "Especially Latvia", Mr. Neivelt told, "has been growing rapidly in the last years".

The expected annual growth rates in the banking sector in Estonia, Latvia and Lithuania as a whole are at the moment 20-25 pct. Mr. Neivelt expected a consolidation of the banking sector to take place thus leaving only three to four banks to control the market in a few years time. Mr. Dalborg predicted later in the session that he believed that Estonia, Latvia and Lithuania would in many ways develop much as the Nordic countries. "The competition in the Scandinavian countries has not been regulated for many years. Investments from Germany and the Netherlands have nevertheless been very small and I think that the continental banks have used their investments elsewhere. And this will be the trend also for Estonia, Latvia and Lithuania."

Huge investments needed to fill the gap within telecom

The fact that the financial sector has to be accessible where the customers are, was one of the conclusions drawn by Mr. Dalborg and Mr. Neivelt. CEO of TeleDanmark Henning Dyremose, used this conclusion in his key note address to emphasise the importance of telecommunication for creating a competitive environment for financial services. His overall message was that investing in the telecommunication sector will yield a higher rate of return than other investments.

Mr. Dyremose referred to the conclusions of the Harvard economist David Canning who headed a World Bank research project on the relationship between communication infrastructure and economic output. David Canning showed that the productivity effect of telephone networks is above the normal productivity of capital. “This really is a crucial point when looking for future investments in the Baltic region”, Mr. Dyremose said urging the countries in the Baltic Sea Region to invest in the telecom sector to facilitate growth in these economies.

Closing the gaps

The Nordic countries have a clear lead in telecommunication while Estonia, Latvia, Lithuania and Poland seem to have a window of opportunity. The relative level of the gap between the Nordic Countries and Estonia, Latvia, Lithuania and Poland was estimated
by a telecommunication index based on four key drivers of a modern infrastructure: fixed penetration, mobile penetration, online penetration and digitization degree of the fixed network. Calculations made by TeleDanmark showed that compared to an EU average of 100, the Nordic Countries together form a leading group in Europe with a score of 112. Poland come closest to the Nordic Countries with a score of 50 closely being followed by the Baltic Countries with an average score of 45. Among the Baltic Countries Estonia is in a leading position.

To close the gap Poland will need to invest €15 bn and €3 bn is needed in Estonia, Latvia and Lithuania to build up the necessary communication infrastructure. Mr. Dyremose admitted that by any standard this was significant investments. "But it is also an interesting window of opportunity for the major European Telecom players" Mr. Dyremose said. He predicted that the investments most likely require direct foreign investments for three reasons:

• the scale requires players with the necessary investment capabilities and willingness to a long-term pay off.
• today it is critical to capitalise synergies and economy of scale within a national operation.
• the necessary key expertise to build and market the communication solutions is not present in numbers within the countries on the Eastern shore of the Baltic Sea.

On that basis Mr. Dyremose outlined that a country interested in attracting investments, thus stimulating a more rapid development, needs to ensure a free and fair competitive environment, an independent and predictable regulatory agency, a stable financial policy and a friendly business climate. "If this is the case you will have a bright future. A number of telcos will be willing to invest in your countries because it will be a good opportunity for them. And TeleDanmark is ready to participate in closing the gaps. We believe in your future and look forward to the cooperation" Mr. Dyremose concluded.

Need for a Baltic Sea Investment Bank?

After more than a decade of transition, the transition economies have more or less achieved macroeconomic stability. Today, the countries suffer from financial underdevelopment not in terms of lack of capital, but from an inadequate institutional capacity within the financial system, Thiery Malleret, Director, World Economic Forum, concluded as moderator of the panel.

Baltic Development Forum took the initiative to investigate the need for setting up a new financial institution to counter the institutional gap in the Eastern Baltic Sea countries. Prof. Erik Berglöf, Stockholm School of Economics, and Prof. Enrico Perotti, University of Amsterdam, looked into this question in the Summit report "Do we need a Baltic Sea Investment Bank?" The study concludes that there is a high risk premium in Estonia, Latvia, Lithuania and Poland and especially in Russia that constrains the development of new and innovative sectors. The problem is not shortage of capital, but poor governance leading to misallocation and a poor composition of finance. The most important reasons are limited microeconomic information and legal uncertainty, the report stated.

Subsequently, the report discusses the need for a special type of institution - 'a Venture Catalyst', a decentralised agency focusing on "software support" and advice rather than
investments. But also to assist companies to test existing legal institutions, e.g., by bringing lawsuits and demanding disclosure of market access.

The panellists recognised the financial underdevelopment in the Eastern Baltic Sea countries as an important obstacle to economic growth in the region. However, they did not believe that a new institution - a Baltic Sea Investment Bank - would be capable of filling the institutional gap in the countries. As CEO Jon Sigurdsson from Nordic Investment Bank clearly said, it seems unlikely that a single institution could successfully deal with the many issues creating the institutional gap. However, he stressed the necessity of closing the gap saying that the question should seriously be addressed.

Country Director for Estonia, Latvia and Lithuania from EBRD, George Krivicky argued that the institutional gap shown in the report could and should be addressed by the existing international financial institutions and added that the EBRD already gives high priority to grass-root initiatives to strengthen the financial capacity in the transition countries. He also noted that the EBRD supports the development of small and medium sized enterprises in the region.

Olli-Pekka Lehmussaari, Executive Director Nordic Chair IMF was also of the opinion that there was no need for a new institution at this late stage of transition. He noted that the Baltic banks are relatively liquid, and there is not much evidence that availability of capital is a major constraint to the development in the region.

But Lehmussaari did point to one major current problem in the financial sector: The limited domestic savings. However, he foresaw a positive change linked to the recently adopted three-pillar pension system which will leave the countries with genuine domestic institutional investors with relatively large resources in the medium term, he predicted.

Under-secretary of State, Ministry of Finance of the Republic of Poland, Krzysztof Janus Ners agreed with the authors of the report, that there is enough capital in the transition countries, but that there is a need for a more efficient and flexible capital allocation to productive sectors. Moreover, he pointed to the need of good and sound projects to be financed reflecting a lack of entrepreneurial capacity.

Adapting to new needs in the second decade of transition

Mats Gabrielsson, Chairman of Gabrielsson Invest bringing in a private sector perspective on the IFI’s, did not see any need for a new regional financial institution as proposed in the report. However, he argued for the need of setting up agencies in some of the less advanced transition countries to help foreign investors covering the high risk of investments. If such agencies were established, he foresaw an explosion of small- and medium sized companies in the region. Moreover, he criticised the IFI’s for being too bureaucratic. "The administrative costs of getting the money is too high, because everybody wants to cover their ass, basically", he explained.
Launching a Regional Strategy for Business Development

The existing international financial institutions and other actors operating within this field should address these needs more seriously to enhance the institutional capacity of the eastern Baltic Sea countries. And thereby adapting to the new needs in the second decade of transition. As George Krivicky said, "While there appears no need for a new IFI, existing institutions need to be ready to innovate, learn from their experiences, and adapt their activities to the needs of the Region as these change."

A Baltic Sea Regional Stock Market?

A major transformation is taking place at the European stock markets. Some alliances are being planned, while new alliances have already been formed. The heads of the major stock exchanges in the Baltic Sea Region offered their assessment of how to accommodate the ongoing internationalisation process at the stock markets.

A pan-European perspective is necessary

Stefan Seip, Head of Market Policy at Deutsche Börse AG, initiated the discussion by referring to the official Summit report “Capital Markets and Stock Exchanges in the Baltic Sea Region - Consequences of stock market concentration in Europe for the Baltic Sea Region”. Mr. Seip stressed that though the report was written only a few weeks prior to the Summit, the scenario in the European stock exchange market had changed dramatically since then. This fact is one of the clear indicators that the international development on the stock exchange arena is marked by a constant degree of uncertainty.

Mr. Seip hereby referred to the planned merger between Deutsche Börse and the London Stock Exchange that along with EuroNext, a merger of the Paris, the Brussels and the Amsterdam Stock Exchange, was to create two centralised trading platforms in Europe.

Mr. Seip subscribed to the report’s assessment that Baltic Sea Region cannot be described as an optimal or logical Region with regard to stock exchanges and financial markets. Following up this point of view, the panellists raised the issue whether a potential cooperation between stock exchanges within the Region can guarantee the inclusion of Russia. There was a broad consensus in the panel that Russia should be able to develop a market independent of the Baltic Sea Region due to the size of its market and to the different standards in the securities and regulation market than the rest of the Baltic Sea Region countries.

Recommendations:

“Institutional intervention is needed not to channel savings but to build up experience in the practical use and implementation of laws, regulatory and facilitating institutions, in particular those directed at enforcing contractual compliance, disclosure requirements and openness to entry.”

“What is needed is a more bottom-up approach reinforcing grass-root initiatives to improve access to legal remedy for business, increase public know-ledge on new rules and accountability for new institutions, build up an implementation record, and create dedicated service institutions with necessary expertise to guide firms through this process.”

Mr. Seip added that the Russian stock exchange market is more than ten years behind the rest of the Region and its legal system does not live up to the demands of the Western stock exchanges. In this respect, Mr. Seip told that Deutsche Börse and Vienna Stock Exchange work on developing a market for Eastern European stocks, particularly for Russian stocks. The idea is to establish a market on EU standards with clear cleaning and settlement solutions at comparable and competitive costs to support the capital markets in Russia.

Talking about Regional alliances, Leonard Furga, Director, Warsaw Stock Exchange, pointed out that one cannot exclusively limit oneself to the Baltic Sea Region. He stressed the importance of having the pan-European perspective in mind, when discussing stock exchange strategies. Poland had considered the possibility of establishing alliance or cooperation with Central European stock exchanges, but the costs of overcoming differences in the system and regulations appeared too high in order to do so. Mr. Furga did not dismiss, however, the option of Warsaw joining the future European network of exchanges.

**Recommendations:**

1. Everybody should be very careful to have too strong ideas as to optimal policy in the stock exchange area.
2. The Baltic Sea countries and their stock exchanges should each strive to implement in law and practice the EU regulation.
3. Legislators should create the legal and regulatory basis for the development of internationally oriented stock markets in the Baltic Sea Region. However, the detailed regulation and the development hereof should be left to the stock exchanges.
4. Stock exchanges should concentrate on short-term strategy as the long run development is extremely unclear.
5. Legislators should be reluctant to interfere as to cooperation between stock exchanges and clearing organisations.


**IT and stronger competition alters dramatically the exchange business**

The most important factor is to view exchanges as entities. Exchange business is like any other business and thus run as commercial companies. This point was stressed by President Carl Johan Högbom, OM Stockholm Exchange. Government controlled monopolies have recently been deregulated giving the opportunity to create new trends: Mergers between exchanges, new partnerships outside the exchange community (cooperation with for instance IT business), increased competition from non-exchanges and more listed exchanges. Mr. Högbom had no doubt that the Internet, giving easy access to the markets, dramatically would alter the exchange business.

Referring to Mr. Seip, Mr. Högbom agreed that a mega Euro Exchange would not be an optimal solution in the European stock market, as exchange customers are understandingly strong opponents of all kinds of monopoly. Expressing his belief in stronger competition among exchanges, he assessed that within five years there would exist no more than three or four competing exchange networks in Europe.

Following up that point, Jukka Ruuska, CEO, HEX, Helsinki Exchanges, drew a parallel to the telecommunication sector, being characterized by both consolidation and
fragmentation trends. The concentration or consolidation will, however, be different in different parts of operations. Taking the Helsinki Stock Exchange as an example, Mr. Ruuska showed that the need for concentration lies in the field of clearing and settlement and not in the field of trading.

According to Mr. Furga, there is a need for both big, consolidated exchanges and small, local exchanges. As he pointed out, 66 pct. of the Warsaw exchange trading is generated by domestic investors, who hardly will start using international trading platforms. In other words, local exchanges serve local needs.

**Viktors Gustsons**, Chairman of the Securities Market Commission in Latvia, assessed the problem of competitiveness in the stock exchange business from a regulatory and supervisory perspective. According to his opinion European capital market’s regulatory and supervisory climate is not as competitive as United States’ markets. Having this in mind, he pointed out that stock exchanges in Europe need to fulfil necessary prerequisites to be able to guarantee a well functioning capital market regulatory environment.

**NOREX - a feasible project**

Discussing the future scenario for the stock exchange markets, **Gert Tiivas**, CEO, Tallinn Stock Exchange, expressed the belief that the fate of small exchanges lies in consolidation and in finding a place where they can become gateway for local companies and investors to the global capital markets network. The stock exchange customers expect internationally known rules and regulations and global distribution through a widely used, modern adaptable network. Due to strong internationalisation trends, the concept of national exchanges is a historical anomaly where national infrastructures constrain international markets and investing.

However, the consolidation of the three Baltic exchanges, Tallinn, Riga and Vilnius, appeared not to be sufficient as their common markets were too small, Mr. Tiivas admitted. Under these circumstances, Estonia, Latvia and Lithuania had signed letters of intent to join NOREX, the cooperation between the Stockholm and Copenhagen Stock Exchanges, hereby creating one-stop-shop for Nordic and Baltic financial products. From his side, Mr. Högbom drew attention to the fact that the NOREX alliance is one of the only cash equity cooperation that is really working successful. Furthermore, the vision of creating a Nordic European Exchange with its origin in NOREX is a feasible project. However, as Mr. Högbom stressed, it must be carried out step by step.
Participants

- 24 Timmar, SWEDEN
- A/S Lindeks, LATVIA
- ABB AB, SWEDEN
- Abi Marketing Oü, ESTONIA
- Air Baltic Corporation, LATVIA
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- American Chamber of Commerce, DENMARK
- American Chamber of Commerce, LATVIA
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- ATP Ejendomme, DENMARK
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